Offshore Voluntary Disclosure Initiative

South Atlantic Area Workshop #1

Handouts – Slides (Notes) and PFIC example

Opening Remarks

- Close non-OVDI casework (limited scope)
- OVDI is not an exam
- The importance of E-trak
- OVDI Coordinator is initial point of contact:
  (b) (6)

Presented by Grace (if present) or Allen:

•First bullet is self-explanatory.

This is not an exam – TP has burden to provide documents to verify the adjustments. The taxpayer should be providing the calculation of tax and highest balance, as well as all the necessary supporting documentation in the clearest possible fashion. It should only be the RAs job to test accuracy and perhaps some very minimal computations.

•The E-trak database is of upmost importance. We understand that some entries can be tedious, but you must keep it up to date as soon as the information is known. This has a compliance impact well beyond this project. We will be going over a couple shortcuts a little later.

•Agents should not be contacting counsel unless told to do so. Only the tech advisor should be initiating contact with counsel. Agents should also be limiting contact with the tech advisor. Try to limit initial contacts on an issue to the OVDI coordinator. The coordinator may already know the answer, or if necessary will pass you along to the tech advisor.

Compliance Case File

- When to establish AIMS?
- 6-year Package
- Workpapers (KISS)
  - ☐ Limited Scope
  - ☐ Mandatory Lead Sheets (not wanted at all)
  - ☐ Issue Lead Sheets (not required)
  - ☐ No income probes
  - ☐ Follow normal structure for simplicity
  - ☐ F3198
- Tax and Balance Due Reconciliation attached to left inside of case file (WP or 906 letter)
- Same Disposal code (DC08 or DC12)
- One Spouse disclosure = MFT 31

•You should be establishing the other years as soon as you can determine the situations that brought them into OVDP. You want to ensure that the case is a true OVDP and will not result in a FAQ 9.

•You MUST pickup six years even if 2008 was filed correctly. If the highest balance was in 2008, the offshore penalty is applied on this balance. Only time you would not control a year is if there was no offshore account, but you mean clearly explain why in the file for tech services.

•Work papers: Take a very limited scope approach. You do not need to use lead sheets, but you must have some record of what actions were performed. Keep it short and sweet, but make sure that it is clear to tech services as they want to know how you came to verify the numbers? What was tested? You do not need a large sample size, just showing you looked at it for reasonableness.

•NO INCOME PROBES, you do not need to even scan IRPS. We are focused on offshore income!

•Will probably develop a F4318 for the compliance file, but I would just follow normal case structure.

•They will be releasing a tax and balance due record sheet that tech services needs, but in meantime you can use the letter sent with the 906.

•The whole case will have the same disposal code – DC08 or DC 12.

•Going into more detail regarding MFT 31 is outside the scope of this lesson.

•There is a cover sheet on the national SharePoint that is to go onto the compliance and offshore penalty case files.

Offshore Case File

- **Short and Sweet**
  - F3198
  - F8278
  - Worksheet with pro forma F886A language
  - Copy of the 906
  - F3244-A
  - Activity record
  - Pickup card

•A F3198 sample is posted on our local SharePoint.

•For both the offshore and compliance cases, you only need the F3244A file copy. Do NOT wait for the payment to post if you have received it. If the taxpayer states it was mailed in, then try to determine when and to where. You should inquire about payment at initial contact so you do not run into delays when closing.

•There is a cover sheet on the national SharePoint that is to go onto the compliance and offshore penalty case files.

Form 906

- F906 guidance in IRM 8.13.1
- Special Language
  - ☐ Statutory Adjustment = NO
  - ☐ PFIC = YES
  - ☐ FTC & AMT FTC = YES
  - ☐ Other AMT = NO
- If making a change F906, go to tech advisor, short turnaround.
- Whereas Section
- Other Notes

•Whereas Section:

  •Use they name they are going by now, in the whereas section define their prior names

  •Died or divorced, in the whereas section mention it.

•Other Notes:

  •Determination section cannot be changed without an approval.

  •Before doing 906, they must verify that there are no pending adjustments on the module, the transcript must reconcile

  •Deceased – one is dead, have other sign and full pay.

  •Date-stamp the reverse of every page.

