

■ Recorded Session

**This CENTRA session is being recorded.
Participant and instructor interaction and
screen action will be recorded.**

Please select the **green check mark ✓ to
confirm your understanding of this
recorded event.**



Matrix Application Training

International Individual Compliance

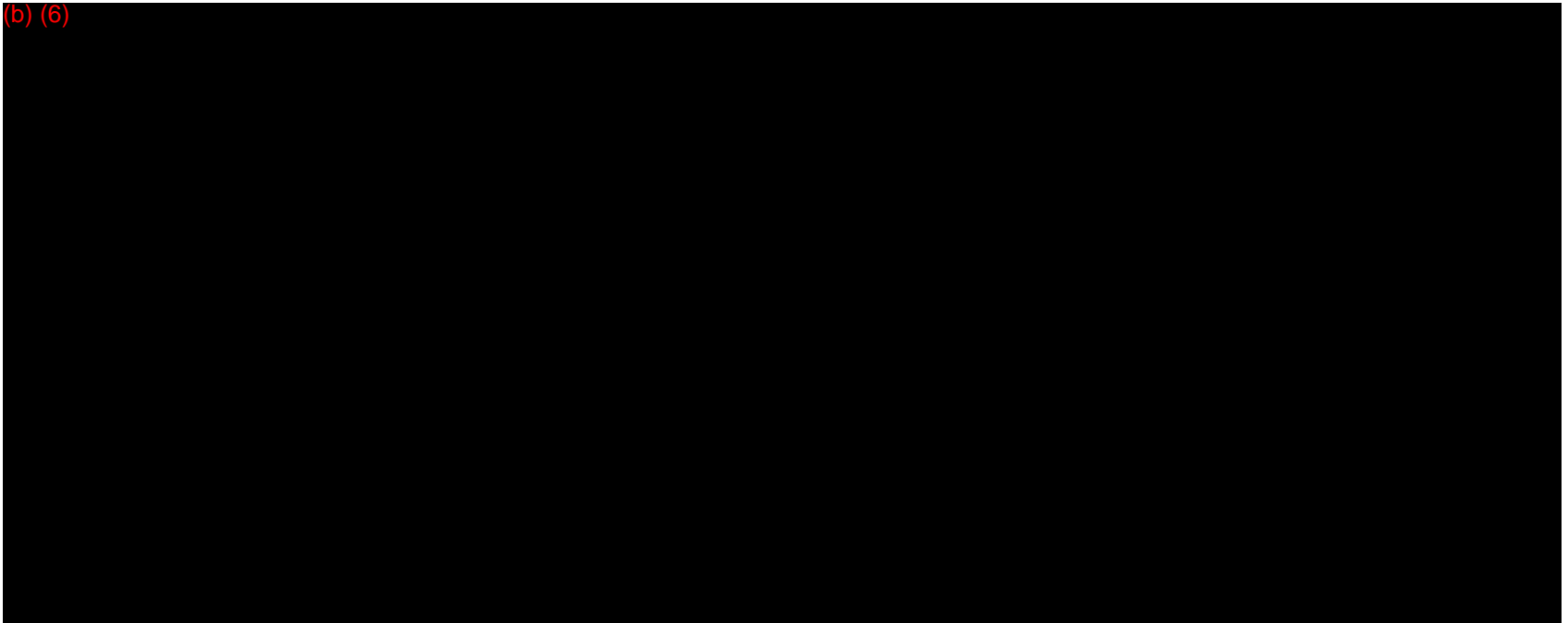
Basic Structures Part III: Interviewing and International Penalties



**Large Business
& International**

Presenters

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



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.



Overview – Interview Procedures and Identifying Applicable International Penalties

- ❖ This presentation will provide materials on Interviewing and International Penalties. Additional information is available on the:
 - Offshore Arrangements IPN
 - Foreign Entities IPN
 - Information Gathering IPN
 - International Practice Service (IPS) System



Objectives

- ❖ At the end of this lesson, you will be able to:
 - Identify relevant parties to interview
 - Prepare for a quality interview
 - Identify the tools and procedures available to secure an effective interview with cooperative and uncooperative taxpayers or third parties
 - Identify challenges faced with uncooperative U.S. Citizens residing abroad, and
 - Describe how penalties which could be applicable as a result of an Offshore Arrangement can be identified and developed

Individual Outbound Face

Jurisdiction to Tax	Foreign Tax Credits	Foreign Corporations	Pass-Thru Entities	Offshore Arrangements
STRATEGIC PRIORITIES				
Determination of Residency Status	Credibility	CFCs	Partnerships	Merchant Accounts
Taxation of Citizens and Residents			Trusts	Insurance
Expatriation	FTC Calculation / Limitation	PFICs		Disregarded Entities
Possessions			Offshore Banking	
Hedge Funds				
Treaties				
Foreign Currency				
Information Gathering				



Introduction to Interviewing Procedures

- ❖ Interviewing Taxpayers and Third Party Witnesses
- ❖ Characteristics of successful interviews
- ❖ Cooperative vs. Un-Cooperative Taxpayer or Third Party Witness



The Purpose of Interviewing

- ❖ Obtain their knowledge of the facts
- ❖ Determine the correct tax, penalties, information return requirements and FBAR filing requirements
- ❖ Establish relationships between the taxpayer, third parties, or witnesses to clarify how the Offshore Arrangement functioned
- ❖ Reduce testimony to a permanent record



Procedures for the Cooperative Taxpayer or Third Party Witness

There are three main parts to interviewing:

- ❖ Part 1 – Identifying Witnesses
- ❖ Part 2 – Preparation and Planning Steps, and
- ❖ Part 3 – Conducting/Memorializing the Interview



Identifying Witnesses to Interview

Customers

Suppliers

Competitors

Other Parties to sales/purchases

Lawyers

Accountants

Bankers

Brokers

Financial Advisors

Current Employees

Former Employees

Secretaries

Family Members

Family Office employees

Prior Examiners

Litigants

Ex-spouses

Business Associates

Drivers

Pilots

UPS Shippers, Fed Ex

Government Agencies

Realtors

Business broker



Preparation and Planning

- ❖ Research the Witness
- ❖ Prepare an Interview Outline/Questions
- ❖ Review and organize available information
- ❖ Determine the location and time for the interview



Research the Witness

- ❖ Review available taxpayer records, particularly correspondence, memos, and e-mail
- ❖ I.R.S. Database searches
- ❖ Public records searches
- ❖ Internet searches for information and business related websites



Prepare an Interview Outline and List of Questions

- ❖ Determine what do you wish to accomplish
- ❖ Organize your thoughts prior to the interview
- ❖ Request that the witness specify and explain answers
- ❖ Review facts gathered to ensure all relevant questions were asked

Be flexible. Ask follow up questions.
Listen to the answers being given.



Review and Organize Your Information

- ❖ Be prepared
- ❖ Arrange data by topic and in the order of importance
- ❖ Prepare documents you intend to use during the interview
 - Copies should be available if a court reporter is used
- ❖ Check with EOI or Whistleblower Office before strategically sharing any information obtained from a Treaty or Informant



Location and Time for the Interview I.R.M. 4.10.3.2

- ❖ Fact and circumstances will dictate location for the interview
- ❖ Sit across from the witness
- ❖ Observe the demeanor of the witness



Conducting and Memorializing the Interview

- ❖ The Successful Interviewer
- ❖ Court Reporter
- ❖ Questioning
- ❖ Follow Through
- ❖ Close the interview



The Successful Interviewer

- ❖ Creates a team for the interview
- ❖ Projects a confident and assured demeanor
- ❖ Creates a non-threatening environment
- ❖ Pays close attention to the witness
- ❖ Listens attentively AND allows witnesses to fully complete their answers
- ❖ Clarifies answers that are vague or unclear
- ❖ Retains control of the interview
- ❖ Remains objective, flexible, and alert



The Court Reporter

- ❖ Meet at least 30 minutes prior to the interview
- ❖ Provide business cards
- ❖ Seat court reporter between witness and the principal questioner
- ❖ Administer an oath to the taxpayer/witness
 - “Do you swear that the testimony you are about to give in this matter is the truth, the whole truth and nothing but the truth.”

