

**Desk Guide for Examining Tax Years
Of Taxpayers Filing an Amended Return
Reflecting an Additional Tax Liability
(Silent Amended Returns)**

Purpose

This guide provides information on examining taxpayers who have filed amended returns reflecting additional tax liabilities. It is not an exhaustive discussion, nor should this guide be cited as authority.

The topics covered in this guide are limited to their impact on quiet amended returns. For complete coverage of the topics herein, examiners should refer to the IRM.

Background

In the last few years, IRS has initiated a number of programs to encourage non-compliant taxpayers with undisclosed offshore accounts or assets to disclose their non-compliance voluntarily and to pay the tax, interest, and penalties due. In return, IRS has agreed to resolve these cases based on pre-determined terms.

Despite the opportunity to resolve the amount of tax, interest, and penalties on terms favorable to taxpayers, many taxpayers choose not to participate in a voluntary program, but instead simply file amended returns to report the additional tax they owe. While IRS appreciates taxpayers who come forward to self-correct errors, it has a duty to insure that these self-corrections are accurate and complete and that penalties, if applicable, are addressed.

Therefore, the purpose of conducting these examinations is twofold:

- Insure that the corrected tax liability reflected on the amended return is correct and
- Address any penalties that might apply

Definition

These amended returns are sometimes called “quiet or silent amended returns,” because taxpayers file them outside of any of the offshore disclosure initiatives, i.e. “silently.” The terms quiet amended and silent amended returns are used interchangeably in this guide.

Program

The Quiet Disclosure program is undergoing several

Plans

modifications at the Campus in order to adapt and meet the ever-changing needs of the Service.

Scope of the Examination

The examination of a case with a quiet amended return is actually an examination of the original tax return. It just happens to have the added component that the taxpayer self-corrected an item improperly reported on the original return.

As in any examination the examiner's role is to determine a taxpayer's correct tax liability for a specific period of time, i.e., a "tax year." In the example on page 3 the examiner assigned Taxpayer's 2009 tax year may inquire into *any* issue related to 2009. The examiner is not limited to inquiring only into the unreported interest income disclosed on the 1040-X. Any penalties applicable to 2009 are also at issue.

The entire tax year is under examination in these cases – not simply the amended return.

Of course, if after consultation with the group manager, it is decided to perform a limited scope examination under IRM 4.10.2.6.1.1 or other authority, the examiner may limit the scope of the examination.

If the original 1040 is not included in the case file with the 1040-X, request a copy in your initial IDR.

Legal Status of a Quiet Amended Return

Examiners are generally familiar with amended returns (1040-X) requesting refunds of previously paid tax. A 1040-X seeking a refund is a claim for the refund of an overpayment of tax authorized under IRC § 6401. There are special rules concerning claims for refund, including statutes of limitations, computations of the amount that may be refunded, and provisions for IRS to recover refunds made in error.

Quiet amended returns are not subject to the special rules for claims for refunds of tax, because they are not claims for refunds. They are corrections to filed returns which result in a tax liability greater than what was reported on the original return. Quiet amended returns are subject to the statutory provisions that apply to assessments of tax, not to refunds of overpayments.

A quiet amended return does not extend the statute of limitations for IRS to assess tax for that tax year.

Example: Taxpayer timely filed his 2009 Form 1040. The 3 year statute of limitations under IRC § 6501(a) expires on April 15, 2013. On October 1, 2012 Taxpayer filed an amended return reflecting additional tax of \$3,000 based on interest income he omitted from his original return. IRS must assess the additional \$3,000 on or before April 15, 2013.

IRC § 6501(c)(7) provides a limited exception to the above general rule which will be discussed later.

**Authority to
Examine
“Barred” Tax
Years**

Examiners, taxpayers, and representatives are accustomed to IRS examining tax years with “open” statutes of limitations and if additional time is needed, extending the assessment date under IRC § 6501(c)(4) with Form 872. Representatives may question whether IRS can begin an examination after the 3 year statute of limitations under IRC § 6501(a) has expired. The answer to this question is an unequivocal “Yes.”

IRS is authorized to examine books and records to determine a taxpayer’s liability (IRC § 7602), but IRS may not subject a taxpayer to an unnecessary examination. (IRC § 7605(b)). An examination of a tax year after the statute of limitations is expired is an unnecessary examination, because generally no assessment of tax can be made for an expired year.

Notwithstanding the above, IRS does not have to prove that the statute of limitations is open before starting an examination. IRS may start an audit *to determine if there is an open statute which would allow an assessment of tax.*

In United States v Powell, 379 U.S. 48 (1964) IRS issued a re-opening letter to the taxpayer after the 3 year statute of limitations had expired, because IRS believed the statute of limitations was still open due to fraud. The taxpayer refused to comply with an administrative summons, alleging the examination was unnecessary because of the expired statute of limitations.

The Circuit Court refused to enforce the summons because IRS did not first establish that there was fraud.

The Supreme Court reversed and enforced the IRS summons even though the 3 year statute of limitations was expired and an assessment could only be made if the IRS proved fraud. The Court did not require IRS to prove fraud before issuing the summons, stating:

We do not equate necessity as contemplated by this provision with probable cause or any like notion. If a taxpayer has filed fraudulent returns, a tax liability exists without regard to any period of limitations. Section 7602 authorizes the Commissioner to investigate any such liability. If, in order to determine the existence or nonexistence of fraud in the taxpayer's returns, information in the taxpayer's records is needed which is not already in the Commissioner's possession, we think the examination is not "unnecessary" within the meaning of 7605 (b). Although a more stringent interpretation is possible, one which would require some showing of cause for suspecting fraud, we reject such an interpretation because it might seriously hamper the Commissioner in carrying out investigations he thinks warranted, forcing him to litigate and prosecute appeals on the very subject which he desires to investigate, and because the legislative history of 7605 (b) indicates that no severe restriction was intended. Powell, 51. [emphasis added]

In other words, an examination undertaken by IRS to determine if an exception to IRC § 6501(a) is present is not an unnecessary examination. Put another way, proof of an exception to the 3 year statute of limitations is not a condition precedent to starting an audit.

Statutes of Limitations and Assessments

Assessments

An assessment of tax is merely the recording of a tax liability in IRS's books and records, but it is *the* critical event in IRS's compliance efforts. IRC § 6203

Generally, the IRS is authorized to summarily assess tax reported to the IRS by the taxpayer on a tax return (Form 1040 and 1040-X). IRC § 6201(a)(1).

For deficiency assessments, the IRS may not assess tax until the taxpayer receives a statutory notice of deficiency (90 Day Letter) and during the 90 days the taxpayer has to decide whether to petition the Tax Court. IRC § 6213(a).

There are several exceptions to the “No Statutory Notice = No Assessment” rule.

- IRC § 6213(a) – permits IRS to assess tax if a taxpayer waives his right to receive a notice of deficiency prior to assessment (Forms 4549, 870, 870-AD)
- IRC § 6213(b) – permits IRS to assess tax attributable to a math or clerical error on a filed return
- IRC § 6213(c) – permits immediate assessment of tax if a taxpayer does not file a petition after receiving a notice of deficiency
- IRC § 6861(a) – permits IRS to immediately assess tax if assessment and collection of the tax is in jeopardy
- IRC § 7121(a) – permits IRS to enter into an agreement where both the taxpayer and the IRS agree to an assessment

When a quiet amended return is received, the IRS should immediately assess the additional tax reflected on it to insure that the Government's interests are protected. However, an assessment of tax cannot be made in a tax year otherwise barred by statute.

Because the processing Campus has no mechanism for determining if one of the excepted statute of limitations provisions applies (25% omission; FATCA; Failure to notify the Secretary of certain foreign transfers), they generally process only those amended returns where the IRC 6501(a) statute remains open.

As such, upon assignment of a quiet amended return, the examiner must make sure the additional tax has been assessed in all years where there is an open statute, including those where the excepted statute of limitations provisions apply. If the additional tax has not been assessed, the examiner needs to protect the Government's interest, and

forward the amended return for manual (i.e. quick) assessment. (See IRM 4.4.25 for Quick Assessment Procedures.)

