

OVDI Opt-Out Case Assist

January 2014

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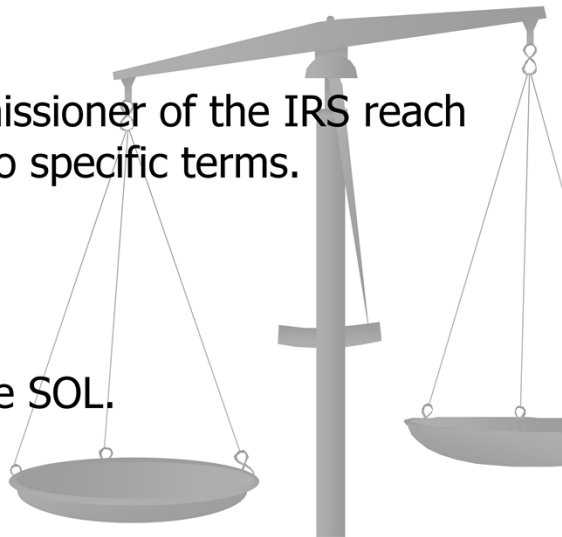
	OVDI – Offshore Voluntary Disclosure Initiative
	<ul style="list-style-type: none">■ The program is for TP's with unreported foreign income from foreign bank accounts or assets<ul style="list-style-type: none">– 2009, 2011 & 2012 programs– FAQs

906 Closing Agreement

The TP & Commissioner of the IRS reach an agreement to specific terms.

The 906 is final.

The TP waives the SOL.



What is the MOP?

The taxpayer agrees to pay the
Miscellaneous offshore penalty in lieu of
the IRS pursuing:

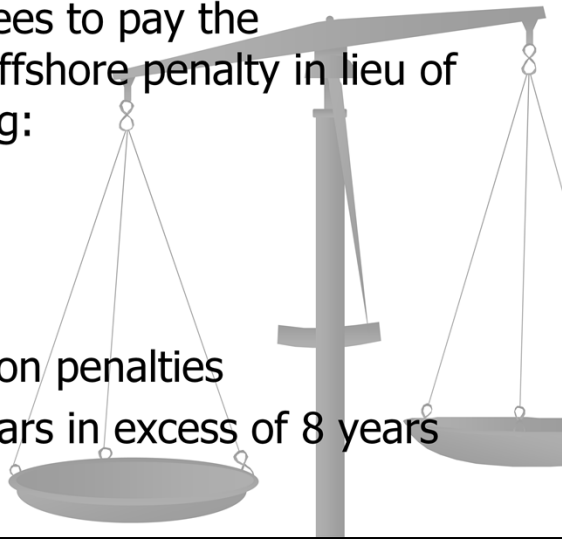
Criminal action

Fraud penalties

FBAR penalties

Foreign Information penalties

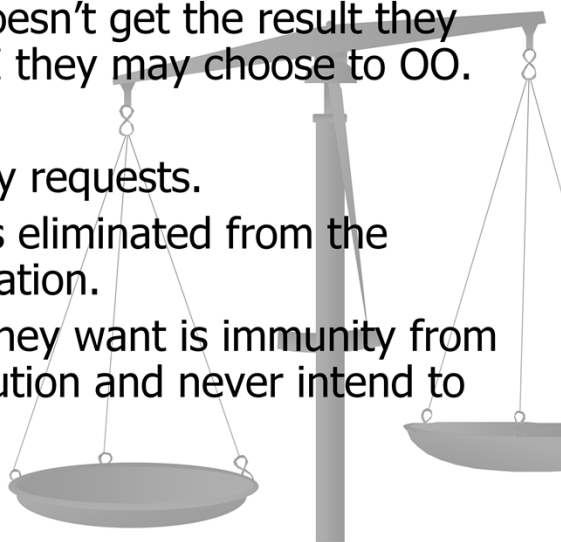
Opening exam years in excess of 8 years



Why would a TP Opt-Out?

If the taxpayer doesn't get the result they wanted in OVDI they may choose to OO.