Securing the Court Reporters Services

Court Reporter Request

(Please complete all items in green highlighted areas)

Specialist		Telephone #	
TP Name Control			
Witness			

Justification	
----------------------	--

Vendor Name			
Address		Telephone #	
City	State	Zip Code	
Contact Name			
Vendor accepts MasterCard	YES	<input checked="" type="checkbox"/>	NO

Description of Services

Date		Time: From		To	
Location	(include Rm or Ste #)				
Duration		Contact Name			
# of Transcripts Needed	Original +	1	Approximate # of pages		

Estimated Costs

Appearance Fee	\$37.50	Per day/hour?	day	Real Time		Cost	\$ 37.50
Cost per page	\$ 4.95/PAGE	Includes Copies?	<input type="checkbox"/>	NO	<input checked="" type="checkbox"/>	YES	If yes, how many?
Estimated Pages		Add'l copy fee (see Justification)					
Delivery Fee	\$ 0.00	Cost or courier, etc.					
Diskette Fee	\$ 0.00	Note : Need 1 Original, 1 copy, and 1 electronic copy on a CD.					
Additional costs:	\$ 0.00	Detail (e.g. exhibit fee, tabs, etc.)					
Cancellation Fee	\$ 0.00						

Ship to Address

--

*Turnaround time should be no later than 10 workdays from the date of the oral reply/deposition. **

Confirmation of Receipt and Acceptance

Awards Number	
Date Services Received (rendered)	
Date Services Accepted *	

*(conformed to contract requirements)



Questioning the Taxpayer or Witness

- ❖ Proceed from general topics to specific topics
- ❖ Lead off with open ended questions
- ❖ Interview like a Reporter
 - Ask the who, what, when, where, and why questions
- ❖ Use silence as an interview tool

Follow Through...

- ❖ Follow up on incomplete answers
- ❖ Do not settle for an “I don’t know”
- ❖ Get specifics
- ❖ Narrow down time line
- ❖ Establish the taxpayer’s story and fact pattern
- ❖ Obtain information on any other party that may have engaged in the same structure
- ❖ Allow I.R.S. counsel to handle legal issues that arise such as claim of privilege or evidentiary objections



Close of the Interview

- ❖ Summarize all important points with the taxpayer
- ❖ If a court reporter was not used:
 - Prepare a Memorandum of Interview (MOI)
 - Allow the witness to make changes to the MOI
 - Secure the witness's signature on the MOI
- ❖ Retain all records secured and notes taken



When Taxpayer Fails to Cooperate

- ❖ Summons for testimony and documents
- ❖ Formal Document Request for foreign documents
- ❖ I.R.S. Tax Attaches, Revenue Service Representatives, and Exchange of Information Groups for foreign documents and interviews



Summons the Taxpayer or Witness

- ❖ The Authority to Summons
- ❖ Reasons for Summons under I.R.C. § 7602
 - To ascertain the correctness of a return
 - To make a return where none has been filed
 - To determine the liability of any person for any tax
 - To determine the liability of any transferee or fiduciary, and
 - To collect taxes due

Resource Offshore Arrangements IPN: Summons Desk Guide



Summons – I.R.M. 25.5 – Form 2039

- ❖ Type of Summons to be issued
- ❖ When to Summons the Taxpayer/Witness
- ❖ Time of Appearance for Taxpayer/Witness
- ❖ Verbiage to use in Summons
- ❖ Physical location of the Taxpayer/Witness



Summoning a Taxpayer or Witness Residing in the U.S.

- ❖ Individual Taxpayer
- ❖ Corporate Taxpayer
- ❖ Third Party Witness
- ❖ Third Party Record Keeper



Summoning a Taxpayer or Witness Residing Abroad

- ❖ A U.S. Citizen who lives abroad may not be summonsed to appear
- ❖ Available data should be used to determine if the U.S. Citizen regularly enters the U.S.
 - Accurint
 - TECs Records
 - Tax Attaché
 - Third Parties
- ❖ Beware of taking official action outside of the U.S. as such acts may be prohibited by law in the foreign country



Claiming Fifth Amendment Privilege for Testimony

- ❖ To claim a Fifth Amendment Privilege:
 - Taxpayer must appear
 - Only the taxpayer can raise this privilege (not the Rep.)
 - May not raise a blanket assertion of privilege
 - Assertion must be made to each and every question asked
 - Have detailed interview questions ready



Claiming Fifth Amendment Privilege for Production of Records

- ❖ Foregone Conclusions
- ❖ Required Records Doctrine
- ❖ Special language is required in summons

Enforcement of the Summons

I.R.M. 25.5.10.4

❖ The Powell Test

In United States v Powell, 379 U.S. 48, 57-58 (1964), the Supreme Court held that a summons is enforceable if it meets 4 standards:

1. The investigation is for a legitimate purpose;
2. The requested material is relevant to the investigation;
3. IRS does not already possess the information and
4. All administrative steps are followed

❖ Information from any year can be summonsed if it might shed light on Taxpayer's correct tax liability



Class Reading

❖ Please take a few minutes to read:

Handout_Summons Enforcement Order



Formal Document Request (FDR)

I.R.C. § 982

- ❖ When and Why to use an FDR
 - IDR must have been issued
 - Failure or Inadequate response to IDR
 - Precludes later admittance of evidence in Court

- ❖ The FDR must be reviewed by Counsel prior to issuance

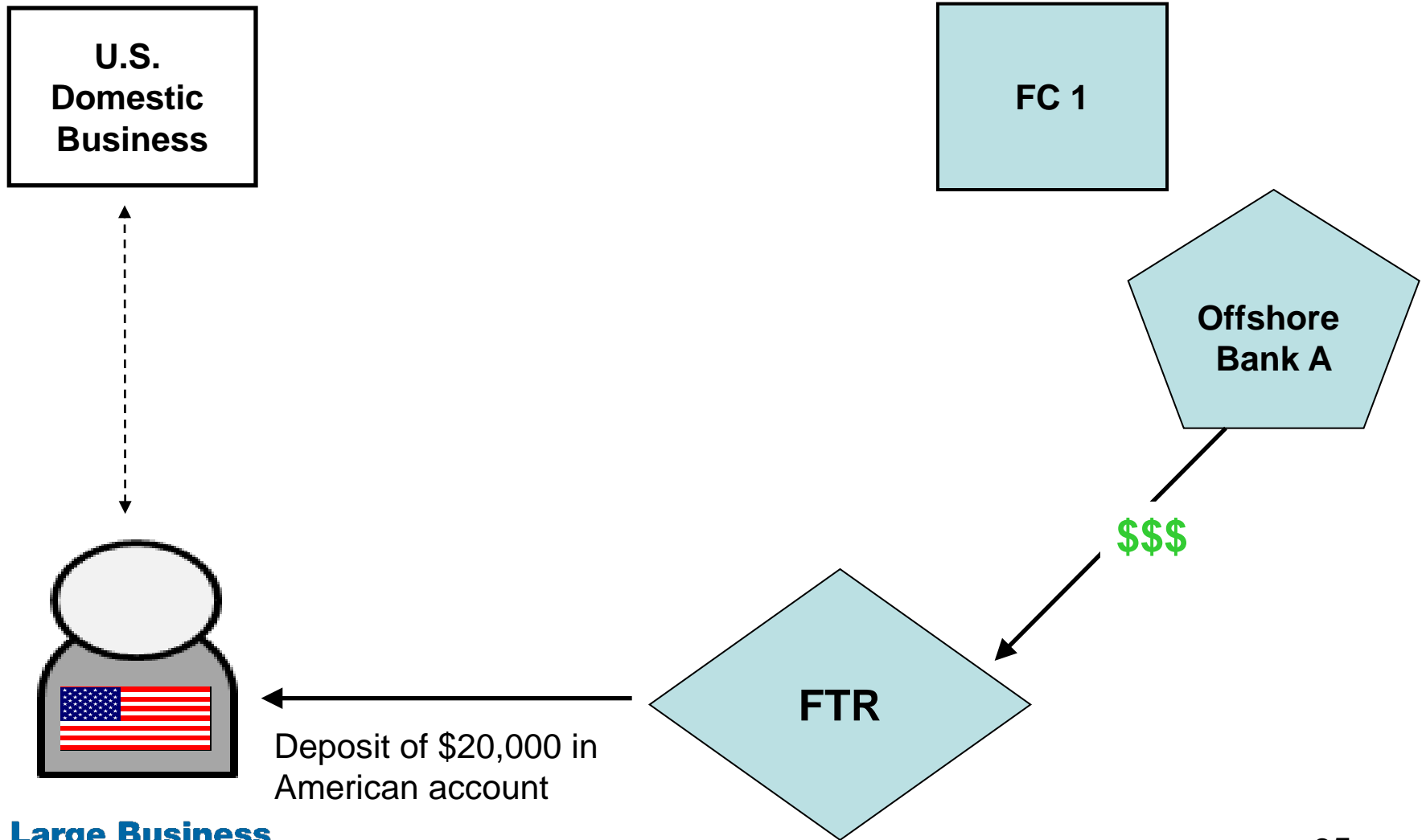
- ❖ Only foreign based documents relevant and material to the tax treatment of item