Quick Assessment vs. Processed Return

When a Quick Assessment is input into a tax module, only the Tax is adjusted. The Taxable Income, AGI, Exemptions, SE tax, and certain tax credit remain unchanged on the tax module. Failure to recognize and correct this mismatch prior to closing the case will cause it case to be returned to the examiner.

The following steps should be taken to recognize a quick assessment and to correct the mismatch in the tax module:

- To determine if a quick assessment has been posted, use IDRS to secure:
 - an IMFOL/BMFOL “T”
A quick assessment can be identified if a TC 370 is posted just prior to a TC 290 tax assessment
 - an IMFOL/BMFOL “R”
A quick assessment can be confirmed if the Tax per the tax modules matches the amended return, but the AGI and TI still reflect the original return amounts
- If the tax was quick assessed, complete Form 3870, *Request for Adjustment*. The following language should be included:
 - Line 11, Reason for Adjustment
“To post and correct AGI and TI from quick assessment on xx/xx/2012”
 - Line 29, Assessment, Item or Credit Adjustment Processing Information

Ref. No.	Item Adjustment	Ref. No.	Credit Adjustment
888	AGI		12,345
886	TAXABLE INCOME		1,234

NOTE: Amended returns with adjustments to Exemptions, SE tax, and credits will require additional reference codes.

- Fax the completed Form 3870 to the FORT:
 Memphis
 SBSE Areas 201 – 207
 Fax Number 901-786-7106

Once the tax is **fully** assessed/processed, in

determining any additional underpayment, the examiner will work from the total tax reflected on the 1040-X. That figure will be the “tax as previously adjusted” on a subsequent Form 4549 or 4549-A.

A discussion of the statute of limitations in the context of quiet amended returns is covered later in this guide.

**Establishing
AIMS/ERCS
Controls**

Review case and IDRS transcripts to determine how many years of “Quiet Disclosures” were filed. Consider establishing additional years on ERCS with form 5345D (using project code 1160) after careful review of statutes, discussing case with manager and Fraud Technical Advisor (FTA) (as appropriate), and using statute exceptions including:

- Fraud/ and 6501(e) for 25% omission of income; or
- FATCA-6501(e) for \$5,000 omission of income from foreign financial assets (6038D) if ASED was open on March 18, 2010 or
- 7609(e)(2) may apply in some cases where a third party summons was issued and unresolved for more than six months i.e. John Doe Summons; or
- 6501(c)(8) for failure to notify Secretary of certain foreign transfers, or
- “YY” memo (discussed later) or
- F906-to assess tax on barred years

FBAR- research CBRS (F10509) to determine FBAR filing history. If taxpayer has an FBAR violation, submit RSM (F13535) to TM, contact FBAR coordinator for assistance (if necessary), and then add FBAR years to ERCS following the attached guide. Complete and forward FBAR Monitoring Document(F13536) to DCC and then agent can begin FBAR examination.

Refer to Exhibit 1 for the FBAR-ERCS Guidelines.

**Payment
Issues:**

Excess Collection

Because some of the taxable amended returns have been filed in tax years that appear to be barred by statute, the processing Campus may have moved the

taxpayer's payment to the Excess Collection File (XCF). The Excess Collection File (XCF) controls remittances that cannot be applied to a taxpayer account and must be accounted for as excess collections (e.g. conscience money and voluntary contributions to reduce the national debt).

To determine if a taxpayer's payment has been moved to XCF, look for a TC 672 debit followed by a notation "EXCESS-COLL" on either an IMFOLT or TXMOD.

To have this payment credited back, complete Form 3870, Request for Adjustment, requesting that the payment be moved out of XCF and credited back to the taxpayer's tax module. A statement justifying the viability of statute of limitations will need to be included (i.e. IRC 6501(e)(1)(A)(ii) or IRC 6501(c)(8), etc.).

A sample of a completed Form 3870 is provided. **See Exhibit 2.**

After securing a Group Manager's signature/approval, the completed Form 3870 should be faxed to Centralized Case Processing (CCP) for processing.

CCP Exam Fax number for SBSE (Memphis):
901-786-7106

Refunded Payments

In some instances, the taxpayer may receive a refund of the payments he submitted with his amended return. This may happen when only the payment posts to the tax module, but the amended return doesn't get processed, hence the payments on account do not match the payments due.

After an examination is initiated, the taxpayer or his representative may contact the Revenue Agent, seeking directions for returning refund checks.

Returned Checks Procedures can be found in the IRM, IRM 21.4.3.4.4, including the mailing addresses of the Refund Inquiry Unit for each Campus.

In order to insure that payment doesn't refund again,

verify that an unreversed TC 570 (-R freeze) or TC 130 (V- freeze) has posted to the tax module.

Starting the Examination

The examination of a tax year when a quiet amended return was filed is a regular examination. Normal examination protocols apply. The examiner will:

- Send the taxpayer a standard examination letter including all “stuffers” such as Pub. 1
- Set the scope of examination after consulting with the group manager
- Prepare a pre-audit analysis identifying any Large, Unusual, or Questionable (LUQ) items
- Adhere to the package audit requirements and inspect prior and subsequent year returns, related returns, etc.
- Perform minimum income probes (IRM 4.10.4)
- Comply with restrictions on lifestyle and financial status examinations (IRC § 7205(e))

The Initial IDR

It is difficult to provide a pro forma IDR for these cases, because examiners are likely to raise additional issues other than the issue on the quiet amended return. It is not practical to try to anticipate all the issues that may warrant investigation. However, a sample IDR is attached which includes a number of documents that should be requested to address the amended return filing. Examiners should expand the partial IDR as needed. **Refer to Exhibit 3.**

The Taxpayer Interview

If a representative under a valid power of attorney is handling the examination for the taxpayer, the examiner may not disregard that designation without reason. However, the examiner, not the taxpayer or representative, should control the examination, including its time and place. See IRC § 7605(a).

Examiners have the right to interview a taxpayer or other witness when necessary. Even a taxpayer with a representative can be summoned if the taxpayer has relevant information and the other Powell requirements are met.

Local Counsel attorneys are available to assist with

summonses and interviews.

Representatives often request a list of questions in lieu of the taxpayer's appearance. Examiners are cautioned that this approach severely restricts the ability to ask follow-up questions and explore other areas of inquiry. It also eliminates the opportunity to observe a taxpayer's (or other witness's) demeanor. Further, providing a list of questions gives a taxpayer time and opportunity to craft responses that may or may not be responsive.

More information regarding interviews is included in the Internal Revenue Manual.

Additional information and authority for interviewing taxpayers and witnesses and controlling an examination can be found at:

- IRC § 6001 - Requirement for taxpayers to keep records
- IRC § 7521(c) - IRS cannot require the presence of a represented taxpayer without an administrative summons
- IRC § 7525 - Confidentiality privileges relating to taxpayer communications with practitioners
- IRC § 7601 - Authority to examine taxpayers
- IRC § 7602 - Authority to Request Information
- IRC § 7605 - Authority to Fix Time & Place of Appointment
- IRM 4.10.1.5.7. Confidentiality - Privileges Relating to Taxpayer Communications
- IRM 4.10.2.7.5 - Scheduling Appointment With the Taxpayer and/or Representative
- IRM 4.10.2.8 - Scheduling Problems
- IRM 4.10.2.9.3 - Authority to Request Books, Records, and Accountant's Workpapers
- IRM 4.10.2.10.2 - Rescheduling the Initial Appointment
- IRM 4.10.3.2.1 - Who To Interview
- IRM 4.10.3.4.5.2 - Interview Techniques
- IRM 25.5 - Summons Handbook
- IRM 21.3.7 - Processing Third Party Authorizations onto the Centralized Authorization File (CAF)
- SB/SE Delegation Order 145.7 - Authority to

- Request and Inspect Preparers Records
- Circular 230 (31 CFR 10.0 through 10.93) - Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the IRS
- Publication 947 - Practice Before the IRS and Power of Attorney

While it is not the intent of this workshop to provide a pro forma interview questionnaire, there is a sample interview questionnaire included at the end of this material. **See Exhibit 3.** These interview areas are merely suggestions of the types of areas that need to be covered and are not meant to be used as an interview tool/checksheet.