- Reduced penalty requests.
- Accounts/assets eliminated from the penalty computation.
- Sometimes all they want is immunity from criminal prosecution and never intend to stay in OVDI.



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Sometimes we must Remove a TP
from OVDI.

- TP doesn't cooperate.
- TP won't sign the 906 but won't OO.
- TP is unlocateable.

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We must Inform the TP before they Opt-Out or
we Remove them from OVDI

- OVDI OO & Removal Guide
 - 2 letters for OO (4728 & 4564)
 - 2 letters for Removal (4729 & 4566)

- Irrevocable Decision
- GM & TM approval
- Opt-out / Removal Committee (OORC)

OVDI Case File

- ◆ IRS.gov and FAQ 25 list the Submission Requirements that a TP must send in:
 - ◆ OVDI letter – CI 3-pager
 - ◆ Original 1040s
 - ◆ Amended 1040Xs – Domestic & foreign
 - ◆ OVDI POA – Covers all years, FBAR, civil penalties
 - ◆ Form 872 & FBAR consent – Requires close review
 - ◆ FBARS & Foreign Info Returns – 5471s, 3520, etc...
 - ◆ Workpapers – HAB/MOP and Foreign Acct Stmt
 - ◆ Gift Tax & Estate Tax Returns
 - ◆ Foreign Bank Statements
 - ◆ Payment
 - ◆ Form 433A/433B – If TP can not full pay

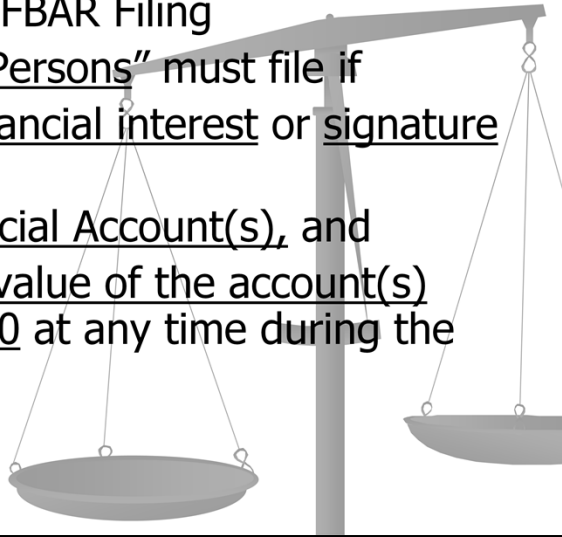
Information Returns

- A partial list of the most common information returns includes:
 - FBARS – Title 31
 - Income Tax Foreign Information Returns – Title 26
 - **Form 5471** – Controlled Foreign Corporations
 - **Form 8865** – Controlled Foreign Partnerships
 - **Form 3520** – Foreign Trust Transactions
 - **Form 3520A** – Annual Foreign Trust Return
 - **Form 926** – Transfers to a Foreign Corporation
 - **Form 8938** – Stmt of Specified Foreign Financial Assets

FBAR Filing Basics

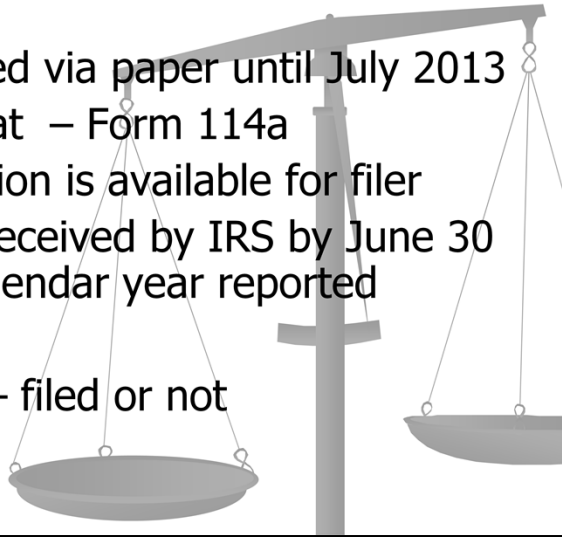
Four Elements of FBAR Filing

- “United States Persons” must file if
- They have a financial interest or signature authority over
- A Foreign Financial Account(s), and
- The aggregate value of the account(s) exceeds \$10,000 at any time during the calendar year.