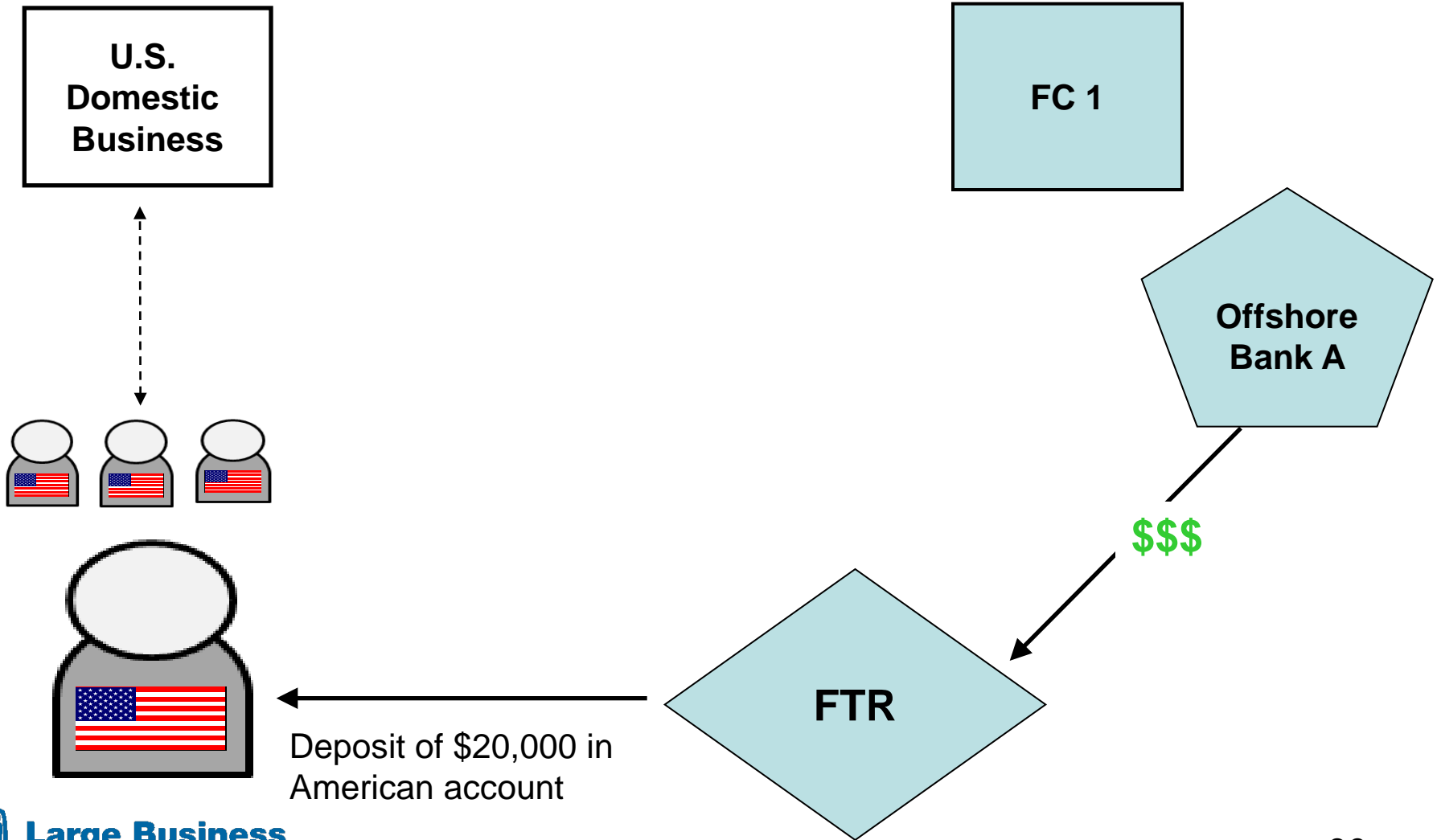
Tax Treaties – TIEA's

- ❖ Tax Treaty or Tax Information Exchange Agreement (TIEA)
- ❖ Only after all domestic efforts have been exhausted
 - I.R.M. 25.5.8.5
- ❖ Records may be limited to public access only items
- ❖ Contact Tax Attaché
 - Records available may vary from country to country

