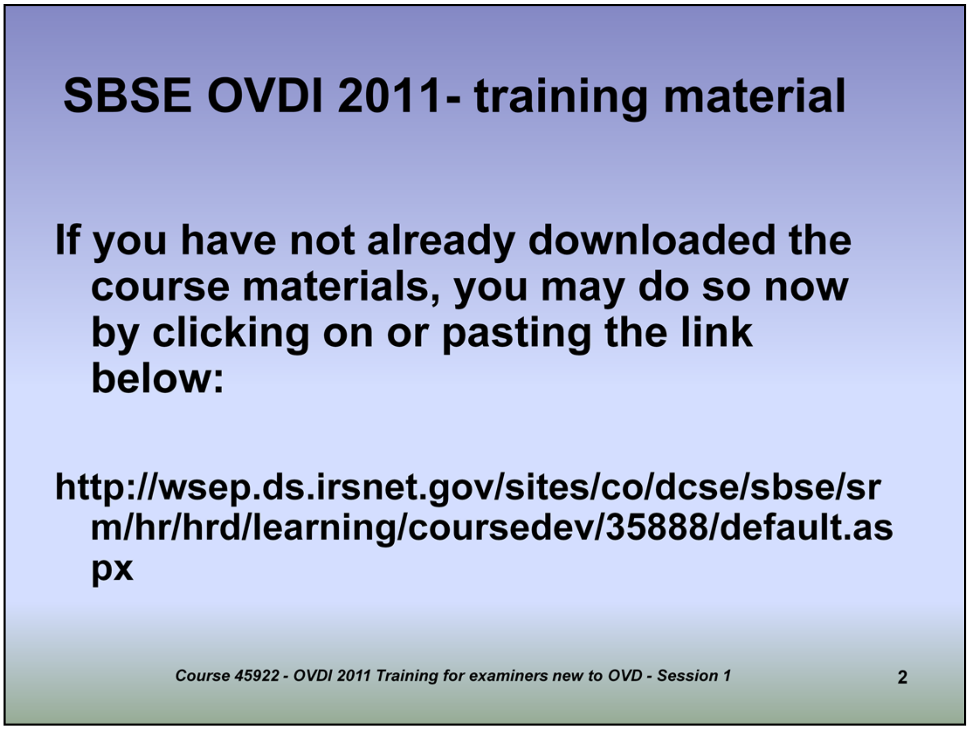
SBSE Offshore Voluntary Disclosure Initiative (OVDI) 2011

Centra Course **#45922**

Welcome, you are attending Offshore Voluntary Disclosure Initiative 2011 CENTRA training designed for examiners who have NOT worked offshore voluntary disclosure cases before.



You previously received information relative to downloading materials for this course from the L&E SharePoint site.

If you have not already downloaded the materials, please do so now by accessing the link below.

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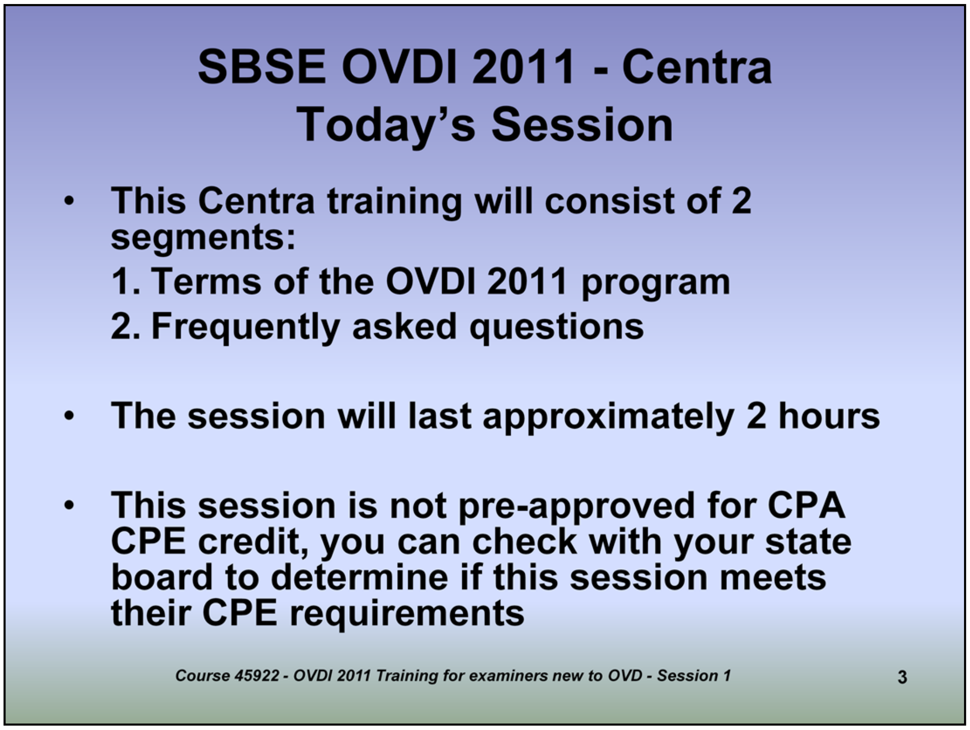