Estate & Gift Issues: How to address

The most common type of Estate or Gift Tax issues encountered by Internal Revenue Agents (RA's) with this type of case will be:

1. The taxpayer states that the foreign bank account is the result of a gift, or
2. The taxpayer states that the foreign bank account is the result of an inheritance, bequest or estate distribution, or
3. Outright denial of the existence of, or any knowledge of, the account.

1. Taxpayer states that the foreign bank account is the result of a gift.

In this case, the RA will ask the following pertinent questions and provide the answers on a referral form:

1. Who was the donor (gift giver)?
2. What was the date of the gift?
3. What is the address of the donor?
4. What was the amount of the gift?
5. What was the form of the gift (cash, securities, etc.)?
6. Was there a gift tax return (709) filed?
7. If so, do you have a copy or the name of someone who does?

The gift tax filing requirement in the years in

question: Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, is used to report transfers subject to the federal gift tax and certain generation skipping tax and to compute the tax, if any, due on these transfers.

A gift must exceed Table 1 per donee or Table 2 to a spouse who is not a citizen of the United States, before the gift is potentially taxable. Any tax due is imposed on the person giving the gift (donor).

Tax Year	Table 1 Individual Donee Exclusions	Table 2 Non-US Citizen Spouse
1997	\$10,000	\$10,000
1998	\$10,000	\$100,000
1999	\$10,000	\$101,000
2000	\$10,000	\$103,000
2001	\$10,000	\$106,000
2002	\$11,000	\$110,000
2003	\$11,000	\$112,000
2004	\$11,000	\$114,000
2005	\$11,000	\$117,000
2006	\$12,000	\$120,000
2007	\$12,000	\$125,000
2008	\$12,000	\$128,000
2009	\$13,000	\$133,000
2010	\$13,000	\$134,000
2011	\$13,000	\$136,000
2012	\$13,000	\$136,000

Form 709 is due generally no later than April 15 of the year following the calendar year in which the gifts were made. If the donor dies during the year the gifts were made, the executor must file the Form 709 the earlier of the due date (including extensions) of the donor's estate tax return (Form 706) or April 15 of the year following the year the gifts were made.

2. Taxpayer states that the foreign bank account is the result of an inheritance, bequest or estate distribution.

In this case, the RA will ask the following pertinent

questions and provide the answers on a referral form:

1. What was the name of the decedent?
2. What was the address of the decedent?
3. What relationship was the decedent to the Volunteering taxpayer?
4. When did the decedent die (date of death)?
5. Who was the executor, administrator or personal representative for the decedent?
6. What was the nature of the bequest or inheritance (cash, securities, partnership interest, closely held business shares, any other asset)?
7. What was the value of the bequest or inheritance when received from the decedent's estate?
8. Was there an estate tax return (706) filed?
9. If so, do you have a copy or the name of someone who does (you may have received it due to step up in basis of the assets you received from the estate)?

The Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, is used to report the estate tax for a taxable estate and to compute the generation-skipping transfer tax on transfers to skip persons of interests in property included in the decedent's gross estate. The Form 706 is due generally 9 months after the date of the decedent's death.

The estate tax filing requirement for the years in question is:

Estate of Decedents Dying During:	Applicable Exclusion Amount
2002	\$1,000,000
2003	\$1,000,000
2004	\$1,500,000
2005	\$1,500,000
2006	\$2,000,000
2007	\$2,000,000
2008	\$2,000,000
2009	\$3,500,000
2010	\$5,000,000*

2011	\$5,000,000
2012	\$5,120,000

- Technically, there was no estate tax due for decedents in calendar year 2010. However, there was an option provided to those estates in excess of \$5,000,000 for filing a return in order to adjust the basis of the estate's assets as defined under IRC §1022. If your decedent's tax year is 2010, contact the E & G Liaison.

3. Outright denial of the existence of, or any knowledge of, the account

While this is an unlikely position taken by the taxpayer in light of having filed amended returns, you may encounter situations where the taxpayer denies all knowledge of the existence of what we know, or suspect, as a result of preliminary research conducted to be either an inherited or a gifted account. At that time, there are certain things that can be done.

The RA should perform the following:

1. Check IDRS to see if the donor (typically, a parent or other relative) filed any gift tax returns or an estate tax return. This would be done by utilizing the IDRS command code BMFOLI followed by the original donor's SSN, followed by the letter V. For example:
BMFOLI123-45-6789V
2. If IDRS shows that either a Form 706 (MFT 52) or Form 709 (MFT 51) was filed, contact the E & G Liaison to request the original return (the liaison will order the return and review it for you, you cannot order these returns yourself).
3. If no information is available on IDRS, you should contact the E & G Liaison to determine whether a referral to E & G is warranted. If so, then you would continue to work your case and, when the referral is assigned within E & G, you will be contacted by the E & G attorney and will coordinate case actions with him/her.

The Utilization of Court Reporters

If the examiner issues a summons to the taxpayer for an appearance, Local Counsel may request that a court reporter transcribe the interview. A transcript of the summoned interview may be pivotal in any future trial.

It is the examiner's responsibility to initiate the procurement of the court reporter. Group Manager (GM) and Territory Manager (TM) approval will be required prior to having your request input into the Integrated Procurement System (IPS) by an approved IPS user (typically a GM or TM's secretary).

The procurement process should be initiated *a minimum of 30 days* prior to the needed services.

The following steps should be taken to initiate the approval of funds for procurement of a court reporter:

- Complete the Court Reporter portion (lines 1-19) of Part 1 of the Court Reporter/Arbitrator Request Form:
<http://awss.web.irs.gov/Procurement/forms/cr-arbitrator-request-form.xls>

NOTE: This form was designed for use by Labor Relations (LR); however it can be used by Exam to capture the information necessary to requisition a Court Reporter. Ignore all references to LR or EDI.

Line-by-line instructions:

Line 1: Today's date

Line 4: Name, telephone, and address of the GM/TM's secretary that has access to the IPS. This person will serve as the Point of Contact (POC) for follow-up during the requisition & procurement process.

Line 5: Same as 4 above

Line 7: Your GM's name and telephone number

Line 8: Your Business Unit/Operating Unit/Area, including your group number

Line 9: Complete only if you know the name of a vendor; otherwise, leave blank.

Line 11: A brief description of the services requested: "Transcription of taxpayer interview under summons"

Line 12: Dates and times of taxpayer interview, as per the summons

Line 13: a) Address where interview will be conducted.

b) If the interview is in the examiner's Post of Duty, then the POC should be the examiner/phone number; If the interview is offsite, provide the name and number of someone within that location.

Line 16: An electronic version (i.e. "Disk") is preferred

Line 18: A brief justification for the services requested: "Court reporter services recommended by Counsel for interview under summons of a Quiet Disclosure taxpayer."

Line 19: \$1,500 (this represents a reasonable estimate for 8 hours of transcription services plus the final report/disc)

The rest of the document should be left blank.

- Forward the completed Court Reporter/Arbitrator Request Form through your GM and TM for approval.
- Once approved, forward the Form to an IPS user (typically a GM/TM's secretary), who will input the requisition request.
 - IPS will automatically channel the request through the funding approval process
 - The IPS user will receive a requisition number for any necessary follow-up.
- Once the funding is approved, the requisition will be assigned to a Contract Specialist, who will make the initial contact with the vendor, and generate the vendor contract. A copy of the contract will be provided to the IPS user.
- The Contract Specialist will provide the IPS user and/or the examiner with vendor contact information so that final logistical details can be arranged.
- The examiner should not accept a copy of the invoice for payment. Instead, she should refer the vendor to the written contract which directs vendors to submit their invoice electronically, through the Invoice Processing Platform (IPP). Once the invoice is received in IPP, the IPS user will receive a notification seeking to confirm delivery of services (i.e. the transcript). The IPS user will then input

Receipt and Acceptance into IPS, after which Beckley Finance Center will issue payment to the vendor.