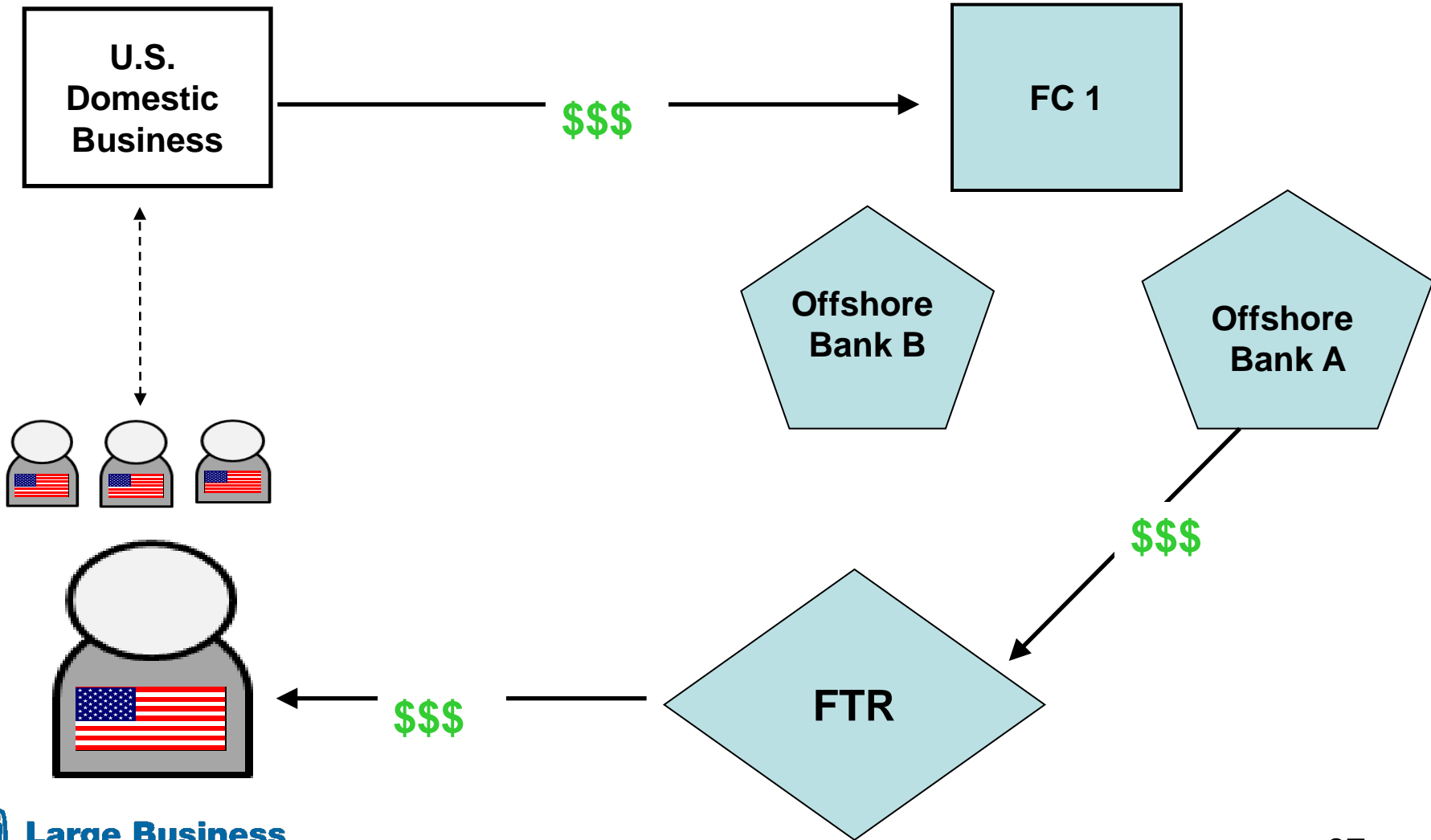
False Invoicing Case Study



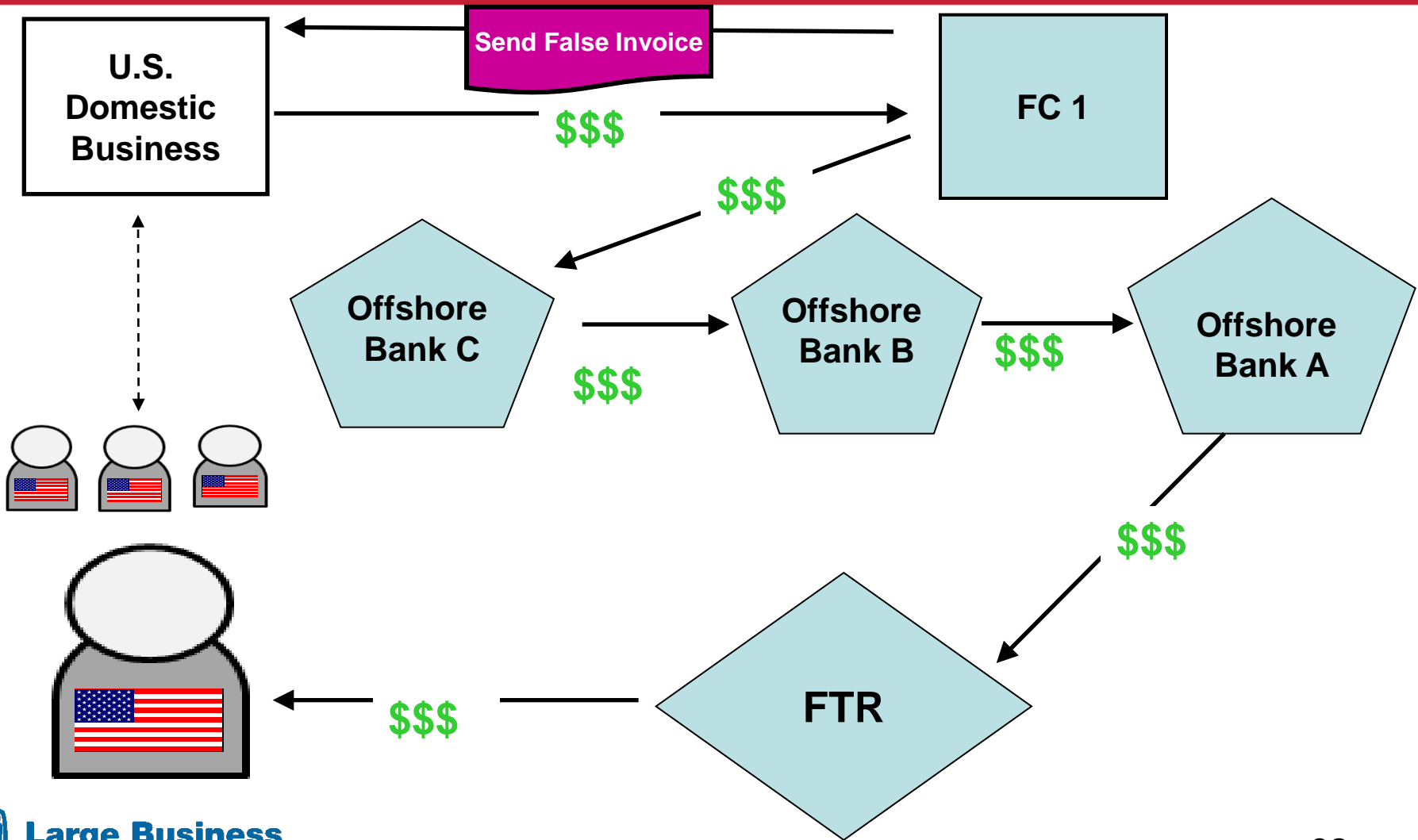
False Invoicing Case Study



False Invoicing Case Study



False Invoicing Case Study



5 Minute Stretch Break



Matrix Application Training International Individual Compliance

International Penalties and Civil Penalties



**Large Business
& International**



International Penalties and Civil Penalties

- ❖ Offshore Arrangements involve Foreign Entities and Foreign Financial Assets or Accounts
 - Generally no indications on U.S. returns
 - Most foreign transactions require reporting based upon ownership and control
 - Congress intended for the penalties to be severe

Foreign Information Forms & Penalties

Penalty Section	Description	Amount
31 U.S.C. Sec. 5321	Failure to File FinCEN Form 114 (Formerly TD F 90-22.1) FBAR Report of Foreign Bank and Financial Accounts.	Willful - up to \$100,000 or 50% of total account balance Non-willful – up to \$10,000 per violation
I.R.C. Sec. 6048 and I.R.C. Sec. 6039F	Failure to File Form 3520 Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts.	35% of Gross Reportable Amount Gifts – 5% of the gift per month up to 25%
I.R.C. Sec. 6048(b)	Failure to File Form 3520-A Annual Information Return of Foreign Trust with a U.S. Owner	5% of the gross value of trust assets determined to be owned by the U.S. person.
I.R.C. Sec 6038 I.R.C. Sec. 6046	Failure to File Form 5471, Information Return of a U.S. Persons with Respect to Certain Foreign Corporations.	\$10,000 per failure with additional \$10,000 per month beginning 90 days after notification of filing requirement not to exceed \$50,000 per return.
I.R.C. Sec. 6038A I.R.C. Sec 6038C	Failure to File Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation Engaged in a U.S. Trade or Business	\$10,000 per failure with additional \$10,000 per month beginning 90 days after notification of filing requirement.
I.R.C. Sec. 6038B	Failure to File Form 926 Return by U.S. Transferor of Property to a Foreign Corp.	10% of the value of the property transferred up to a maximum of \$100,000 per return with no limit if the failure to report was intentional

Foreign Information Forms & Penalties

Penalty Section	Description	Amount
I.R.C. Sec 6038 I.R.C. Sec 6038B I.R.C. Sec 6046A	Failure to File Form 8865, Return of U.S. Person with Respect to Certain Foreign Partnerships.	\$10,000 per failure with additional \$10,000 per month beginning 90 days after notification of filing requirement not to exceed \$50,000 10% of the value of the property transferred up to a maximum of \$100,000
I.R.C. Sec. 6651(f) I.R.C. Sec. 6663	Civil Fraud Penalty where the failure to file or the understatement of tax is due to Fraud.	up to 75% of the unpaid tax
I.R.C. Sec. 6651(a)(1)	Failure to File a Tax Return	5% of the balance due plus additional 5% per month or fraction thereof during the failure not the exceed 25%
I.R.C. Sec. 6651(a)(2)	Failure to Pay amount of tax shown on the return	.5 % of the amount of tax shown on the return plus an additional .5% for each month or fraction thereof that the amount remains unpaid not to exceed 25%.
I.R.C. Sec. 6662(a)	Accuracy Related Penalty on Underpayments	20% penalty
I.R.C. Sec. 6038D and 6662(b)(7) and 6662(j)	Form 8938 – Statement of Foreign Financial Assets	40% of underpayment of tax that is attributable to an undisclosed foreign financial asset understatement