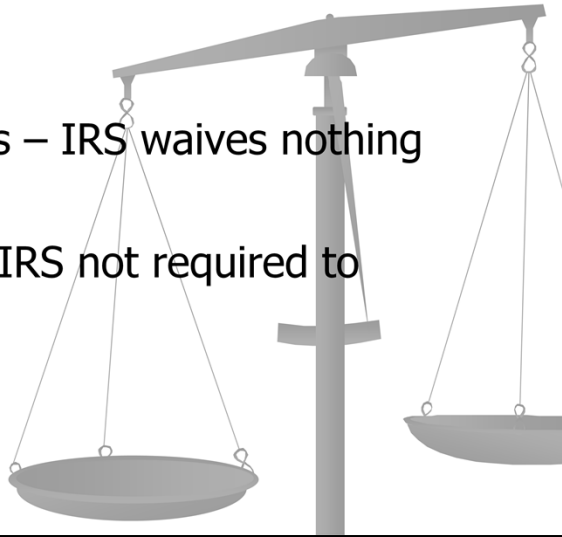
FBAR

- TD F90-22.1 filed via paper until July 2013
- Electronic format – Form 114a
- No filing extension is available for filer
- Form must be received by IRS by June 30 of year after calendar year reported
- SOL is 6 years – filed or not



FBAR Consent

- Six years
- TP waives rights – IRS waives nothing
- TP must sign – IRS not required to countersign



FBAR Outcomes

- 4 possible outcomes
 - No violation
 - Warning Letter
 - Non-willful
 - Willful
- Work with FBAR Coordinators and FBAR Counsel

FBAR Penalties

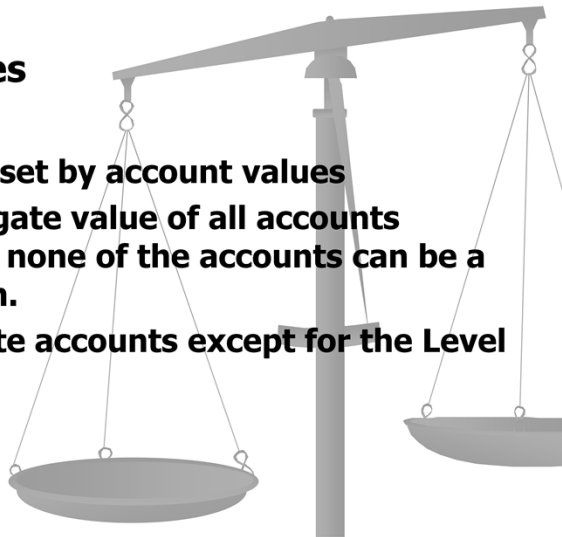
- Reasonable Cause
- Intent & Knowledge

- Mitigation
 - Levels of violations

FBAR Penalties

- **Mitigation Tables**

- **Violation levels set by account values**
- **Once the aggregate value of all accounts exceeds \$50K – none of the accounts can be a Level 1 violation.**
- **Do not aggregate accounts except for the Level 1 violation test.**



	<u>Account Balance</u>	<u>Penalty Structure</u>	<u>Account Balance</u>	<u># of Violations</u>	<u>Computed Penalty Amount</u>
Non-Willful Penalties	Level I - Balance <\$50,000	\$500 for each violation, not to exceed an aggregate penalty of \$5,000			\$ -
	Level II - Balance <\$250,000	\$5,000 for each violation, not to exceed 10% of the maximum balance in the account during the year			\$ -
	Level III - Balance >\$250,000	\$10,000 for each violation			\$ -
Willful Penalties	<u>Account Balance</u>	<u>Penalty Structure</u>	<u>Account Balance</u>	<u># of Violations</u>	<u>Computed Penalty Amount</u>
	Level I - Balance <\$50,000	The greater of \$1,000 for each violation or 5% of the maximum balance in the account during the year			\$ -
	Level II - Balance <\$250,000	The greater of \$5,000 for each violation or 10% of the maximum balance in the account during the year			\$ -
	Level III - Balance >\$250,000 but <\$1,000,000	The greater of 10% of the maximum balance during the year or 50% of the account balance in the account as of the last day for filing the FBAR			
	Level IV - Balance >\$1,000,000	The greater of \$100,000 or 50% of the closing balance in the account as of the last day for filing the FBAR			\$ -