Questions regarding the Procurement process can be directed to the Procurement Hotline: (202) 283-1478, Option 5.

Summonses

Taxpayers required to file returns must keep permanent books of account or records sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown in any return. IRC § 6001; Treas. Reg. 1.6001-1(a). Wage earners are required to keep records so the IRS can determine the correct amount of tax. Treas. Reg. 1.6001-1(b) Examiners determine the time and place of an examination, which must be reasonable under the circumstances. IRC § 7605.

IRC § 7602 authorizes examiners to examine any books, papers, records, or other data which is or may be relevant or material to an examination. This includes issuing a summons to the taxpayer under examination or anyone an examiner deems proper. The summons power also includes the right to take testimony, under oath, of the summoned person. A summons can be used to determine a taxpayer's tax liability; to collect a tax; or to secure information to prepare a return when a taxpayer has failed to file one.

Statutory authority, Internal Revenue Manual guidance, and court cases relevant to this topic include, but are not limited to:

Internal Revenue Code

- IRC § 6001 – Taxpayers are required to keep records
- IRC § 6201 – IRS is authorized to make inquiries, determinations and assessments of tax, interest, and penalties
- IRC § 7602 – Examination of Books and Witnesses
- IRC § 7603 – Service of Summons
- IRC § 7604 – Enforcement of Summons

- IRC § 7605 – Time and Place of Examination
- IRC § 7609 – Special Procedures for Third-Party Summonses
- IRC § 7610 – Fees and Costs for Witnesses
- IRC § 7612 – Special Procedures for Summonses for Computer Software
- IRC § 7622 – Authority to Administer Oaths and Certify
- IRC § 7210 – Failure to Obey Summons

Income Tax Regulations:

- 1.6001-1 – Requirement to Maintain Books and Records

U.S. Supreme Court

- United States v Powell, 379 U.S. 48 (1964)

Internal Revenue Manual

- IRM 25.5, et al – Introduction to summons, preparation, service, fees, and enforcement

Although examiners have broad authority to issue a summons, this authority is not absolute. An examiner must insure that the summons passes the “Powell Test.” In United States v Powell, 379 U.S. 48 (1964), the Supreme Court held that a summons is enforceable if it meets 4 tests:

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

The threshold for a valid summons is broadly interpreted and courts should be cautious in restricting the IRS’s authority, because it might “undermine the efficacy of the federal tax system.” United States v. Bisceglia, 420 U.S. 141 (1975).

In subsequent cases, courts have analyzed the 4-prong test by holding that:

- **Legitimate Purpose** – An IRS examination is a legitimate purpose. In Powell, the Supreme Court thus noted that the IRS can issue a summons to investigate “merely on suspicion that the law is being violated or even just because it wants assurance that it is not.” 379 U.S. at 57 (quoting United States v. Morton Salt Co., 338 U.S. 632, 642-43 (1950)). Courts have also held that once IRS has secured information relevant to a legitimate investigation, the information may be used for other legitimate reasons as well. In other words, the use of summoned information is not limited to one specific case. Tiffany Fine Arts v. United States, et al, 469 U.S. 310 (105 S.Ct. 725, 83 L.Ed.2d 678).
- **Relevancy** – The relevancy test is met if the information “may be relevant.” United States v Norwest Corporation, 116 F.3d 1227 (8th. Cir. 1997) or if it “may shed light” on the accuracy of the tax returns. See United States v. Arthur Young & Co., 465 U.S. 805 (1984) (accepting “might throw light” standard of relevance); See also, United States v. Davey, 543 F.2d 999 (2d Cir.1976).
- **Documents not in IRS’s possession** – IRS may not require production of documents already in its possession. Therefore, examiners may not summons copies of filed returns. In United States v. Monumental Life Ins. Co., 440 F.3d 729 (6th Cir. 2006) the court rejected the IRS’s claim that documents obtained by IRS during the audit of a different taxpayer were not accessible because of disclosure laws.

Courts have, however, required production of documents already in the IRS’s possession in situations when the IRS only had copies and wished to inspect the originals. United States v. Davey, 543 F.2d 996, 1001 (2d Cir. 1976); United States v. Luther, 481 F.2d 429, 432 (9th Cir.1973).

Courts have also held this prong of the test was

met upon a showing that the documents were too difficult to retrieve United States v. First Nat'l State Bank, 616F.2d 668, 673-74 (3d Cir. 1980) (the IRS can summon documents that may be in its possession but which are difficult to retrieve).

- **Administrative Steps Followed –**
Administrative steps are followed if the summons is properly served and if notice is given to anyone required to receive it.

Formal Document Requests

IRC § 982 provides a procedure for formally requesting foreign based documentation from the taxpayer. If the taxpayer fails to respond to an informal request for foreign records, the Service may formally request the records under IRC § 982. If the taxpayer fails to produce the records within 90 days of the formal request, without reasonable cause, any court later handling the taxpayer's case will prohibit the taxpayer (but not the Government) from using in evidence any records not produced. The Code explicitly states that foreign secrecy laws do not provide reasonable cause for failing to reply to a Formal Document Request.

IRC § 982 is normally thought of as useful in deduction cases, where the burden is on the taxpayer to prove his deductions. However, in any case where the Service ultimately develops some evidence of the receipt of income, it may prove beneficial to have used the formal document request earlier in the case. For this reason, examiners are encouraged to use a Formal Document Request for foreign based records as a complement to summoning the taxpayer for all records, foreign and domestic.

The process begins with serving the taxpayer with an IDR for foreign records. The foreign record IDR is similar to a *pro forma* initial IDR, but is limited to foreign records. Once the taxpayer fails to comply, the foreign IDR becomes an attachment to a cover letter, and together they constitute the 982 Formal Document Request. A full discussion of FDRs is in the IRM at 4.61.2.5.

Statute of Limitations Issues

The Law

The statute of limitations begins to run when a return is filed. A return is filed when IRS receives it. There are two exceptions to this general rule.

1 – Under IRC § 6501(b), for statute of limitations purposes only, a return filed before its original due date is deemed filed on the due date. That is why every 1040 filed between January 1 and April 15 has a statute of limitations which begins on April 15 and expires three years later.

2 – Under IRC § 7502 (the Mailbox Rule), if a return is postmarked prior to the due date and received after the due date, the postmark date is the date of delivery (i.e. filing date). That is why there are lines at the post office on April 15. Taxpayers must have their returns postmarked before midnight, April 15th.

Now that we know when the statute of limitations on assessment begins, we can turn to when it ends.

Under the general rule IRS must assess tax within 3 years of the original due date or date the return is filed, whichever is later. IRC § 6501(a).

Example: The tax for a 2010 tax year when Form 1040 is filed on or before April 15, 2011 must be assessed by April 15, 2014.

Example: The tax for a 2010 tax year when Form 1040 is timely-filed under extension on October 1, 2011 must be assessed by October 1, 2014

Although the general rule under IRC § 6501(a) applies to the majority of tax returns, there are a number of exceptions to the general rule that provide the IRS with more than 3 years for assessing tax.

Under IRC § 6501(c)(3) the statute of limitations does not start to run until a return is filed. Once filed, the statute runs for 3 years. If a taxpayer never files a return, there is no statute of limitations on IRS assessing tax for that year.

Under IRC §§ 6501(c)(1) and (2) if a return is false or fraudulent or is filed as part of an attempt to evade taxes, there is no statute of limitations on assessment of tax for that tax year.

