



# 2011 Offshore Voluntary Disclosure Initiative

South Atlantic Area Workshop  
April, 2012

# Basics

- Technical Advisors

(b) (6)

- SAA SharePoint-OVDI Library
- National SharePoint
- E-Trak
- Reviewer's Checklist



## Income Tax Certification

### ■ Statutes

- CENTRA #45923
  - IRC Section 6501
  - IRM 25.6
- Managerial direction
- Taxpayer cooperation

## Income Tax Certification

- Form 2848 (See SAA-OVDI Library for example)
  - Income Tax
    - Form 1040 (1040X)
    - 2003 through 2011
  - Civil Penalties
    - “N/A” for Tax Form Number
    - 2003 through 2011
  - Foreign Bank and Financial Accounts Report (FBAR’s) Matters
    - TD F 90-22.1
    - 2003 through 2011
    - Item 5, “Other” language

•One of your first steps should be to check the accuracy of the F2848. OVDI cases should include 3 types of tax matters in Item 3. If the F2848 only lists Income Tax Matters, you will be unable to provide the representative with complete information because certifying the case involves civil penalty matters and FBAR-related issues. You will not be able to discuss the Offshore Penalty nor allow the representative to sign Form 906 unless the Form 2848 is properly completed.

•There is an example of the F2848 special language on the SAA SharePoint. That example shows how Items 3 and 5 should be completed.

•Show the F2848 on the SAA SP.

# Income Tax Certification

## ■ Case File Contents

- CI Folder (usually blue)
- Originally filed 1040s
- 1040Xs
- Foreign Account or Asset Statement
- Foreign Financial Institution Statement
- Bank records and FAQ #25
- PFIC Workpapers

You should look for this information in the case file for each taxpayer:

The CI folder should contain the taxpayer's initial application letter (sometimes referred to as the "3-pager") and letters from CI stating the taxpayer has been preliminarily accepted into the OVDI program. You may also see some of the CI research on the taxpayer to determine if they qualify to be accepted into the program. (b) (7)(E)

There should be copies of Forms 1040 for 2003 through 2010, as originally filed by the taxpayer. If the taxpayer amended any of these years prior to the OVDI program, copies of those amended returns should have been provided, as well.

There should be Form 1040X for each year in the 2003 through 2010 disclosure period in which there was unreported income from the offshore account or asset.

In addition, the taxpayer was required to submit a Foreign Account or Asset statement for every offshore account or asset held during the disclosure period. So, every case should have at least one of these statements. If any of the accounts held assets of \$1 million or more, then there should also be the Foreign Financial Institution statement for that account.

If the taxpayer's account balances were less than \$500,000, then bank records were not required to be submitted. If you can certify the case without those records, you should document (either on the activity record or on the HAB schedule) your basis for making the certification. Although the taxpayer's were not required to send the statements for the accounts under \$500,000, you may request the statements if you need them to complete the certification. FAQ #25 clearly states that the records may be requested at a later time.

## Income Tax Certification

- **Not an Examination**
  - No L2205, Pub 1, etc., required
  - No reopening procedures required
  - No Appeal Rights
- **Evaluation of taxpayers' disclosure**
  - Review taxpayers' computations and schedules
  - Minimal testing of taxpayer assertions
  - Use auditing skills/experience to evaluate overall reasonableness of disclosure
  - Document steps in most expedient way
- **Incorporate results into 4549A for preparation of F906**

We cannot stress the point enough that these are not examinations. If you have any questions about what to do/not to do, talk to your TA until you feel comfortable with the process.

You are not responsible for auditing the disclosure. You are checking to ensure that the information provided in the disclosure package is consistent with the 1040X amounts and the Offshore Penalty computation provided by the taxpayer.

There are no mandatory issue leadsheets. You may document your findings in the activity record and/or on copies of the taxpayer's schedules. You do not need to do IRP matching, internal control evaluations, manager concurrence meetings, initial contact documentation, GM penalty approval. . . .