FBAR Penalty Example #1

- 2008 Year
 - Acct #1 12,000
 - Acct #2 15,000
 - Acct #3 22,000

- NW FBAR penalty?
- Willful FBAR penalty?

FBAR Penalty Example #1 - Answer

- 2008 Year

- Acct #1 12,000
- Acct #2 15,000
- Acct #3 22,000

- NW FBAR penalty? \$1,500
- Willful FBAR penalty? \$3,100

FBAR Penalty Example #2

- 2008 Year

- Acct #1 \$ 12,000
- Acct #2 \$ 100,000
- Acct #3 \$ 265,000
- Acct #4 \$1,200,000

- NW FBAR penalty?
- Willful FBAR penalty?

FBAR Penalty Example #2 - Answer

- 2008 Year

- Acct #1 \$ 12,000
- Acct #2 \$ 100,000
- Acct #3 \$ 265,000
- Acct #4 \$1,200,000

- NW FBAR penalty? \$ 26,200
- Willful FBAR penalty? \$ 747,500

Why do we care about foreign Information Return Penalties?

- The TP thinks they will get a better deal outside of OVDI
 - We must be vigilant about SOL
- The TP will argue Reasonable Cause
 - Reliance on Preparer
 - Interview Preparer
 - Interview TP



Form 5471

- Who is required to file?
 - Several categories & conditions
 - 10% owner
 - Treated as a shareholder
 - Control and voting power

LOOK AT THE FORM INSTRUCTIONS

The form itself has multiple parts. The instructions will identify what parts a taxpayer must complete.



Foreign Transfers Information Returns

Form 5471

“Information Return of U.S. Persons With
Respect to Certain Foreign Corporations”

■ **Due Date for Filing**

- **Parallels shareholder’s income tax return
including extensions**

Foreign Transfers Information Returns

Form 5471

“Information Return of U.S. Persons With Respect
to Certain Foreign Corporations”

– **Penalties for Failure to File**

- IRC 6679, 6046, 6046A, 6038
- \$10,000, max \$60,000
- For EACH F5471 required to be filed
 - Ex: have 3 CFC's – 3 F5471's are required

The penalty for failure to file is \$10,000 per Form 5471 that the U.S. shareholder fails to file, and if not filed w/in 90 days after the notice of the failure to file, then an additional penalty of \$10,000 for each 30 days period the failure to file continues. The maximum additional penalty for each Form 5471 is \$50,000.

So you can see the failure to file each Form 5471 can be significant. For example, you have the initial penalty \$10,000 and then the additional penalty of \$50,000 so you can see where failing to file ONE Form 5471 can reach \$60,000.

Foreign Transfers Information Returns

Form 926

“Return by U.S. Transferor of Property to a
Foreign Corporation”

- Generally who must file
- Due date of return
- Penalties for Failure to File
 - 10% of transferred property value up to \$100K

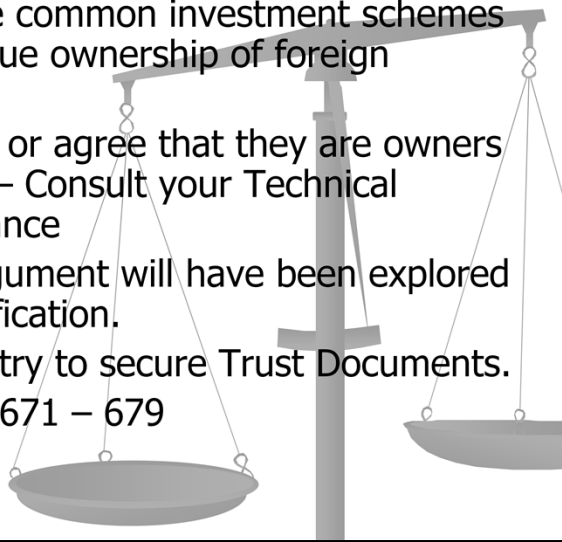
And the last information return we'll look at today is Form 926. Generally Form 926 must be filed by a U.S. citizen/resident or, domestic corporation, or domestic estate or trust to report transfers of property to a foreign corporation. There are several exceptions to filing Form 926 that should be considered when discussing this form with representatives.