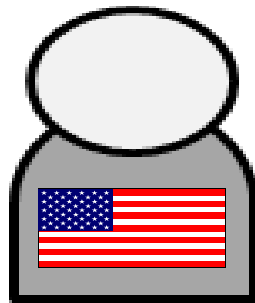


Potential Penalties in an Offshore Arrangement

**U.S.
Domestic
Business**

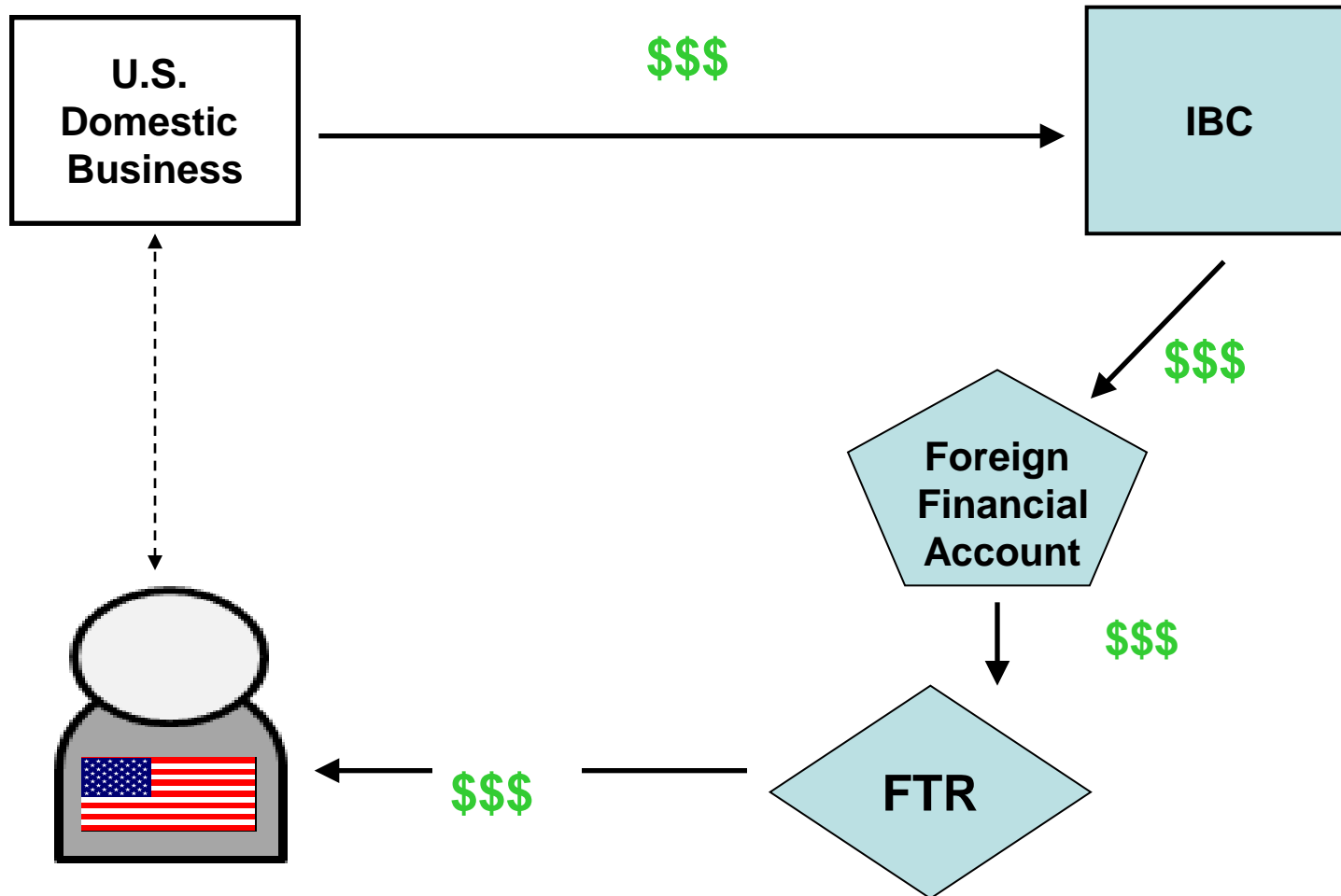
**Offshore
IBC**

FTR

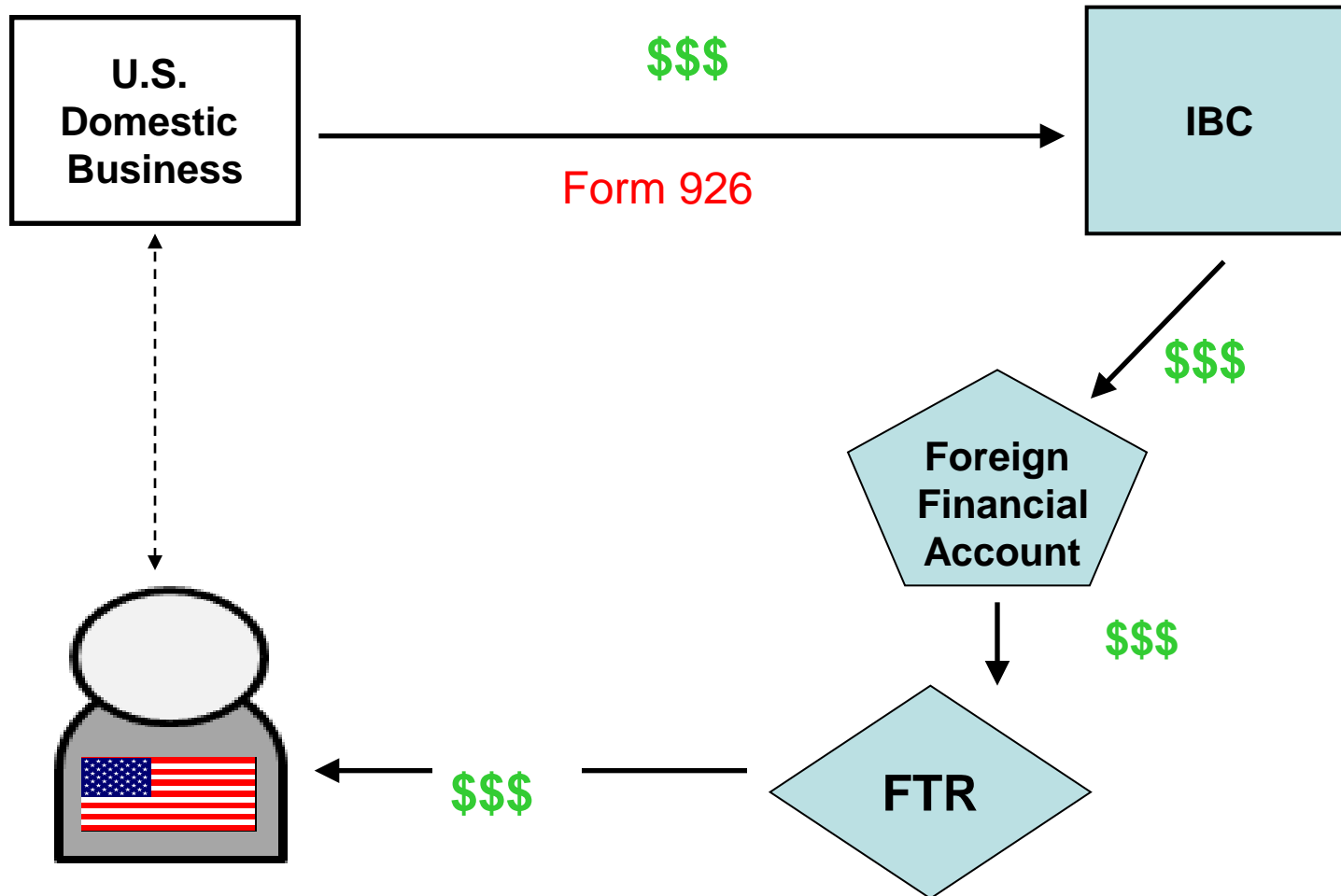