This exception to the general rule means that there is no time limit on IRS starting an audit of a fraudulent tax return and if IRS discovers fraud during an audit, there is no limit on the amount of time IRS has to develop fully all the issues on the return

From a taxpayer's perspective, the consequences of filing a fraudulent return are final. In fact, as previously mentioned, a taxpayer cannot even purge the fraud on an original tax return by filing a completely accurate and truthful amended return. See Badaracco v. Commissioner, 464 U.S. 386 (1984) (filing a subsequent non-fraudulent amended return does not start the running of the statute of limitations under IRC § 6501(a)).

Congress has recognized that on rare occasions the 3 year general rule does not provide IRS with sufficient time to identify and audit some non-fraudulent returns. In the following situations, Congress has extended the 3 year statute of limitations to 6 years. The statutorily extended statute of limitations generally applies when a taxpayer fails to disclose required information on a return and the IRS is placed at a disadvantage, because it must develop facts not readily obvious from reviewing the tax return.

Under IRC § 6501(e) if a taxpayer omits more than 25% of his gross income from his tax return, the statute of limitations on assessment is 6 years. The computation of the amount of the omission is a fraction:

$$\frac{\text{Gross income omitted from the return}}{\text{Total Gross Income Reported on the Return}}$$

Two adjustments may be required.

Because the 6 year statute of limitations gives IRS more time to audit items that it cannot know about by merely looking at the return, if a taxpayer discloses the omitted gross income from the return, but tells the IRS about it

by including a statement in the return (or attached to it), it is not considered “omitted” for purposes of computing the percentage of the omission. The disclosure must be adequate to apprise the Commissioner of the nature and amount of the omitted item. In effect, disclosure of the omitted item by the taxpayer on the return reduces the numerator in the above equation.

The second adjustment impacts the denominator. A taxpayer is deemed to have reported not only the gross income on his tax return, but also his share of any flow-through entity’s gross receipts. This means that if a taxpayer reports flow-through income or loss, the percentage of omission of gross income cannot be computed without reviewing the flow-through entity’s return. See Revenue Ruling 55-14; Rose v. Commissioner, 24 T.C. 755 (1955); Roshuni v. Commissioner, 44 T.C. 80 (1965).

A final word. If the omission of gross income is greater than 25%, the 6 year statute of limitations applies to the entire tax return, not just the omitted gross income. See Colestock v Commissioner, 102 T.C. 380 (1994) (6 year statute of limitations on assessment applies not just for the “omitted” income but for the entire return).

In United States v. Home Concrete & Supply, LLC, Sup. Ct. No. 11-139 (Apr. 25, 2012), the Supreme Court held that overstated basis is not an omission of gross income. Therefore, it does not extend the statute of limitations on assessment from 3 to 6 years.

If a quiet amended return reports additional gross income in excess of 25% of the amount of gross income reported on the original return, the 6 statute of limitations applies. IRC § 6501(e).

The principle that a taxpayer should not benefit by withholding required information from IRS also applies in cases where a taxpayer is required to file certain information returns.

If a taxpayer holds an interest in a foreign entity such as a controlled foreign corporation (CFC), partnership or trust, he is required to file information returns reflecting his foreign interests. The most common required

returns are Forms 926, 5471 and 5472 for foreign corporations; Forms 3520 and 3520-A for foreign trusts; and Form 8865 for foreign partnerships. Under IRC § 6501(c)(8), the statute of limitations on the individual's return does not start to run until the information return is filed. Once filed, the statute of limitations runs for 3 years.

Prior to FATCA, IRC § 6501(c)(8) kept the statute of limitations open only for items related to the failure to file.

Under FATCA, it keeps the entire tax return open, unless the failure to file the return was due to reasonable cause. If the failure to file was due to reasonable cause, the statute of limitations on assessment remains open only with respect to issues related to the undisclosed entity.

FATCA also extended the statute of limitations on assessment in cases where foreign accounts are present, but there are no foreign entities. Under IRC § 6501(e)(1)(A)(ii), the statute of limitations is 6 years in cases where a taxpayer omits more than \$5,000 in gross income from a foreign asset. There is a spreadsheet that can be utilized in a tool to determine whether the \$5,000 in gross income has been met.:

Refer to Exhibit 4.

Under IRC § 6501(c)(4), the taxpayer and IRS can agree to an extension of the statute of limitations on assessment by entering into a written agreement prior to the current statute of limitations date. This agreement is memorialized on Form 872 (or one of its spin-off forms).

The critical factor in agreements by consent is the requirement that the statute of limitations must still be open when the agreement is executed by *both* parties. It is an agreement to *extend* the statute of limitations on assessment, not an agreement to *revive* an expired statute of limitations.

Under IRC § 7609(e)(2) special rules may apply to determining the statute of limitations. If the IRS issues a John Doe summons, the statute of limitations on assessing tax on any member of the John Doe class is

suspended starting 6 months from service of the summons and ending on the date the final resolution of the summons occurs.

A final note on statutes of limitations. The law generally provides sufficient time for the performance of a routine, perfunctory act. There is such a provision under IRC § 6501(c)(7), which holds, that if a taxpayer files an amended return reflecting an additional tax liability (i.e., a quiet amended) within 60 days of the statute of limitations date, IRS has 60 days from the date of receipt of that amended return to assess the tax reflected in it.

Example: Taxpayer timely-filed his 2009 Form 1040 on April 15, 2010. The 3 year statute of limitations expires on April 15, 2013. On April 1, 2013 IRS received an amended return from Taxpayer reflecting a \$10,000 additional tax liability. Normally, IRS would have to assess the additional tax by April 15, 2013. Fortunately, IRC § 6501(c)(7) gives IRS until May 30 (60 days after April 1) to make the assessment.

**Statute of
Limitations
Exceptions:
Using the YY
Statute**

When the examiners receive the Quiet Disclosure cases, they will need to determine if the statutes have been updated, or need to be updated, to the alpha statute: yy.

Alpha code yy is used when the decision is made to allow the normal statute to expire. This decision must be made in a timely manner, must be fully documented, and be approved by the Territory/Program Manager.

Refer to Exhibit 5 for a copy of the YY Statute Memorandum.

The documentation required to support the determination that special conditions exist will be satisfied by including the statement that it has been determined that there is a likelihood in the case that one or a combination of the following conditions exist:

- The tax return is false/fraudulent;
- There is a sufficiently large omission of gross income to rely on the six-year assessment statute; or
- The taxpayer has failed to notify the Secretary of foreign transfers under IRC 6501(c)(8).

Typically, the alpha code yy should only be used for tax returns filed by participants in abusive offshore arrangements where it has yet to be determined whether or not a specific statutory exception to the normal three-year period of time for assessment of tax applies. However, the alpha code yy may also be used to update the AIMS ASER when the normal three-year period of time for assessment of tax has already expired before the commencement of the examination of a return for a tax period which involves abusive offshore arrangements and it has yet to be determined whether or not a specific statutory exception to the normal three-year period of time for assessment of tax applies.

Civil Penalties

Examiners must consider whether penalties are appropriate during every examination. With the limited exception of a qualified amended return discussed below, filing an amended return does not insulate a taxpayer from most civil penalties. These penalties may be due to underpayments of tax, failure to file required offshore information returns, failure to comply with FATCA's requirement to report foreign financial accounts, or failure to file FBARs.

Accuracy-related Penalties

IRC §§ 6662(a) and (b) impose a 20% penalty on an underpayment of tax that is due to: (1) negligence or disregard of rules or regulations, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, (4) any substantial overstatement of pension liabilities, and (5) any substantial estate or gift tax valuation understatement.

Only one penalty may be imposed on an underpayment of tax, even though the underpayment may be due to more than one of the above reasons (e.g. only one penalty may be asserted on an underpayment that is due to negligence and also meets the dollar criteria for a substantial understatement of income tax.)

In a quiet amended return situation the accuracy-related penalty may arise in one of two contexts:

- 1 - If the examiner determines that the failure to report

correctly on the original return the items now reflected on the amended return was due to negligence or is a substantial understatement of tax, the accuracy-related penalty can be imposed on the additional tax reflected on the amended return.