After certification of the 1040X disclosure, you incorporate that information into a 4549A. How you prepare the adjustments will depend on whether or not the 1040X has been processed (quick assessment) or not.

The CENTRA class on Case and Penalty Development, #45924, provides detailed information on how to make the RGS adjustments based on the 1040X-processed or not and delinquent returns.

The National SharePoint, Job Aid #6, also provides detailed information on the RGS set-ups for the 1040X adjustments and delinquent returns. When referring to the National SharePoint job aids, remember that they have not been updated for the 2011 program (as of 04/2012), so there may be some differences. Just check with your TA if you have any questions.

There are also some RGS tips included in this workshop presentation (a bit later). But, we have allowed time for one-on-one case assistance to help you with the RGS set-up part of the certification process and think this hands-on approach will be the best way for you to learn. Also, after the on-site workshop is completed, we are available to work with you through OCS. And, the RGS coordinators will be available for OCS assistance as well, where they can actually share your screen to help solve problems.

If you gain nothing else out of OVDI, you will become an RGS expert!

## Income Tax Certification

- Your documentation and workpapers
  - Transcript Analysis: **REQUIRED** for all cases
  - Activity record: Can use to document all audit steps
  - No other mandatory issues/workpapers for income tax certification

Preparation of the Transcript Analysis is required for all cases. There are two tools to help you with this (both are available on the SAA OVDI site) and we will demonstrate how each works.

First, there is the basic tool. You actually keystroke in the TC's, dates, and amounts from the IMFOLT for each year. This provides a summary as well as an ongoing worksheet to update payments, proposed assessments, etc., until the case is ready to close.

The second tool automates the spreadsheet population and eliminates typos and missed TC's. It provides the same summary on ongoing worksheet fields to update as the case progresses.

The other "work paper" that needs to be provided in every Income Tax Certification file is the activity record, F9984. Not only will you use to record time, but this may be used to record your audit steps instead of separate work papers. For some cases you will probably need a separate work paper to show what you tested and/or checked---but, there are no mandated income tax file work papers other than the transcript analysis and the activity record.



## Income Tax Certification

- Income Tax penalties
  - Accuracy-related penalty
  - Delinquency penalties, if applicable
- Reasonable cause does not apply to any of these cases

## Reconciling RGS Setup

- RAR MUST = latest tax per module
- TC 150 is just the start
- Has 1040X been processed? Have there been unrelated adjustments?
  - **TC 971** – A miscellaneous transaction which performs different actions based on the action code. (AC10)
  - **TC 976** – A posted duplicate return.
  - **TC 977** – An amended or 1040X return.
  - **TC 290 through TC 309** – Tax Adjustments
  - Other Credit Adjustments
- Utilize IMFOLA and IMFOLR
- TRDBV
- True variances are fine

- MUST reconcile transcripts before preparing F906.
- Keep in mind that the original figures on the 1040X may be inaccurate or not up to date to include perhaps a CP2000 adjustment.
- Ensure whether or not the OVDI 1040X has not already been processed.
- Not all 290s involve a tax adjustment
- If you need an original older return data, try using TRDBV as it may still be online while RTVUE will already have been removed.
- Do NOT try to force numbers to work (balance) in RGS, if there is a true variance document it and move on.



## Income Tax Certification

- Transcript Analysis
- Must reconcile tax per return or previously adjusted (Line 12 of 4549A) to latest transcript (IMFOLT)
- Originally filed 1040s
- IMFOLA
- Quick Assessment information

The starting point for RGS is to match your return set-up to the taxpayer's account information: That's why we stress this step and it is a mandatory document in the case file.