**Foreign
Financial
Account**

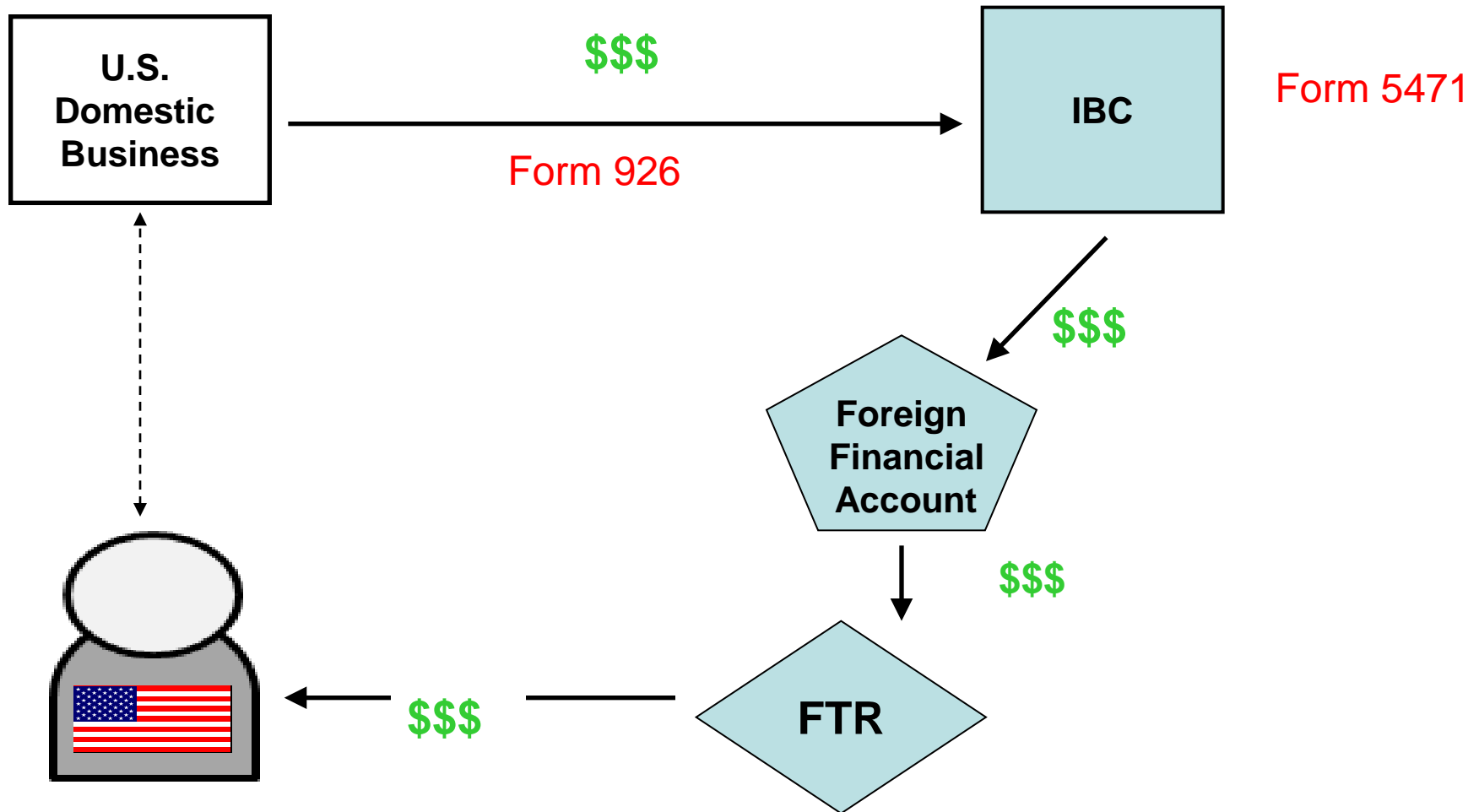
Potential Penalties in an Offshore Arrangement



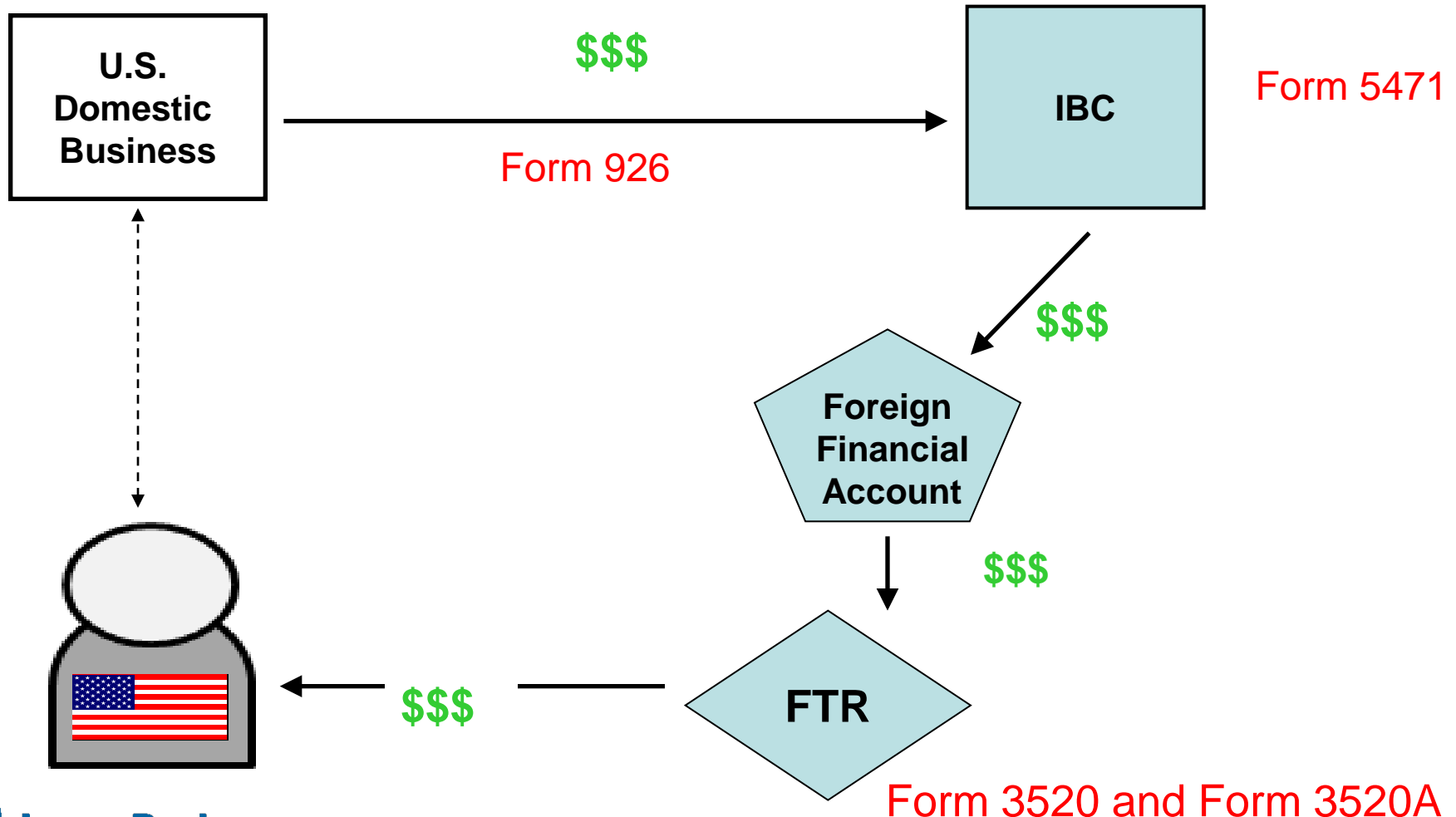
Potential Penalties in an Offshore Arrangement