2 – If the examiner makes adjustments to items on the original return and determines they were due to negligence or a substantial understatement of tax the accuracy-related penalty can be imposed on the underpayment attributable to those items.

If a taxpayer exercised reasonable cause and acted in good faith regarding all or a part of an underpayment, no penalty is imposed on that part. IRC §6664(c)(1); Income Tax Regulations §1.6664-4(a).

A penalty cannot be imposed on the additional tax reflected on a quiet amended return if the quiet amended return is a “qualified amended return.”

Congress encourages a taxpayer to correct mistakes on his original tax return and pay any additional tax he may owe. Obviously if IRS were to penalize a taxpayer who voluntarily corrects an error, taxpayers would be discouraged from “doing the right thing.” Therefore, Income Tax Regulation § 1.6664-2 states that an underpayment of tax does not include an amount of additional tax reflected on a qualified amended return.

A return is a qualified amended return if it is filed before:

1. The date the taxpayer is first contacted by IRS concerning any examination (including a criminal investigation) with respect to the return;
2. The date any person is first contacted by the IRS concerning an examination of that person relating to the penalty for promoting abusive tax shelters for an activity with respect to which the taxpayer claimed any tax benefit
3. In the case of a pass-through item the date the pass-through entity (as defined in § 1.6662-4(f)(5)) is first contacted by the IRS in connection with an examination of the return to which the pass-through item relates; or

4. The date on which the IRS serves a John Doe summons relating directly or indirectly to the tax liability of a group that includes the taxpayer.

For purposes of the last factor, examiners must consider the date of the John Doe summons and the tax years covered. The following dates that IRS served John Doe summonses are relevant for determining whether an amended return is a qualified amended return.

<u>Witness</u>	<u>Date Served</u>	<u>Years Covered</u>
UBS	July 21, 2008	2002 – 2007
Stanford	December 9, 2009	2002 – 2008
HSBC	April 8, 2011	2002 – 2010
UBS Wegelin	February 1, 2013	2002 – 2011

Civil Fraud

The filing of an amended return to correct fraudulent items on an original return does not correct or “purge” the fraud. The filing of the non-fraudulent amended return also does not start the running of the statute of limitations under IRC § 6501(a). Badaracco v. Commissioner, 464 U.S. 386 (1984).

The existence of fraud is a question of fact to be resolved from the entire record. Gajewski v. Commissioner, 67 T.C. 181 (1976). The Government must prove fraud with affirmative evidence, because fraud is never imputed or presumed. See Niedringhaus v. Commissioner, 99 T.C. 202 (1992).

Because fraud requires an inquiry into a taxpayer’s intent there is seldom direct evidence of fraud. Therefore, certain “badges of fraud” are recognized as indicators of fraudulent intent:

- (1) Understating income,
- (2) maintaining inadequate records,
- (3) failing to file tax returns,
- (4) implausible or inconsistent explanations of behavior,
- (5) concealment of income or assets,
- (6) failing to cooperate with tax authorities,
- (7) engaging in illegal activities,

- (8) an intent to mislead which may be inferred from a pattern of conduct,
- (9) lack of credibility of the taxpayer's testimony,
- (10) filing false documents, and
- (11) Dealing in cash.

Spies v. United States, 317 U.S. 492, 499 (1943).

Examiners should be alert to indications of fraud and contact their Fraud Technical Advisor for further guidance if they believe fraud is present.

Offshore Penalties

Taxpayers with an interest in certain foreign entities are required to file information returns to report transactions or relationships with those entities. Depending on a taxpayer's particular facts and circumstances, the following penalties could apply:

- A penalty for failing to file Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts. Taxpayers must also report various transactions involving foreign trusts, including creation of a foreign trust by a United States person, transfers of property from a United States person to a foreign trust and receipt of distributions from foreign trusts under IRC § 6048. This return also reports the receipt of gifts from foreign entities under section 6039F. The penalty for failing to file each one of these information returns, or for filing an incomplete return, is the greater of \$10,000 or 35 percent of the gross reportable amount, except for returns reporting gifts, where the penalty is five percent of the gift per month, up to a maximum penalty of 25 percent of the gift.
- A penalty for failing to file Form 3520-A, Information Return of Foreign Trust with a U.S. Owner. Taxpayers must also report ownership interests in foreign trusts, by United States persons with various interests in and powers over those trusts under IRC § 6048(b). The penalty for failing to file each one of these information returns or for filing an incomplete return, is the greater of \$10,000 or 5 percent of the gross value of trust assets determined to be owned by the United States person.
- A penalty for failing to file Form 5471, Information Return of U.S. Persons with Respect to Certain

Foreign Corporations. Certain United States persons who are officers, directors or shareholders in certain foreign corporations (including International Business Corporations) are required to report information under IRC §§ 6035, 6038 and 6046. The penalty for failing to file each one of these information returns is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return.

- A penalty for failing to file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Taxpayers may be required to report transactions between a 25 percent foreign-owned domestic corporation or a foreign corporation engaged in a trade or business in the United States and a related party as required by IRC §§ 6038A and 6038C. The penalty for failing to file each one of these information returns, or to keep certain records regarding reportable transactions, is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency.
- A penalty for failing to file Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation. Taxpayers are required to report transfers of property to foreign corporations and other information under IRC § 6038B. The penalty for failing to file each one of these information returns is ten percent of the value of the property transferred, up to a maximum of \$100,000 per return, with no limit if the failure to report the transfer was intentional.
- A penalty for failing to file Form 8865, Return of U.S. Persons with Respect to Certain Foreign Partnerships. United States persons with certain interests in foreign partnerships use this form to report interests in and transactions of the foreign partnerships, transfers of property to the foreign partnerships, and acquisitions, dispositions and changes in foreign partnership interests under IRC §§ 6038, 6038B, and 6046A. Penalties include \$10,000 for failure to file each return, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of

\$50,000 per return, and ten percent of the value of any transferred property that is not reported, subject to a \$100,000 limit..

- Beginning with the 2011 tax year, a penalty for failing to file form 8938 reporting the taxpayer's interest in certain foreign financial assets, including financial accounts, certain foreign securities and interests in foreign entities, as required by I.R.C. §6038D. The penalty for failing to file each one of these information returns is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return.

FBAR Penalty Cases

This section of the guide contains a brief summary of FBAR penalties and FBAR case procedures. Additional details regarding FBAR penalties is contained in the following guides:

- FBAR Penalty ERCS Guide
- FBAR Penalty Case File Procedures
- FBAR Penalty Investigative Techniques

The FBAR portion of the Centra PowerPoint presentation on Quiet Disclosures also contains additional details on FBAR penalty cases.

FBAR Overview

FBAR is the acronym for the Foreign Bank and Financial Account Report, Form TD F 90.22-1, which a person must file to report foreign bank and financial accounts. FBAR may refer to both the form itself and the penalties for failing to file the form (for example, FBAR penalties).

A U.S. Person with a financial interest in, or signature or other authority over foreign financial accounts, the aggregate value of which exceeded \$10,000 at any time during the calendar year must file an FBAR.

The IRM provisions for Title 31, FBAR law, and FBAR procedures are in IRM §§ 4.26.15, 4.26.16, and 4.26.17, respectively.

Examiners responsibilities include:

- Investigate possible civil FBAR violations and
- Assess and collect civil FBAR penalties

Due Dates, etc.:

- Filed on a calendar year basis
- Due by June 30 of the following year
- Filed by mailing it to Detroit Computing Center
- Not filed with Form 1040
- Filed when it is received in Detroit, not when it is postmarked. (IRC § 7503 does not apply)

Statute of Limitations:

- 6 years from due date
- SOL runs even if no FBAR is filed
- 2005 and prior FBARs are expired
- 2006 FBARs expire on June 30, 2013
- Do not use Form 872 to extend SOL
- Counsel has approved an FBAR SOL extension

**Related
Statute
Determination**

The examiner must secure a related statute determination prior to using Title 26 income tax information in an FBAR penalty case. For Quiet Disclosure cases, the examiner should secure a related statute determination immediately, preferably before the initial contact with the taxpayer.