This CENTRA training session is intended to highlight the key points of the 2011 OVDI, and will include discussion of the Program features that you need to be aware of as you start working these cases.

There are 2 topics the instructors will be discussing in this session

This training is expected to run between 1-2 hours

And it is not pre-approved for CPA CPE but you should check with your state association to determine if this session meets their CPE requirements

SBSE OVDI 2011 - Centra Training presenters

- David Breen, Counsel

(b) (6)
[redacted]

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All of the presenters involved with this training are from the SBSE division and each of them has extensive experience with offshore voluntary disclosures. They represent Counsel, Exam HQ and several Exam Areas.

Handout: SBSE OVDI 2011 - Contacts

David A. Breen, Senior Counsel, Philadelphia, PA (215) 861-0707

(b) (6) [redacted]

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Contact information for these folks is one of the handouts found on the L&E's SharePoint site

(b) (6)
[redacted]
(b) (6)
[redacted] South Atlantic Area

TERMS of 2011 OVDI PROGRAM

•You will not find an IRC section or Treas. Regs. describing 2011 OVDI. This program uses existing IRS processes and procedures within a special framework to bring taxpayers into compliance with respect to offshore issues.

•My name is (b) (6) [redacted] in the South Atlantic Area. (b) (6) [redacted] In addition to explaining this framework, "Terms of 2011 OVDI Program", I will be discussing the processes, procedures, and terminologies you will encounter in working 2011 OVDI cases.

•The 2011 OVDI program is a follow-up initiative to the 2009 OVDI program. The 2009 program was extremely successful in bringing 1000's of taxpayer into compliance using stream-lined processes and focusing on offshore issues.

•In 2011 OVDI you will benefit from the intense efforts and experiences of LB&I Technical Advisors, Counsel, SBSE Area OVD coordinators, and the Revenue Agents who participated in 2009 OVDI. From that experience, the organization learned how to make this program even better.

•We want you, also, to understand what a major impact you will have on the organization's efforts to foster offshore tax compliance and to understand the critical role you play in that effort.

IRS Processes & Procedures
2011 OVDI

- Voluntary Disclosure Practice
- Certifications
- Closing Agreements (Form 906)
- FAQ's: Frequently Asked Questions
- Other Topics
  - Quiet disclosures
  - Opt Outs

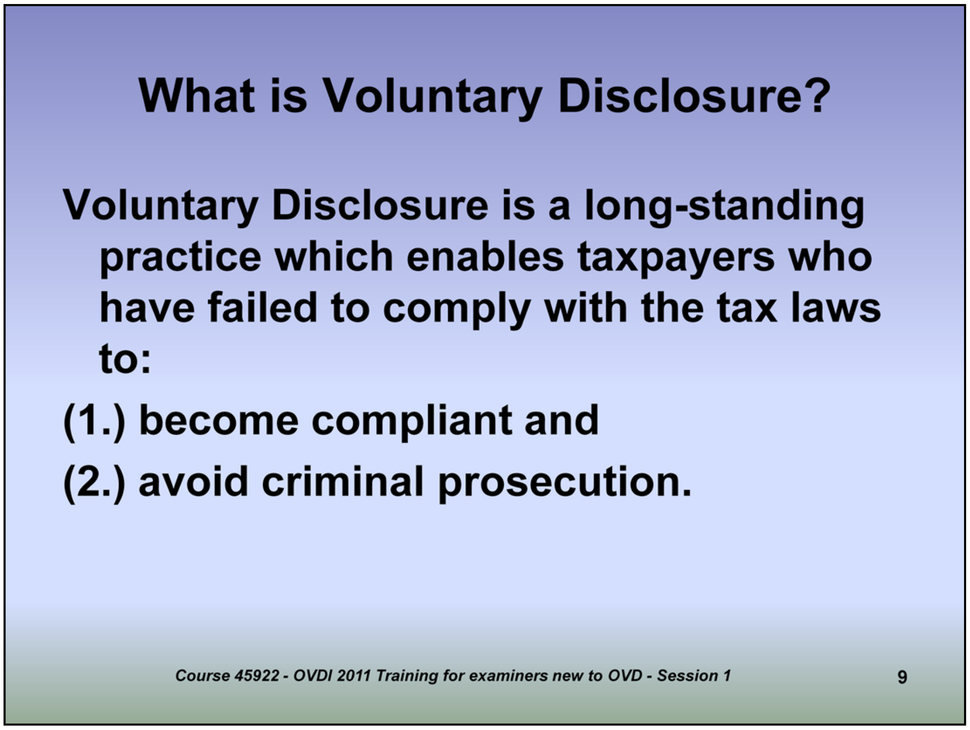
•The IRS's Voluntary Disclosure Practice is the fundamental process on which the 2009 and 2011 OVDI programs are based. So, we will discuss this process and how it is used within this initiative.