## RGS Reminders

- Use the key case project code for all prior/subsequent years
- Work unit code 70
- Total Tax Shown on Return or as Previously Adjusted, Line 12 of 4549A, must match transcript analysis

# Work Unit Code

The screenshot displays the 'Case Management' application window. The interface includes a menu bar with 'Active', 'Recent', 'Create Case', 'Pending Cases', and 'IDRS Download'. The main area is divided into sections for entering case details. The 'TIN and name' section contains fields for TIN, Secondary SSN, Name, and Name control. The 'Case information' section includes dropdown menus for Form type, MFT code, Tax period, Plan number, Plan type, Work unit code (highlighted with a red circle and containing the value '70'), Source code, Activity code, Project code, Tracking code, Post of duty code, Status code, Universal location, Claim type, and Claim amount. There is also an SFR indicator checkbox. The 'AIMS assignee codes' section at the bottom contains dropdown menus for Primary Business (set to '000'), Secondary business, and Employee group. On the right side, there are buttons for 'Add Case', 'Cancel', 'Add to Pending Cases', 'Clear Fields', and 'Add Case - CJE File'.



## Income Tax Certifications

- Issues requiring special language
  - 1291 PFIC
  - MTM PFIC
  - RITCB (MTM PFIC-related)
  - FTC (Foreign Tax Credit)
  - AMT FTC



## Passive Foreign Interest Company

- 1291 PFIC
  - Described at IRC Sections 1291-1297
  - Used in regular income tax examinations
- MTM PFIC
  - OVDI method only: **Not authorized by the Code/Regs**
  - Cannot be used outside of OVDI income tax certifications



## 1291PFIC

- Similar to domestic Mutual Fund
- IRC Sections 1291 – 1297
- Anti-deferral tax regime
- Calculators available to test 1040X computations
- F906 Special Language needed; Requires Technical Advisor approval



## **Taxation of Excess Distribution**

### **Prop. Reg. 1291-2(e)**

- The excess distribution is allocated pro-rata to each day of the PFIC shareholder's holding period.
  - The portion allocated to the current year is taxed in the current year of the distribution.
  - The portion of the distribution allocated to the PFIC holding period years is subject to the deferred tax at IRC § 1291(c).
  
- **Deferred Tax.** The deferred tax is:
  - Calculated without any deductions;
  - Calculated at the highest rate applicable (ordinary income); and
  - Added to tax due in the current year, with interest due from the due date of the return for the allocation year until the due date for the current year.

Continued

## Example Disposition of Section 1291 Stock

### Facts:

- 1/1/2001: Purchase PFIC Stock for \$10,000
- 12/31/2004: Sale of stock for \$60,000
- Gain on Sale of Stock = \$50,000 Entire amount treated as Excess Distribution

### Gain on Sale Taxed as Excess Distribution:

- Calculation of Deferred tax & Interest:
  - 2001:  $\$12,500 \times 39.1\% = \$4,888 + \$791$ (3 years of interest)
  - 2002:  $\$12,500 \times 38.6\% = \$4,825 + \$470$ (2 years of interest)
  - 2003:  $\$12,500 \times 35.0\% = \$4,375 + \$214$ (1 year of interest)
- Current gross income:
  - 2004: \$12,500 ordinary income

### Tax Consequences in 2004:

- Ordinary Income of \$12,500 (Other Income in RGS)
- Deferred Tax = \$14,088 (Additional Taxes, 1291 Tax in RGS)
- Deferred Interest = \$1,475 (Other Taxes in RGS)

(Although the Centra session will not cover all the aspects of PFIC and every possible scenario, a brief discussion of a basic example should be beneficial to participants to understand the mechanics behind the concepts discussed in previous slides.

Items to highlight on this slide include the fact that the entire \$50,000 gain on the sale of the PFIC stock is treated as Excess Distribution and the fact that the pro-rata distribution of income to the affected years is multiplied by the highest tax rate for each respective year to arrive at the deferred tax amount.)