Examiners use Form 13535, *FBAR Related Statute Memorandum*, to secure a determination that the FBAR violation may have been in furtherance of a Title 26 violation. The examiner prepares a separate related statute memorandum for each person required to file an FBAR for each year there is a violation.

The related statute memorandum is a good-faith determination that the FBAR violation was in furtherance of a Title 26 violation. For quiet disclosure cases, the examiner may use one of the following explanations, with appropriate modifications, on the related statute memorandum:

For a year where the taxpayer filed an amended income tax return:

This taxpayer filed an amended income tax return on [insert date] to correct a previously-filed, inaccurate return that failed to include income from foreign sources. On [insert date] the taxpayer also filed a delinquent FBAR. Based upon the information shown

on the amended return there is good-faith belief that the taxpayer's failure to file a timely FBAR was to conceal Title 26 violations that existed up to the time the taxpayer filed the amended return.

For a year where the taxpayer filed a delinquent income tax return:

This taxpayer filed a delinquent income tax return on [insert date] to report income from foreign sources. On [insert date] the taxpayer also filed a delinquent FBAR. Based upon the information shown on the delinquent return there is good-faith belief that the taxpayer's failure to file timely an FBAR was to conceal Title 26 violations that existed up to the time the taxpayer filed the delinquent return.

For a year where the taxpayer filed only a delinquent foreign information return:

This taxpayer filed a delinquent information return on [insert date]. The information on this return relates to an entity that may own, or an activity that may appear in, a foreign bank account. On [insert date] the taxpayer also filed a delinquent FBAR. There is good-faith belief that the taxpayer's failure to file a timely FBAR was to conceal Title 26 violations that existed up to the time when the taxpayer filed the delinquent information return.

If the taxpayer filed both a delinquent information return and a delinquent or amended income tax return for a year, then it is only necessary to include in the related statute memorandum the language for the amended or delinquent income tax return.

Once the designated official (currently the territory manager) makes a related determination, the examiner may use Title 26 information in the FBAR penalty case. Until that time, the examiner may not

- Ask the taxpayer specifically about the FBAR,
- Request a copy of the FBAR, or
- Request information, on an IDR, that relates only to the FBAR violation.

FBAR Power

After the designated official signs the related statute

of Attorney

memorandum, the taxpayer may use, and the examiner may accept, Form 2848 to designate a person to represent the taxpayer in matters related to the FBAR penalty.

To designate a representative for FBAR-related matters, the taxpayer must place the following entries on Form 2848, line 3:

- Column 1: "FBAR Examination"
- Column 2: "TD F 90-22.1"
- Column 3: the relevant calendar years

The taxpayer may use a single Form 2848 to designate a representative for both income tax matters and FBAR-related matters.

Examiners follow the regular procedures to process an FBAR-related Form 2848.

FBAR Monitoring Document

The Detroit Computing Center, DCC, maintains a database of all open FBAR penalty cases. Examiners use Form 13536, *FBAR Monitoring Document*, to notify the DCC that they started an FBAR penalty case. The examiner prepares a separate FBAR monitoring document for each taxpayer and for each year where the designated official made a related statute determination. Examiners also use the FBAR monitoring document to notify the DCC of the examination results, including accepted referrals to criminal investigation and cases where the taxpayer appealed the FBAR penalty.

To open the FBAR case, the examiner prepares the FBAR monitoring document, attaches a copy of the related statute memorandum, and faxes or scans and emails the documents to the DCC. The fax and email address appear in the next section.

Additional information on the FBAR monitoring document is in the FBAR Penalty Case Procedures guide.

DCC FAX and Email Address

The DCC fax number for the FBAR monitoring document is (313) 234-2278.

The email address for the DCC is *SBSE BSA

COMPLIANCE-FBAR PENALTY COORDINATOR.

FBAR ERCS Procedures

The ERCS procedures for FBAR cases are in the FBAR Penalty ERCS guide.

The examiner must establish a penalty case on ERCS for each year the designated official made a related statute determination; the FBAR cases on ERCS must match the FBAR cases on the DCC database.

Examiners establish FBAR penalty cases on ERCS using MFT P9 and activity code 545.

Examiner charge time working FBAR penalties directly to the case.

FBAR IDR

Provided the examiner secured a related statute determination prior to the first contact with the taxpayer, the initial IDR should solicit a list of foreign bank accounts subject to reporting on an FBAR. Do not assume the taxpayer reported all of his account on the filed FBAR, if any.

On the initial IDR the examiner also should request from the taxpayer a statement of reasonable cause for failing to file the FBARs.

There is no need to issue a separate FBAR IDR. As long as the designated official made a related statute determination, the examiner may include the FBAR-related items on the income tax IDR.

Working the FBAR Case

It is important that examiners do not propose FBAR penalties until Counsel has opined on whether the facts support a specific FBAR penalty. See the next section of this guide for additional information.

The purpose of the FBAR penalty case is to determine whether the taxpayer is liable for an FBAR penalty or whether an FBAR warning letter is appropriate.

Since the government has the burden of proof in all penalty cases, it is up to the examiner to locate and secure the necessary evidence to support the FBAR penalty. FBAR coordinators, fraud technical advisors, Counsel attorneys, and national office FBAR analysts are

available to assist examiners with their FBAR penalty investigations.

In all FBAR cases the examiner must attempt to interview both the taxpayer and the return preparer (or return preparers).

During the interview of the return preparer, the examiner should focus on the exchange of information between the return preparer and the taxpayer to identify the opportunities for the taxpayer to reveal the existence of the foreign bank account. Opportunities include both direct questions by the return preparer about the existence of the foreign bank account (for example, does the taxpayer have a foreign bank account), and indirect questions about the foreign bank account (for example, sources of interest or dividend income).

The examiner should summons a copy of the tax return preparation files and workpapers for each year of the FBAR penalty investigation. If the return preparer claims privilege, contact Counsel for guidance.

During the interview of the taxpayer, one focus of the interview will be the question of why the taxpayer did not reveal the foreign bank account to the only tax professional who may have been in a position to provide competent advice.

Additional details regarding the FBAR penalty investigation, including investigative techniques, are contained in the FBAR Penalty Investigative Techniques guide.

FBAR Penalties and Mitigation

Once the examiner identifies an FBAR violation and completes the FBAR penalty investigation, there are two possible outcomes to the case:

- Issue a warning letter either because the violation does not warrant an FBAR penalty or the taxpayer had a reasonable cause, or
- Assess an FBAR penalty

If a penalty is warranted, the examiner must decide whether the taxpayer's failure to file the FBAR was non-willful or willful. If the failure was non-willful, the maximum penalty is \$10,000 per violation. If the failure

was willful, the penalty is the greater of \$100,000 or 50% of the account balance on the date of the violation. The date of the violation is the due date of the FBAR, which is June 30 of the subsequent year.

Unlike Title 26 that defines a specific computation of all penalties (for example the civil fraud penalty is equal to 75% of the understatement of tax due to fraud), the Title 31 FBAR penalty statute only defines the maximum penalty. While the examiner has no authority to mitigate the Title 26 civil fraud penalty, for example from 75% to 40%, in appropriate cases, the examiner may assess less than the maximum statutory penalty. IRM section 4.26.16.4.6 and IRS Exhibit 4.26.16-2 contain the FBAR penalty mitigation guidelines.

Reasonable Cause – evidence of reasonable cause in an FBAR setting is similar to that in a Title 26 examination. Defenses may include:

- Reliance on professional advice,
- Ignorance of the FBAR filing requirement,
- Mistake as to law – not knowing the foreign, account fell within the reporting requirements, and
- Failure despite exercise of ordinary care.