The Form 926 must be filed as an attachment with the transferors income tax return, or the taxable year that includes the date of the transfer and must be filed by the due date of the transferor's income tax return, including extensions.

The penalties for failing to file Form 926 is 10% of the fair market value of the property at the time of the transfer and is not to exceed \$100,000 unless the failure was due to intentional disregard. So for example you transfer your IRA worth \$500,000 to a foreign corporation. The penalty for failing to file the Form 926 would be \$50,000.

Foreign Foundation/Stiftung is a Foreign Trust

- Foreign Trusts are common investment schemes used to conceal true ownership of foreign assets.
- TP may not admit or agree that they are owners of a foreign trust – Consult your Technical Advisor for assistance
- Generally, this argument will have been explored during OVDI certification.
- The OVDI RA will try to secure Trust Documents.
- Refer to IRC Sec. 671 – 679



Foreign Transfers Information Returns

Form 3520A

“Annual Information Return of Foreign
Trust With a U.S. Owner”

- Who Must File
 - **U.S. owner of foreign trust**
 - **Reports accounting of trust activities/operations**

Now lets talk about Form 3520 A and **who must file.** Each (emphasize the word Each) person who is treated as an owner of any portion a foreign trust under the grantor trust rules is responsible for ensuring the filing requirement is met. The purpose of the form is to ensure a reporting and accounting of the trust activities and/or operations.

Foreign Transfers Information Returns

Form 3520A

“Annual Information Return of Foreign
Trust With a U.S. Owner”

- Due Date for Filing
 - **15th day of 3rd month after end of trust’s tax year**

Check for extension filed when checking IDRS for 3520A filing
An automatic 6 month extension is granted if F7004 is filed.

Foreign Transfers Information Returns

Form 3520A

“Annual Information Return of Foreign Trust With
a U.S. Owner”

- **Penalties for Failure to File**

- IRC 6677, 6048

- Pre 12/31/2009 filing:

- 5% of the FMV of the trust, Max penalty is value of the trust

- Post 12/31/2009 filing:

- The greater of \$10,000 or 5% of the FMV of the trust, Max penalty is value of the trust

FMV of the trust = gross reportable amount

FMV includes income producing assets in addition to financial accounts.

Reduce FMV of asset by any encumbrances.

NOTE: Research if asset is a precious metal.

The **penalties for failing to file** Form 3520-A includes a continuation penalty if TP fails to file after being noticed. If the failure to file continues for more than 90 days after notification by the Service, then an additional penalty of \$10,000 for each 30 day period the failure continues, up to the gross reportable amount.

Foreign Transfers Information Returns

Form 3520

“Annual Return to Report Transactions With
Foreign Trusts and Receipt of Certain Foreign
Gifts”

– Who Must File

- **Reportable Events**
- **Grantor Trust**
- **Distributions**
- **Gifts**

Now we will look at some of the specific information returns. First we will look at Form 3520.
What is the purpose of Form 3520?

It's for any U.S. person who creates a foreign trust or who directly or indirectly gratuitously transfers money or property to a foreign trust. It doesn't matter whether the Foreign Trust has a U.S. beneficiary or not. U.S. persons file Form 3520 to report:

- Certain transactions with foreign trusts
- Ownership of foreign trust under the rules of sections 671 through 679 and
- Receipt of certain large gifts or bequests from certain foreign persons

Now ***who must file*** the Form 3520? There are four reportable events which may trigger the filing of the form. They include –

1. the transferor responsible for any reportable event such as the creation of a foreign trust by a U.S. person or when there is a direct or indirect transfer of money or property to a foreign trust by a U.S. person.
2. any U.S. person who was treated as owner of any of the assets of a foreign trust under the grantor trust rules.
3. any U.S. person who during the tax year received a distribution from a foreign trust or
4. any U.S. person who received during the taxable year more than \$100,000 from a nonresident alien or foreign estates that was treated as a gift or bequest OR more than \$12,375 from foreign corporations that was treated as gifts. (The \$12,375 is for tax year 2005 only and is different for earlier years).