## MTM PFIC

- Uses 20% rate of gains/losses to compute additional PFIC tax/credit (special RGS category)
- Cannot claim losses greater than prior year inclusions
- In 1<sup>st</sup> year of MTM PFIC (2003), 7% of MTM PFIC tax treated as interest on deferral (Other Taxes in RGS)
- F906 Special Language needed; Requires Technical Advisor approval

## Example: MTM PFIC Computation

### Facts:

**ABC Money Fund held prior to 1/1/2003 (so it is subject to 7% interest in 1<sup>st</sup> year computation)**

**1/1/1998: Purchase price of fund \$10,000**

**2/5/2006: Sale of fund for \$50,000**

**Fair Market Value (FMV): 12/31/2003 \$15,000, 12/31/2004 \$8,000, 12/31/2005 \$18,000**

### Computations:

Year	Adjusted Basis	Sale or MTM Price	Realized Gain/Loss	Unreversed Inclusions	Recognized Gain/Loss	Adjusted Basis for Next Year
2003	10,000	15,000	5,000	5,000	5,000	15,000
2004	15,000	8,000	(7,000)	-	(5,000)	10,000
2005	10,000	18,000	8,000	8,000	8,000	18,000
2006	18,000	50,000	32,000		32,000	

Continued from previous slide.

(Discuss above slide in sufficient detail for participants to follow along)

## Example: MTM PFIC Computation *continued*

### Tax Consequences:

Year	Recognized Gain/Loss	Alternative Tax Rate	Alternative Tax	Alternative Interest - 7% of tax
2003	5,000	20%	1,000	70
2004	(5,000)	20%	(1,000)	-
2005	8,000	20%	1,600	-
2006	32,000	20%	6,400	-

Underpayment interest and penalties on the deficiency are computed in accordance with the Internal Revenue Code and the terms of the OVDI.

For any PFIC investment retained beyond 12/31/2010, the taxpayer must continue using the MTM method, but will apply the normal statutory rules of IRC § 1296 as well as the provisions of IRC §§ 1291-1298, as applicable.

Continued from previous slide.

(Discuss above slide in sufficient detail for participants to follow along)



## MTM PFIC: Reduction in Tax Carryback (RITCB)

- Occurs when MTM PFIC “credit” is greater than tax due for that year (Line 9 of 4549A - loss cannot be fully absorbed in that year)
- Carry back “credit” to the most current year(s) in which the “credit” can be fully absorbed
- For carry back years, the accuracy-related penalty is computed on the tax due prior to the RITCB
- MTM PFIC RITCB needs F906 special language and requires Technical Advisor approval



## Foreign Tax Credit (FTC)

- Do not rely on amount claimed or amounts withheld from account
- Pub 901- U.S. Tax Treaties
- Tax withheld, but refundable
- FTC (and AMT FTC) need F906 special language and require Technical Advisor approval



## Other Items

- [OVDI Inventory Management Tool](#)
- Currency Conversions
- Information sent to CI/Austin



## **Misc. Offshore Penalty - MOP**

- This is not “The FBAR” penalty
- This is a penalty that was created to address the taxpayer’s past foreign tax non-compliance matters.
- The taxpayer agrees to pay the MOP to settle their tax issues with the Government
- Voluntary program



## **MOP**

- Your only MOP penalty options:
  - 25%
  - 12.5%
  - 5%
  
- A taxpayer can not get 5% on one acct & 25% on another
  
- You have no authority to enter into any other penalty arrangement within OVDI.
  
- Technical Advisor approval required for 5% MOP.