Examiners should use general reasonable cause principles in determining whether or not to apply the FBAR penalty. Treas. Reg. 1.6664-4, Reasonable Cause and Good Faith Exception to § 6662 penalties, may serve as useful guidance in determining the factors to consider. Although this tax regulation does not apply to FBARs, the information it contains may still be helpful in determining whether the FBAR violation was due to reasonable cause and not due to negligence.

Willfulness – willfulness is defined as a voluntary, intentional violation of a known legal duty. United States v Bishop, 412 U.S. 346 1973. The burden of proof is on the government to prove willfulness with a preponderance of the evidence. United States v Williams, 110 AFTR 2d 2012-5298 (CA-4, 2012)

Willfulness also includes the failure to inquire as to whether a law exists (“willful blindness”). “Willfully”

includes conduct marked by careless disregard whether or not one has the right to so act." Therefore, "willfulness" may be satisfied by establishing the individual's reckless disregard of a statutory duty, as opposed to acts that are known to violate the statutory duty at issue. An improper motive or bad purpose is not necessary to establish willfulness in the civil context. U.S. v McBride, Case No. 2:09-cv-378 DN. (USDC D. Utah, Central Division., 11/8/2012).

FBAR coordinators, fraud technical advisors, Counsel attorneys, and national office FBAR analysts are available to assist examiners and group manager with matters related to the appropriate FBAR penalty to assert.

Summary

What's an examiner to do?

- 1 – was taxpayer required to file FBAR?
- 2 – did taxpayer file an FBAR?
- 3 – there is an FBAR violation
- 4 – is the violation due to reasonable cause and not negligence?
- 4a – if yes, issue a warning letter
- 4b – if no, consider appropriate penalty and whether mitigation applies
- 5 – what is the amount of the FBAR penalty? (willful v non-willful)

FBAR Penalty Memorandum

If the examiner and group manager determine that penalties are appropriate, the examiner must prepare a memorandum to summarize the FBAR penalty investigation and the penalty recommendation. The purpose of the FBAR penalty memorandum is to secure legal advice from Counsel on whether the facts of the case support the penalty determination.

The FBAR coordinator must review this memorandum before it is sent to Counsel. Where the examiner proposes a willful FBAR penalty, a fraud technical advisor also must review the memorandum.

Counsel requires 45-60 days to review the memorandum and render legal advice. If Counsel advises against asserting FBAR penalties, the examiner and group manager must consult an FBAR coordinator

for guidance.

**Letter 3800,
FBAR
Warning
Letter**

If the group manager and the examiner agree that no FBAR penalty is appropriate, they should discuss that decision with an FBAR coordinator. If all agree not to assert FBAR penalties, then the examiner must send an FBAR warning letter, Letter 3800 to the taxpayer.

The warning letter is the conclusion of the FBAR penalty case. The FBAR Penalty Case File Procedures guide contains the details for closing FBAR penalties cases where the examiner issued a warning letter.

**FBAR 30-day
Letter
Package:
Letter 3709
Form 13449**

Do not send the taxpayer a copy of the FBAR penalty memorandum sent to Counsel. That memorandum and Counsel's response may contain confidential information and legal advice. The examiner may provide the taxpayer with the FBAR lead sheet to explain the nature of the proposed FBAR penalties.

If the group manager and the examiner agree that it is appropriate to assert FBAR penalties, and Counsel concurs with this decision, the examiner prepares the FBAR 30-day package to send to the taxpayer.

The FBAR 30-day package includes Letter 3709, the FBAR 30-day letter, and Form 13449, the agreement form for FBAR penalties. The FBAR Penalty Case File Procedures guide contains the details for issuing the FBAR 30-day letter.

**FBAR
Appeals**

Taxpayers may appeal proposed FBAR penalties to Appeals.

For the taxpayer to have pre-assessment appeal rights, Appeals must receive the case with at least 180 days on the FBAR penalty assessment statute.

The taxpayer has post-assessment, pre-payment appeal rights in cases where there will be less than 180 days on the assessment statute when the case arrives in Appeals. For these cases:

1. The examiner directs the DCC to assess the FBAR penalties;
2. DCC sends to the examiner proof of the FBAR

- penalty assessment; and
3. The examiner sends the case to Appeals.

DCC will delay collection activity during the appeals process.

The FBAR Penalty Case File Procedures guide contains the details for sending FBAR penalty cases to Appeals.

No-Response FBAR Penalty Cases

If the taxpayer fails to respond to the FBAR 30-day letter, the examiner closes the case to Detroit as an unagreed case. DCC will assess the proposed FBAR penalties and the taxpayer only has post-assessment, pre-payment appeal rights. If the taxpayer appeals the assessment, DCC will route the case to Appeals for consideration.

The FBAR Penalty Case File Procedures guide contains the details for closing a no-response FBAR penalty case.

Agree FBAR Penalty Cases

To agree to the FBAR penalties, the taxpayer signs Form 13449 and returns it to the examiner.

The FBAR Penalty Case File Procedures guide contains the details for closing an agreed FBAR penalty case.

FBAR Penalty Payments

Taxpayers who wish to pay the FBAR penalties must do with a separate check or money order. The taxpayer may pay multiple FBAR penalties with a single check or money order, but the taxpayer cannot use a single check or money order to make both a Title 26 and Title 31 payment.

The examiner sends the check or money order to the DCC for posting. **FBAR penalty payments are not posted to the Master File.**

The FBAR Penalty Case File Procedures guide contains the details for processing FBAR penalty payments.

If the examiner mistakenly posts an FBAR penalty payment to Master File, the group manager must contact a national office FBAR analyst for directions on how to transfer the payment to DCC.

**Closing
Agreements
and IRC §
7121**

Dave When a taxpayer executes Form 870 or Form 4549 he agrees that IRS may assess the underpayment of tax reflected on it without receiving a notice of deficiency, but he does not necessarily agree that he owes the additional tax. He could file a claim for refund and contest the underlying adjustments through refund litigation.

During the examination of quiet amended returns, it may be advantageous for a taxpayer and the IRS to enter into an agreement that determines certain facts with finality, that is, an agreement that binds the parties forever unless someone misrepresents a material fact. The device used to bind taxpayers and the IRS to specific facts is Form 906, *Closing Agreement on Final Determination Covering Specific Matters* or simply “closing agreement.” The statutory authority is IRC § 7121.

Detailed information on preparing and processing closing agreements is in IRM 8.13.1.

In the context of quiet amended returns, a closing agreement can be used to determine with finality any number of facts:

- The amount of unreported income
- The amount of penalties
- The basis of securities or other assets
- The classification of offshore entities
- The designation of investments (i.e. PFICs)

A closing agreement determines facts that are relevant in computing a tax liability. It does not determine the tax liability itself. For example, if the taxpayer and IRS agree that a taxpayer’s dividend income in 2009 was \$25,000, not \$15,000 as he reported, they could enter into a closing agreement stating that his 2009 dividend income was \$25,000. Because the parties agree that is an absolute fact, IRS can now compute his tax liability for 2009 based on \$25,000 of dividend income.

A closing agreement can also be used by a taxpayer to waive rights he would otherwise be entitled to raise. For example, a taxpayer can agree that IRS may assess and collect a tax even though the statute of limitations is

expired.

Unlike Form 872 used by taxpayers and the IRS to extend the statute of limitations *before* it has expired (See IRC § 6501(c)(4)), a closing agreement can be used to permit assessment and collection of tax *after* the statute of limitations is expired. See Dubinsky v. Becker, 64 F. 2d 601 (8th Cir. 1933), agg'g 15 A.F.T.R. 691 (E.D. Mo. 1931) and IRM 8.13.1.7.1(1).

A closing agreement cannot be used to determine FBAR penalties, because a closing agreement under IRC § 7121 can only be used for Title 26 purposes.

Because closing agreements can cover a multitude of facts and be used in many situations, it is not practical to discuss every aspect of them in this guide. Examiners must work closely with their technical advisors and local Counsel attorneys to insure that the language in every closing agreement is enforceable and that it does not bind the IRS to facts that are in dispute.