  •Okay to do multiple F906s if MFS not going to sign same 906.

  •Must be numbered (i.e. 1 of 2, 2 of 2)

  •Draw a diagonal line through (Z) blank part

  •Need three originals but can get by with one.

Penalties

- **Compliance case**
  - accuracy OR delinquency
  - de minimis does not apply
- **Multiple Accounts = Aggregate Balance**
- **FAQ 40 - Multiple Account Scenario**
- **FAQ 9 and 40 – no OVDI requirement**
- **FAQ 35 – do not give hope!**

•Can only assert accuracy or delinquency, not both.

•All cases must be penalized as de minimis does not apply.

•In the case of multiple unreported accounts, you will use the aggregate high balance in computing the penalty. This is computed by taking the highest balance in each account during the year and then removing any possible transfers. The high balance may occur at any time during the year, and not necessarily at the end of each year. If the taxpayer does not list any transfers do not go looking for it, but if claimed verify the transfer. The individual account high balances can occur in different months.

   •You do not need every bank statement. Based on the facts and circumstances, you just need enough statements in order to make a decision on the validity of the taxpayer's workpapers.

•FAQ 40 – If a couple accounts were not disclosed, but one had its income reported, the offshore penalty is only based on the unreported income account.

•FAQ 9 - If taxpayer failed to report any income (i.e., interest, dividends) earned on the offshore account or by an offshore entity, even if there are offsetting deductions (i.e., IRC 212 expenses such as maintenance fees) FAQ # 9 would not apply because the taxpayer did not report that income earned on the offshore account on their timely filed original income tax return and there is in fact tax noncompliance with respect to that offshore account even though there is no additional income tax due.

•FAQ 35 – Rep's may argue that the penalties are less under normal procedures. You need to convince this is not the case. If we do not agree, case would become a regular exam if FAQ 35 was fully pursued. An agreed FAQ 35 will remain in OVDI. See the FAQ 35 comparison spreadsheet for penalty structures of the various non-filed information returns. Also FAQ 15 is a good reference.

Penalties – 5%

- Almost never applies!
- Must be approved by Tech Advisor.
- Qualifications:
  - Did not open account, cause it to be open, or form entities
  - No TP activity with the account during control
  - The account was not funded with evaded taxable income.

Slide is self-explanatory

E-trak

- Keep up to date!
- One key entry for multiple accounts at same bank
- Interview not necessary
- Promoter vs. Professional
- DC 12 notation

•Account deactivates after 45 days inactivity.

•Put the bank account in once, and then list out all the account numbers within the comments.

•An interview of the taxpayer is not necessary, unless you determine that the 3-pager indicates that there may be some valuable information to the project.

•Promoters are the bankers and individuals that got them offshore. Professionals are other people involved. In the end, do not worry between the labeling of promoter and professional, as long as the information is entered into e-trak.

•If a case is closed DC12, be sure you make some sort of notation in the comments section of the adjustment screen.

Passive Foreign Investment Corporation (PFIC)

- Penalize for deferring, back interest
- What in the world is a PFIC?!!!
  - Mutual Fund, Units or Equity Fund.
- Time of Sale = Ordinary Income on Gain
- Gain is pro-rated over the holding period
- Taxed at highest yearly tax bracket
- Form 8621 required
- Job Aid is being finalized

•Penalize taxpayers for deferring gain in year of sale as international mutual funds do not typically distribute their earnings like a domestic one. So it is penalizing taxpayers for back due interest.

•Only PFIC rule we are following is in the year of sale only.

•Ways you recognize a PFIC, it will be named mutual fund in the title. It may also state units or equity fund.

•In year mutual fund is sold, look at holding period, in year sold, pro rate out gain over holding period. Year sold, booked as ordinary income. In prior years, look at highest tax rate in that year.

•The TPs will be trying to book sale as a capital gain, must be ordinary.

•The TPs must prepare a F8621 that lists the tax amounts. You will verify the accuracy, then enter the adjustments into RGS.

•A job aid is being finalized which will show how to enter the adjustments into RGS so we will not do that at this time.

•Only same holding periods should be aggregated.

•The current year's proration is reported as other income.