## **5% MOP**

- FAQ # 52
  - Did not open the foreign account
  - Minimal contact with the account
  - Withdrawn not more than \$1,000 in any year
  - Funds in account have not escaped US Tax
  
- “Accidental” Citizens could get 5%
- Foreign Residents could get 5%



## **Closing Agreements – Form 906**

- Four Agreements available on National SharePoint site:
  - ❖ Standard 906 – Full Pay
  - ❖ Standard 906 – No Full Pay
  - ❖ Dissolve – Full Pay
  - ❖ Dissolve – No Full Pay



## **SPECIAL LANGUAGE**

- Five pre-written Special Language modifications:
  - FTC
  - AMT FTC
  - 1291 PFIC
  - MTM PFIC
  - MTM PFIC with RITCB
- All require Technical Advisor approval



## **SPECIAL LANGUAGE**

- Request approval by e-mail.
- Subject line for the e-mail:  
**NAME – F906 Review**
- Attach to the e-mail
  - 906
  - 4549-A (page 1 & 2 for each year only)
  - HAB Wkp
  - Transcript Analysis Wkp (The “LOADER”)
  - Special Language TA Tables (SAA SharePoint site)

## How Many 906s Do I Need?

If	And	Then
Both taxpayers made a voluntary disclosure	Filed joint returns for all 6 years	Use 1 Form 906 naming both taxpayers as parties
	Did not file joint returns for all 6 years	Use 1 Form 906 for the joint years naming both taxpayers as parties; use separate Forms 906 for each taxpayer who is disclosing an unreported account in a MFS year
Only 1 taxpayer made a voluntary disclosure	Filed joint returns for all 6 years	Use 1 Form 906 for the taxpayer who made the voluntary disclosure
	Did not file joint returns for all 6 years	Use 1 Form 906 for the taxpayer who made the voluntary disclosure



## **What if the Txp can't Pay?**

- FAQ # 20 & 25
- Txp must submit form 433-A or 433-B
- If the txp has assets they must pay
- Refer to Collections
  - National SharePoint site
    - Collection Procedures for Examiners
- F906 – No Full Pay
- RO will notify you of payment resolution



## **OPT-OUT & REMOVAL**

- FAQ 51
- National SharePoint site has OO/Removal Guide
- FAQs 51.1 & 51.2 ... scenarios to consider if deciding to OO.
- Examination with applicable penalties



## **REVIEWER'S ROLE**

- Cases must be reviewed in MIAMI!
  - ❖ 906 review
  - ❖ Case closing review
  
- Mandatory Check Sheet required
- Cases close to Jacksonville Tech Services
  - ❖ Grace Flowers will execute the 906



## Case Closing Procedures

- 2 separate files for each taxpayer
  - Both closed through Technical Services (Status 21)
  - Income Tax certification file
  - Offshore Penalty certification file



# Income Tax File

- OVDI Coversheet, (Form 895), Form 3198
- Transcript Analysis, current IMFOLI, current TXMODA
- F906 (3), Form 4549A, 1040Xs/1040s, and work papers
  - Form 4318
  - Form 9984 – Activity record
  - Foreign Account or Asset statements (submission requirement)
  - Foreign Financial Institution statements (submission requirement), if applicable
  - Correspondence
  - FBARs and/or CBRS prints
  - Foreign entity information reports (5471s, 3520/3520As, 926s, etc.)
  - Bank Statements, if applicable
  - CDE Prints
  - CI Folder



## Offshore Penalty File

- OVDI Coversheet, (Form 895), Form 3198
- 5345D for P9, if applicable
- Copy of F906, F8278 (signed by GM), work papers
  - Copy of F9984 (Activity record)
  - F3244A for Offshore Penalty payment
  - Offshore Penalty computation schedule
  - Supporting work papers with source document reference, if applicable

## Other case closing information

- FBAR Information sheet
  - E-mail to \*SBSE BSA Compliance-FBAR Penalty Coordinator” per Instructions on form
  - Include a copy of form in FBAR section of Income Tax file
- F3870s
  - If payment transfers posted, place in Correspondence section of Income Tax file
  - If payment transfers not posted and are pending, place inside case file folder(s) where easily seen by reviewer
- E-trak: Managerial review
  - Provide case file and documentation to GM or designated e-trak reviewer
- Reviewer’s checklist
  - Should be with case file submitted to GM for final closure from the group
- Closing letters
  - See Reviewer’s checklist