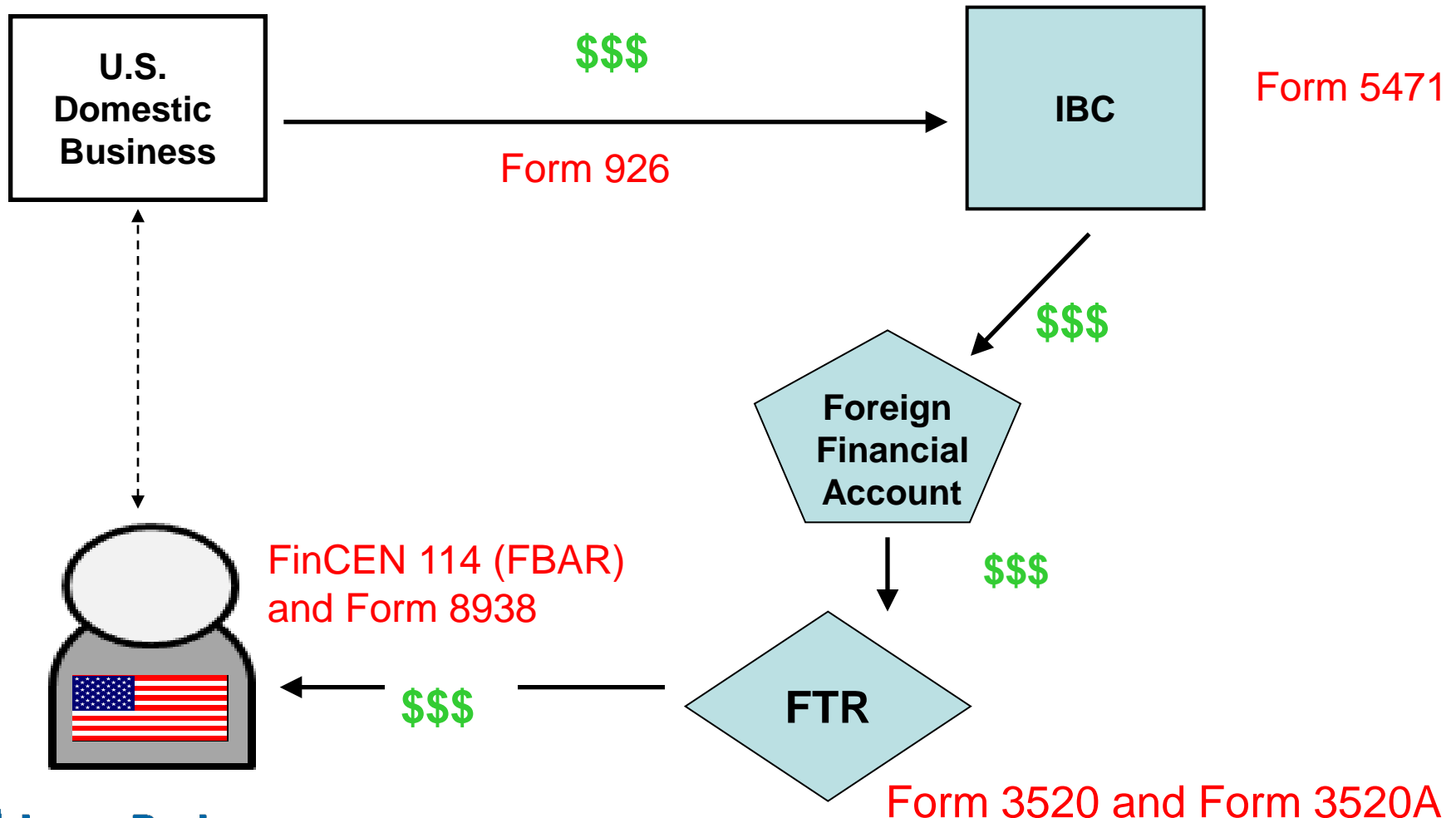
Potential Penalties in an Offshore Arrangement



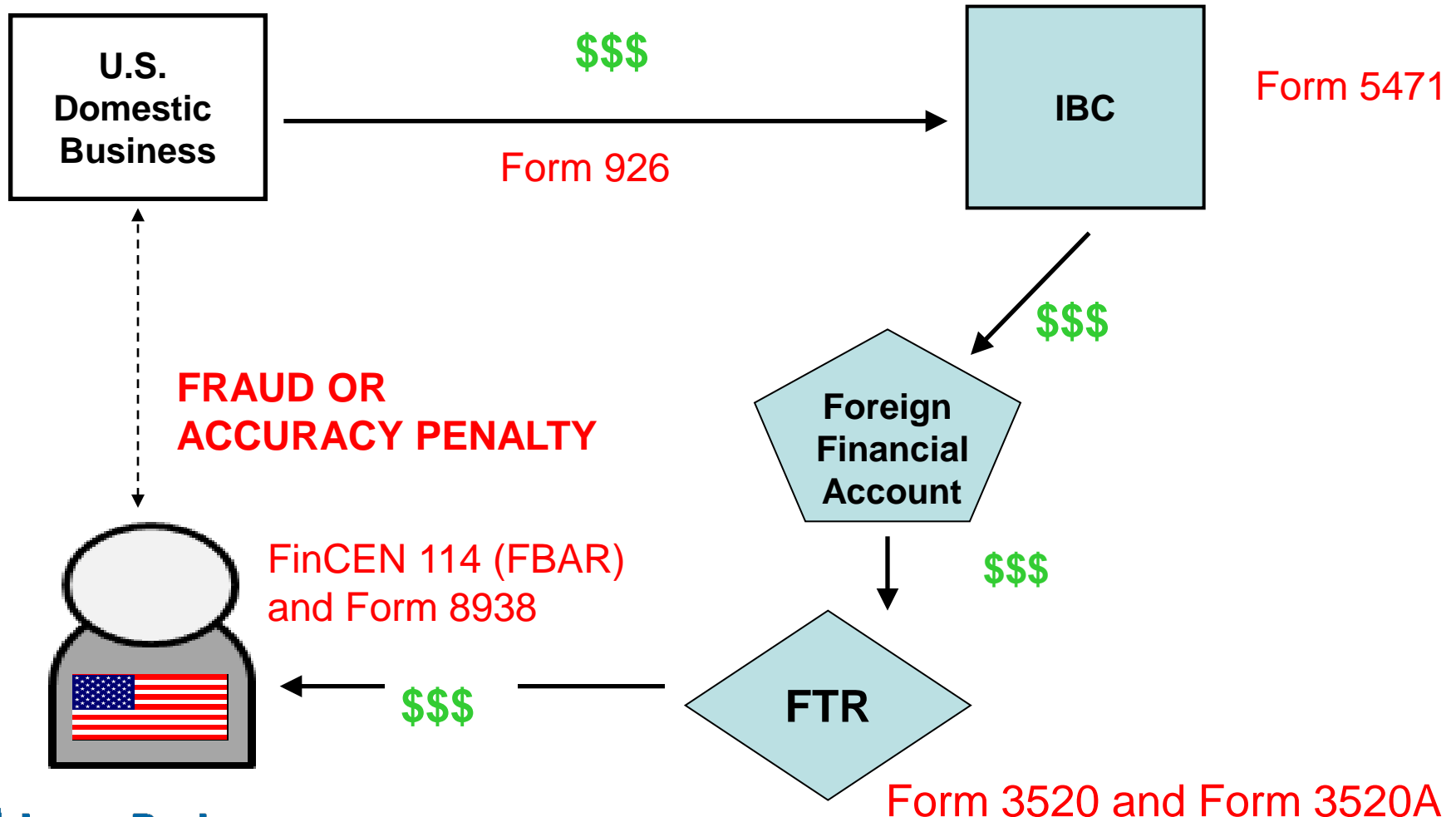
Potential Penalties in an Offshore Arrangement



Potential Penalties in an Offshore Arrangement



Potential Penalties in an Offshore Arrangement





Civil Penalty Decisions

- ❖ I.R.C. § 6663 - Fraud Penalty
- ❖ I.R.C. § 6662(b)(7) and (j) - Accuracy Related Penalty




Civil Penalty Decisions

I.R.C. § 6663 - Fraud Penalty

- ❖ IRS has the burden to prove that:
 1. an underpayment in tax exists, and
 2. the taxpayer willfully intended to conceal, mislead or otherwise prevent the collection of taxes

- ❖ Willfulness is determined by showing the following:
 1. Knowledge
 2. Intent
 3. Purpose



Civil Penalty Decisions

I.R.C. § 6663 - Fraud Penalty

❖ Taxpayer Involvement

- Did the client have control over the offshore accounts/transactions?
- How did the client access the funds?
- How complex was the client's financial transactions? (Multiple Trusts, Multiple Countries, Convoluted Arrangements)
- What role(s), or title(s), did the taxpayer hold under the scheme arrangement? e.g. Manager, Director, Trustee, Beneficiary
- Did the taxpayer play an active role in the scheme?
- Who set up the scheme?
- What communications did the taxpayer initiate or become involved in (emails, letters etc.) concerning the scheme?
- What types of reports, if any, did the taxpayer receive from the promoter regarding the funds and/or the program?
- Look for badges of fraud (unreported income, concealment, destruction of records, use of code words, etc.)