•All prior years prorations are computed by the taxpayer at the highest marginal tax rate in each year (not the taxpayers rate) and this amount is added to the tax figure.

•There is also an interest calculation that is added.

•Look at Schedule C to identify PFICs also, but note that they should NOT be on the Schedule D.

•A PFIC loss is deductible as a capital loss, it cannot offset a PFIC gain.

Foreign Tax Credit (FTC)

- Do not rely on amount claimed or amounts withheld from account.
- Pub 901- US Tax Treaties
- Tax withheld, but refundable
- FTC needs F906 language and TA approval

•Be wary of FTC claims

•Taxpayers may have taxes withheld from their foreign bank account that they are not legally liable for and then will claim FTC on this amount.

•If the TP does not exercise their available remedies to reduce the amount of foreign tax to what they legally owe, a credit for the excess amount is not allowed.

•For example: There is a foreign tax treaty between the US and Switzerland on interest income that reduces the tax to 0%, but the bank may withhold tax at 35% on the interest earned on the account, but the U.S. taxpayer has no tax liability to the Swiss with respect to the interest earned.

> •So the individual has to file with the Swiss Tax authorities to get the 35% tax back withheld by the foreign bank and we don't allow any FTC with respect to tax paid to the Swiss on interest income earned in Switzerland.

•Another Example. Country X withholds $25 of tax from a payment made to you. Under the income tax treaty between the United States and Country X, you owe only $15 and can claim a refund from Country X for the other $10. Only $15 is eligible for the foreign tax credit (whether or not you apply for a refund).

•Publication 901 should be ordered by your groups as it describes all the tax treaties.

•The 906 will need special language and TA approval.

•Be wary of LUQ foreign source income claims.

Processing Other Forms

- Forms 3520, 3520A, 5471 and 8865:
  - ☐ Date Stamp
  - ☐ Write in red across the top – "Delinquent Return Secured by Exam-Penalty Considered by Exam"
  - ☐ Make a copy for your case file
  - ☐ Mail to via FedEx, DHL, etc.:
    Internal Revenue Service
    1973 North Rulon White Blvd
    Ogden, UT 84404

Slide is self-explanatory

Processing Other Forms (cont.)

☐ Mail to via USPS:

    Internal Revenue Service

    P.O. Box 409101

    Ogden, UT 84409

■ Estate and Gift Tax Returns:

☐ There is a referral sheet on SharePoint under Alerts – E&G Issues

☐ Contact: (b) (6) ███████████████

Slide is self-explanatory

Reconciling RGS Setup

- RAR MUST = latest tax per module
- TC 150 is just the start
- Has 1040X been accepted? 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 closing

•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 (E.S.P.).