•You will hear us use the word Certifications throughout this training. Often, you will hear it used within the phrase: "Certifications, not Examinations." That phrase is critical to your role in this program.

•Another IRS procedure that exists outside of 2011 OVDI is the use of Closing Agreements to settle specific tax matters between the IRS and a taxpayer. We will utilize this procedure to streamline the agreement process and assessment of the taxes and penalties asserted in this program.

•An acronym you will hear constantly from this point forward is: F A Q. The FAQ's, along with the penalty framework memo discussed later, will be your guidelines in defining and applying the terms of this program.

•And, we want to expose you to two topics which will not be discussed in any depth, but may be mentioned in discussing other aspects of the program.



•The Voluntary Disclosure Practice is under the control of CI and is used outside of this initiative.

•It is used as a consideration for CI in determining whether criminal prosecution will be recommended in an investigation.

Voluntary Disclosure Practice

- **The Voluntary Disclosure Practice and the rules for participation are described at IRM 9.5.11.9**
- **A voluntary disclosure occurs when the communication is truthful, timely, complete, and when the taxpayer:**

  -Shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining correct tax liability and

  -Makes good faith arrangements with the IRS to pay in full, the tax interest, and penalties

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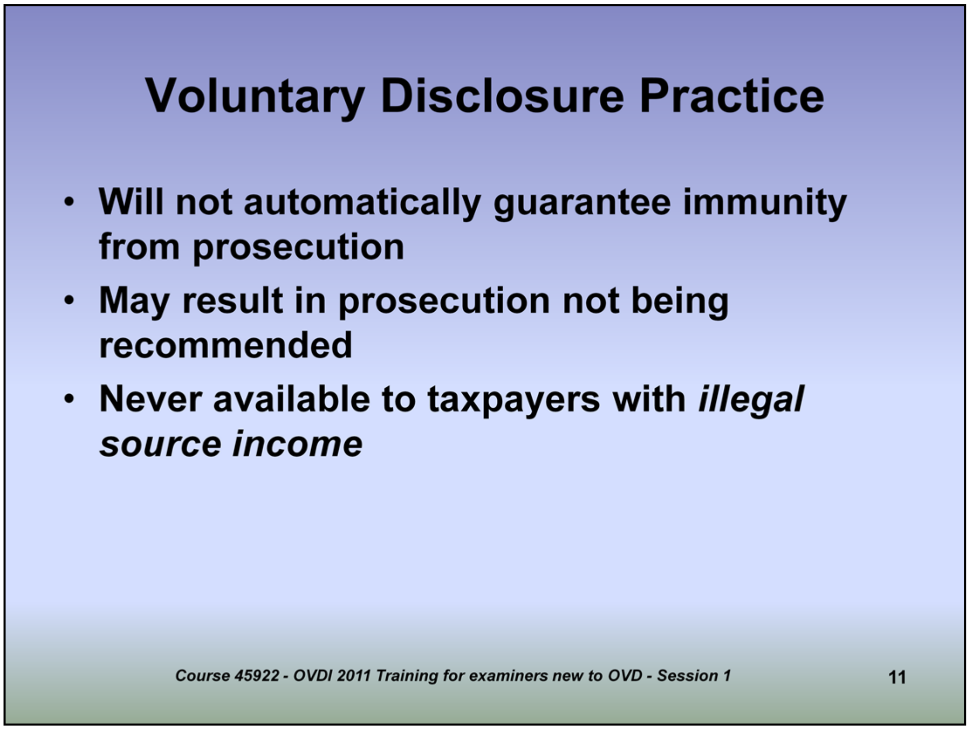
•The Voluntary Disclosure Practice creates no substantive or procedural rights for taxpayers because it is simply a matter of internal IRS practice, provided solely for guidance to IRS personnel.