Civil Penalty Decisions

I.R.C. § 6663 - Fraud Penalty

❖ Taxpayer Knowledge of Scheme

- Did the taxpayer change accountants during the period of involvement in the scheme?
- Has the taxpayer participated in previous abusive schemes?
- Did the taxpayer disregard competent advice from the Service or other sources?
- How many years was the taxpayer involved in the scheme?
- Prior convictions for similar offenses?
- Prior civil examinations, adjustments, fines, penalties, criminal investigations and correspondence relative to illegal schemes?
- Information/documentation in the possession of the taxpayer that address illegality of the scheme?



I.R.C. § 6662(b)(7) and (j) 40% Accuracy Related Penalty

As a part of FATCA, I.R.C. § 6662(b)(7) and (j) were enacted. This section calls for a 40% Accuracy Related penalty on underpayments of tax that are attributable to an undisclosed Foreign Financial Asset* understatement

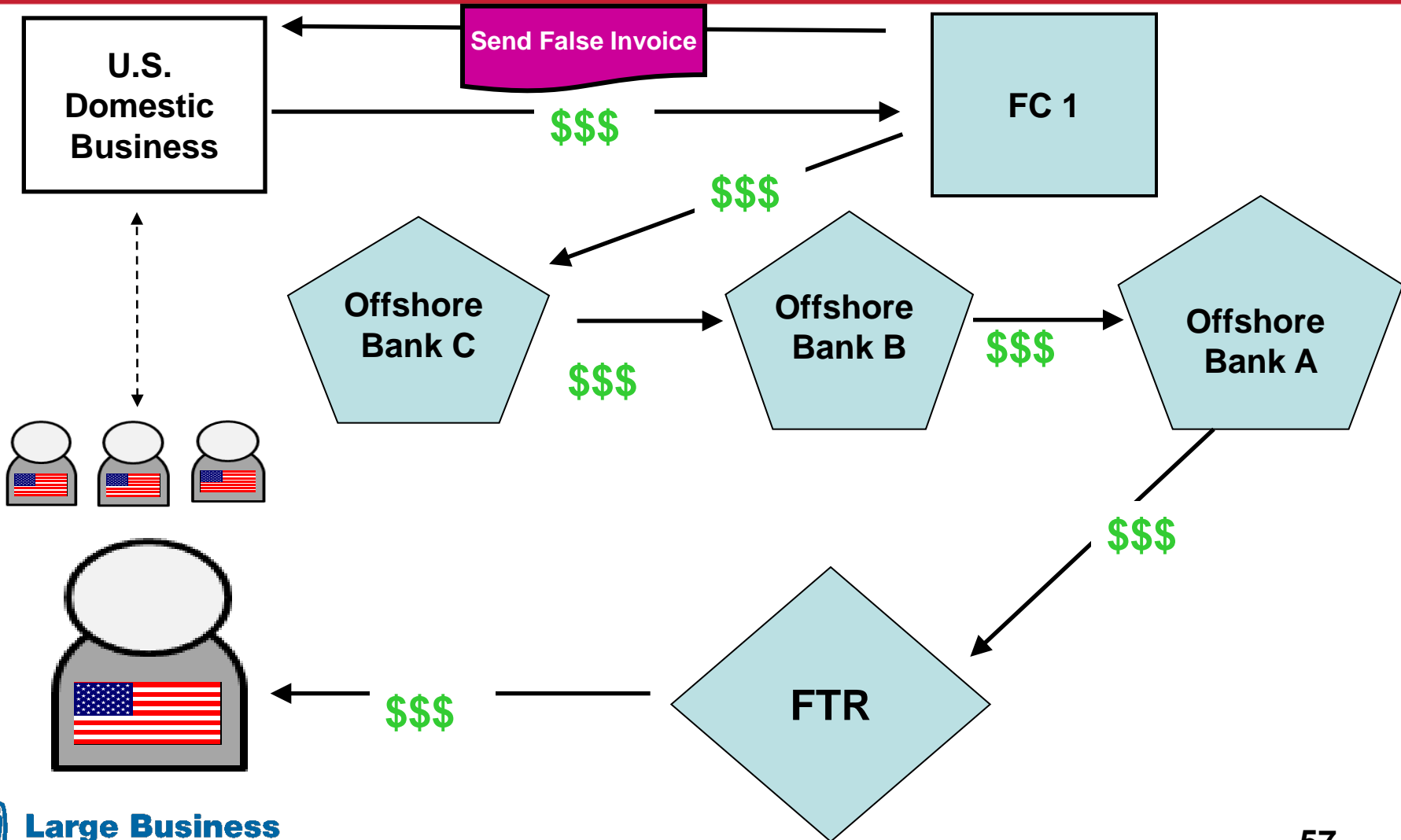
An undisclosed foreign financial asset includes any asset that is subject to information reporting under I.R.C. 6038, 6038B, 6046A, 6048, and 6038D



Civil and Information Return Penalties

- ❖ Understand the taxpayer's Facts and Circumstances
- ❖ Consider Reasonable Cause Arguments
- ❖ Once established the Taxpayer is subject to the resulting tax consequences of the Offshore Arrangement
- ❖ The substance of a transaction controls, not the form
 - The Supreme Court and Tax Court have consistently held that the substance rather the form of a transaction is controlling for tax purposes.

False Invoicing Case Study



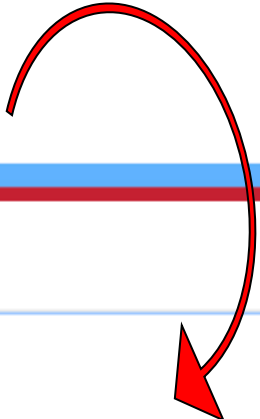
Summary

- ❖ Identifying an Offshore Arrangement requires a thorough interview and extensive fact finding.
- ❖ Interviewing the taxpayer and memorializing testimony is crucial in the conduct of a quality examination.
- ❖ Summons are an administrative tool Congress has provided to enable an examiner to perform their duties.
- ❖ Failure to file required information returns, may result in severe penalties.
- ❖ When an abusive arrangement is identified, examiners should consult with the manager and FTA in considering applying fraud penalties.
- ❖ FATCA provides for a 40% accuracy related penalty on underpayments of tax that are attributable to an undisclosed Foreign Financial Asset.

❖ You are now able to:

- Identify relevant parties to interview
- **Prepare** for a quality interview
- Identify the tools and procedures available to secure an effective interview with cooperative and uncooperative taxpayers or third parties
- Identify challenges faced with uncooperative U.S. Citizens residing abroad, and
- **Describe how penalties which could be applicable as a result of an Offshore Arrangement can be identified and developed**

Contact



IPN Contact List

<input type="checkbox"/>	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	<u>lbi.iic.offshore.arrng.ipn@irs.gov</u>
<div style="background-color: black; color: red; padding: 5px;">(b) (6)</div>				



CPE Question #1

True or False

Do you want CPA CPE Credit for this lesson?



CPE Question #2

True or **False**

When interviewing a taxpayer or witness, the Examiner should adhere strictly to predetermined and pre-approved questions.

Which of the following items is not a part of Interviewing the Taxpayer?

- a. Identifying the Witness
- b. **Writing the case file up for Appeals**
- c. Preparing and Planning for the Interview
- d. Conducting the Interview



CPE Question #4

True or **False**

A Summons may be served by certified or registered mail to a taxpayer or witness residing abroad.

True or False

Generally, an examiner should not allow a taxpayer or witness to claim a blanket assertion of their Fifth Amendment Privilege.



CPE Question #6

True or **False**

Penalties must be asserted for the failure to file foreign information returns.



CPE Question #7

True or **False**

The burden of proof in the application of the fraud penalty rests with the Taxpayer.



CPE Question #8

True or False

An examiner should consider the possibility of fraud when an abusive Offshore Arrangement is identified.

True or **False**

I.R.C. § 6662 only allows for the application of an Accuracy Related penalty of 20% of the identified understatement of Tax.