•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.
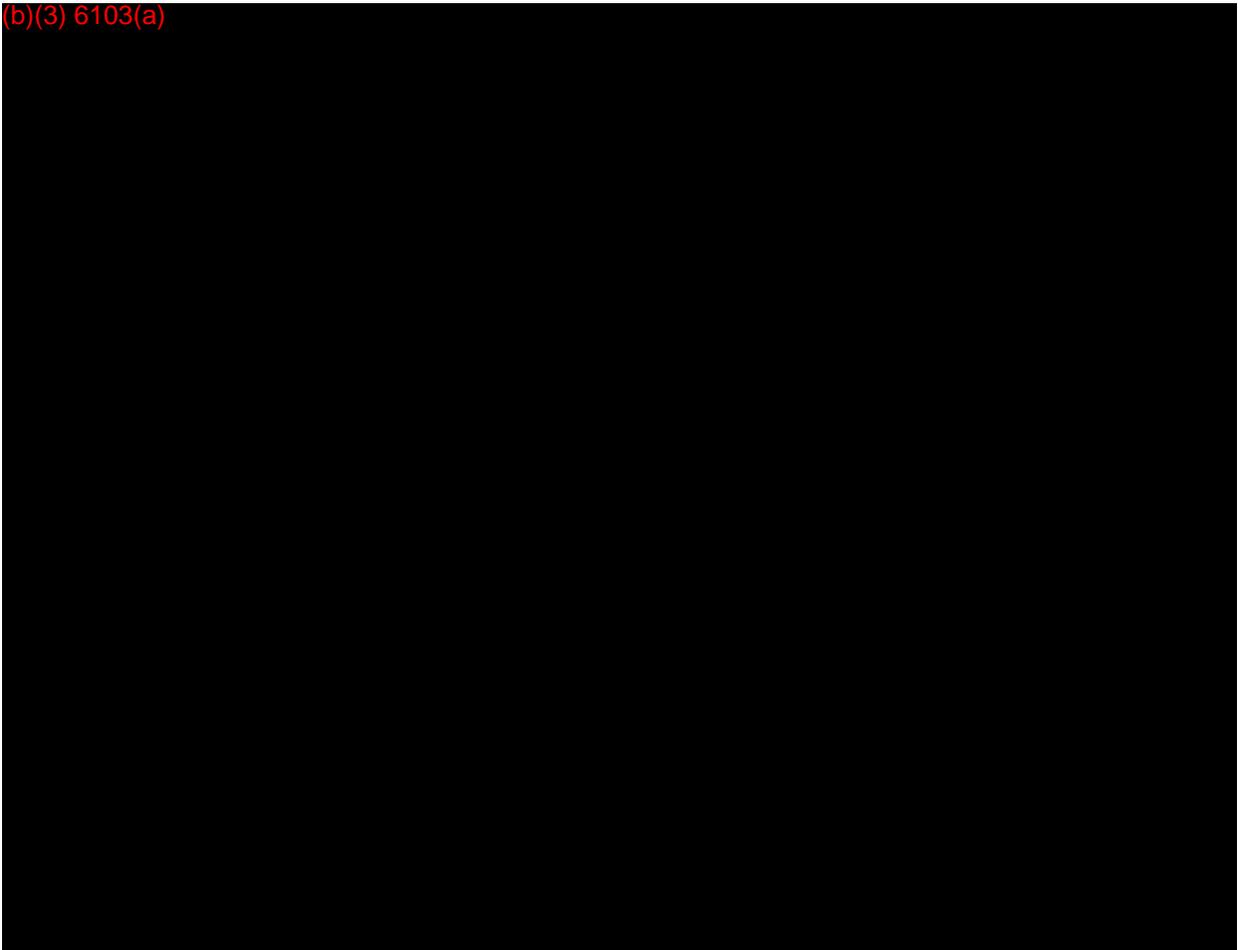
•Refundable credits such a EITC and ACTC may adjust on their on TC code.

•Taxes withheld may adjust if a W-2 was not reported.

•What changed? Try to get info from taxpayer, but a lot of times you can determine the changes on your own.

•IMFOLR is a snapshot of key return items, but unlike the RTVUE may be adjusted per tax adjustments to the module.