Now there are exceptions to filing Form 3520 for certain transactions and those seven exceptions can be found on the instructions to Form 3520.

Foreign Transfers Information Returns

Form 3520

“Annual Return to Report Transactions With
Foreign Trusts and Receipt of Certain
Foreign Gifts”

- Due Date for Filing
 - **Same as U.S. Persons Income Tax return including extensions**

Foreign Transfers Information Returns

Form 3520

"Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts"

– Penalties for Failure to File

- **IRC 6677, 6048, & 6039F**
- **Pre 12/31/2009 filing:**
 - **35% of amount transferred, 100% of transfer max**
- **Post 12/31/2009 filing:**
 - **The greater of \$10,000 or 35% of the amount transferred, 100% of transfer max**
- **5% of foreign gift, 25% of gift maximum**

There are **penalties** for not filing the Form 3520 on or before the due date or not including accurate information. The penalty for failing to file Form 3520 is 35% of the gross reportable amount and if the failure to file continues for more than 90 days after notification by the Service, a \$10,000 penalty for each 30 day the failure to file continues, with the maximum penalty amount capped at the gross reportable amount.

FOR RETURNS FILED AFTER 12/31/2009:

In 2010, P.L. 111-147, Sec. 535(a) (applicable to notices and returns required to be filed after 12/31/2009, as provided by Sec. 535(b) of P.L. 111-147, which appears as a note to this section), amended the concluding matter of subsec. (a) by inserting "the greater of \$10,000 or" and by substituting the sentence beginning "At such time . . ." for "In no event shall the penalty under this subsection with respect to any failure exceed the gross reportable amount."

Form 3520 is also used to report the receipt of gifts from foreign persons. Under IRC 6039F the penalty for failure to file Form 3520 is equal to five percent per month of the amount of such foreign gift for the period that the gift is not reported, up to a maximum of twenty-five percent.

Also, penalties will be imposed on the extent the transaction is not reported. For example, a if a U.S. person transfers property worth \$1 million to a foreign trust, but only reports \$400,000 of that amount, penalties would only be imposed on the unreported \$600,000.

Foreign Gift – Tax Law Change for returns beginning with the 2012 return:

Law changes and now requires more people to file on receipt of lesser gift amounts.

Foreign Transfers Information Returns

Form 8938

“Statement of Specified Foreign Financial Assets”

- Who Must File – foreign financial assets over \$50,000 at year end
- Due Date of Filing your 1040
- Penalties for Failure to File - \$10K
- Accuracy- Related penalties – 40% of underpayment

Lets take a look at Form 8865 and who must file it. A U.S. person qualifying under one or more of the four categories of filers must complete and file Form 8865. Now we won't go into the details of what encompasses each category, but they can be found in IRC Sec. 6038B However, the type of category you will encounter most often in abusive cases is category 1 where a U.S. person controls a foreign partnership at anytime during the year (with control being defined as more than 50% interest in the partnership) It is important to note that if you qualify under more than one category for a particular foreign partnership, you must submit all the items required for each category under which you qualify.

The Form 8865 must be filed with the U.S. persons' income tax return (or if applicable, partnership or exempt organization return) and is due on or before the due date of the return, including extensions. If an income tax return is not required the F8865 must still be filed by the due date of the F1040, including extensions.

The penalties vary for failing to file Form 8865 depending on the category of filer the taxpayer falls into but generally it's similar to Form 5471 that we just talked about, i.e., \$10,000 initial penalty and the \$10,000 additional penalty for each 30 day period, with the maximum penalty capped at \$60,000.