•Every item does not change, but just the ones that are key in reassessing the tax. In most cases it will be limited to taxable income and AGI changes as shown on the IMFOLA next.
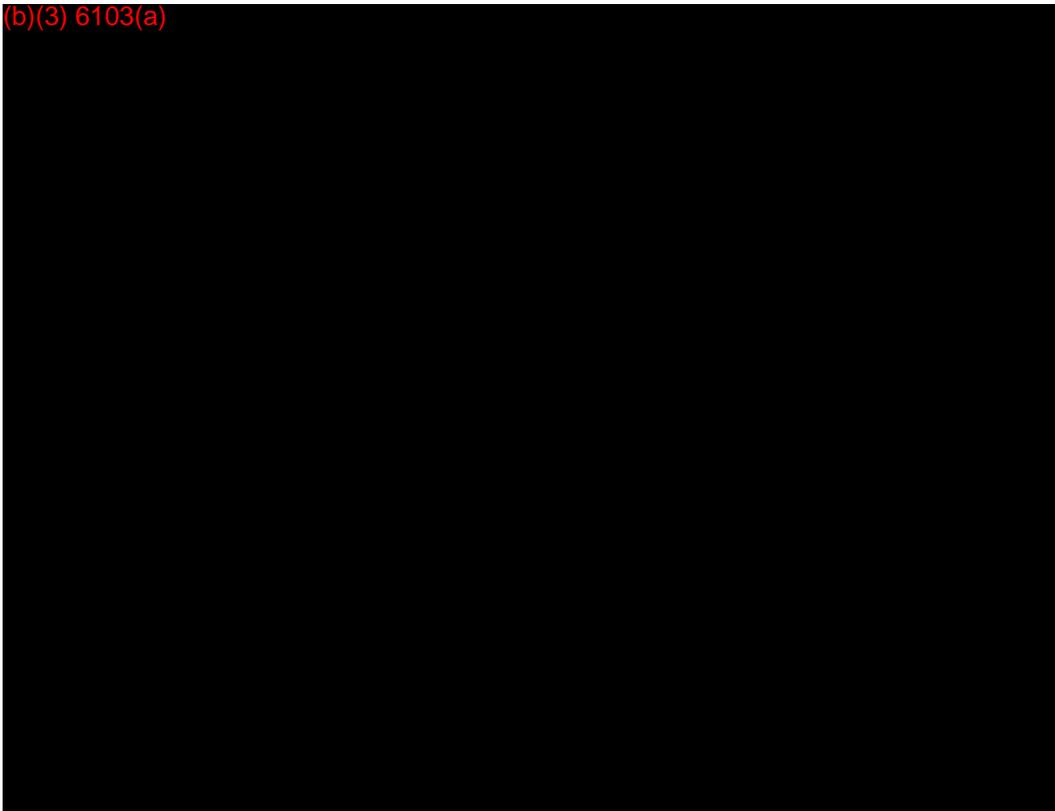
You can use IRM 4.4.12 or Doc 6209 to decipher what the references are.

•The IMFOLA only shows the main items that change in order for MF to re-compute the tax. It does not list all the statutory adjustments as those are implied.

•If you are lacking full documentation, you can typically use these two numbers to determine the other statutory effect.

•A TP may forget to update their return to reflect a CP2000 adjustment. If you see a TC 290 for this, you can reconcile IRPS versus the original return to determine what may have been updated. There is a RSN code for each IMFOLA set that is deciphered in Doc 6209.

•Restate, get the correct info from the taxpayer, they may still have the CP2000 letter or in the case of this example, copies of the F1045.

•TXMOD will display pending transactions that are not always yet captured by IMFOLT. You can access the pending transactions with definer code A or L.

•Definer code L will just provide the pending transactions.

•Definer code A will provide all TXMOD information as shown on the slide.

•Review before issuing F906 and closing case.

Other Items

- SharePoint
- OVDI Inventory Management Tool
- Currency Conversions
- Information sent to Philadelphia
- FBAR Procedures
- Soft Letter
- No-Change (DC12)

•The national OVDI SharePoint site will not be updated very frequently, so we are starting to put together a local SharePoint site for the area. For now it will be similar to a shared drive. We will be uploading files to this instead of sending them as email attachments.

•I have prepared an excel spreadsheet to use for inventory management. You are by no means required to use this tool, but it can be very beneficial in keeping track of your inventory which can become quite large. It can also help speed up IVLs if it is kept up to date. Sample it.

•Conversions – the rates on the OVDI website are good, do not get too hung up if it is reasonable.

•The latest regarding records sent to Philly is that they are trying to get the documents associated with the cases, but in the meantime you should try to get the taxpayer to resubmit directly to you. If you do not receive documents by the end of May, you should assume you never will.

•Legacy OVDI groups who had to follow Title 31 procedures can instead follow the simplified VSP offshore procedures.

•When receiving original FBAR, follow procedures from SharePoint job aid. If you receive a copy, and are told that the original has been filed, use your judgment, even if it is not in the system. Document what you used to judge that it has been filed. If you have issue, get a clean signature and file it for them.

•When closing the case, you will send the FBAR information sheet to the address on the form. Due to technical difficulties, you may need to go to tools -> send/receive -> download address book for this to work.

•You do not need CBRS because it takes too long for FBARs. Just explain how you know that the FBARs have been filed.

•When sending out the soft letter, let OVDI coordinator know and this information will be forwarded to Larry Akins and Barbara so that they can track it. Keep in mind that you are not sending out the soft letter without managerial involvement.

•DC12 go to CCP, not tech services

Q&A

- Submitted Questions
- Additional Questions