•Cooperation is a key element of the voluntary disclosure and will be evident as a key term of the 2011 OVDI program.

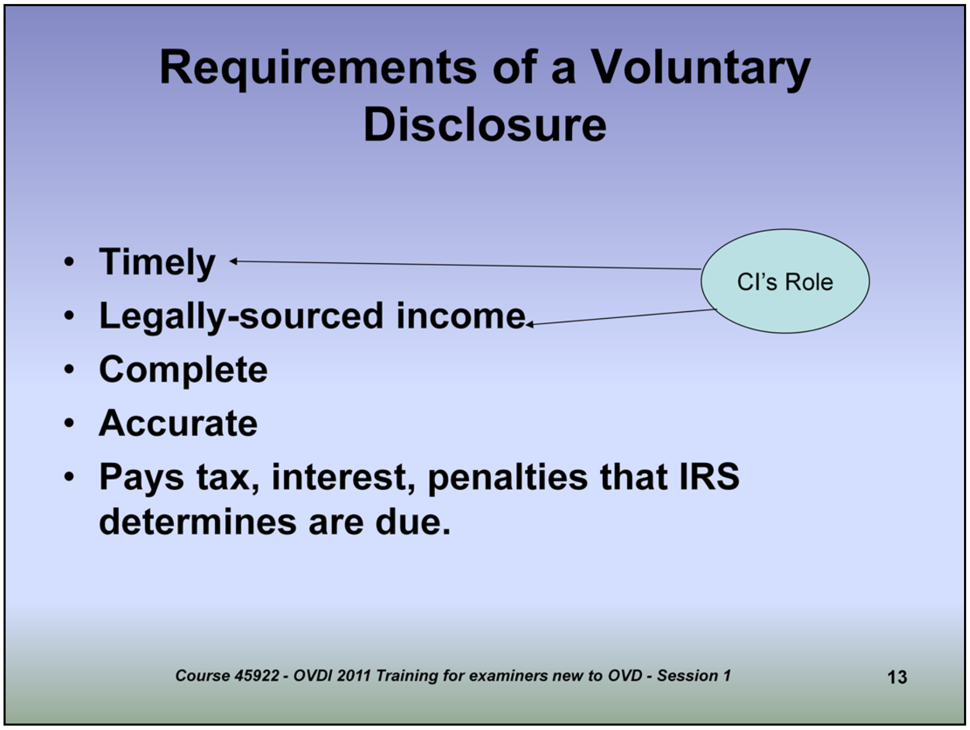


•The rewards versus risks to the taxpayer is the potential for protection from prosecution. But, a voluntary disclosure cannot be used to shield taxpayers with illegal source income.

Requirements of a Voluntary Disclosure

- **Timely**
- **Legally-sourced income**
- **Complete**
- **Accurate**
- **Pays tax, interest, penalties that IRS determines are due.**

•For all voluntary disclosures, these requirements are to be met.



•This is a CI-controlled process and they make the determination of the timeliness of the disclosure and a preliminary determination on whether or not legally-sourced income.

•As we discuss the 2011 OVDI program, we will address how the other requirements of a Voluntary Disclosure are evaluated.

•For CI's part, they make the timeliness determination based on several factors.

Timeliness

A disclosure is timely if it is received before the IRS has:

- **Initiated a civil examination (or Taxpayer notified)**
- **Initiated a criminal investigation (or notified)**
- **Received information from a third party concerning the taxpayer**
- **Initiated a *related* civil examination or criminal investigation**
- **IRS has acquired information directly related to the taxpayer**

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•CI will have checked and evaluated the timeliness of a voluntary disclosure before going further into the process.

•If CI determines the disclosure was not timely, such as the taxpayer was under exam at the time of their disclosure, then that decision is final.

•By the time the Examination function is involved in any voluntary disclosure case, the timeliness of the disclosure has been determined as acceptable by CI and you will not have any responsibility in making this determination. And CI will have made a preliminary determination on legally-sourced income , as well.

•To recap: CI is the gatekeeper for any voluntary disclosure. As such, they are responsible for evaluating the timeliness of the disclosure, as well as making the initial determination whether the disclosed income is legally-sourced.

Certification

Process used to evaluate the taxpayer's disclosure

- **Is the disclosure complete?**
- **Is the disclosure accurate?**
- **Taxpayer pays all taxes, penalties, and interest that IRS determines are due**

Bifurcated Approach (2 Cases)

- **Income Tax, income tax penalties, and interest**
- **Offshore Penalty**

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•Now let's discuss the process which you, the Revenue Agent, will control.

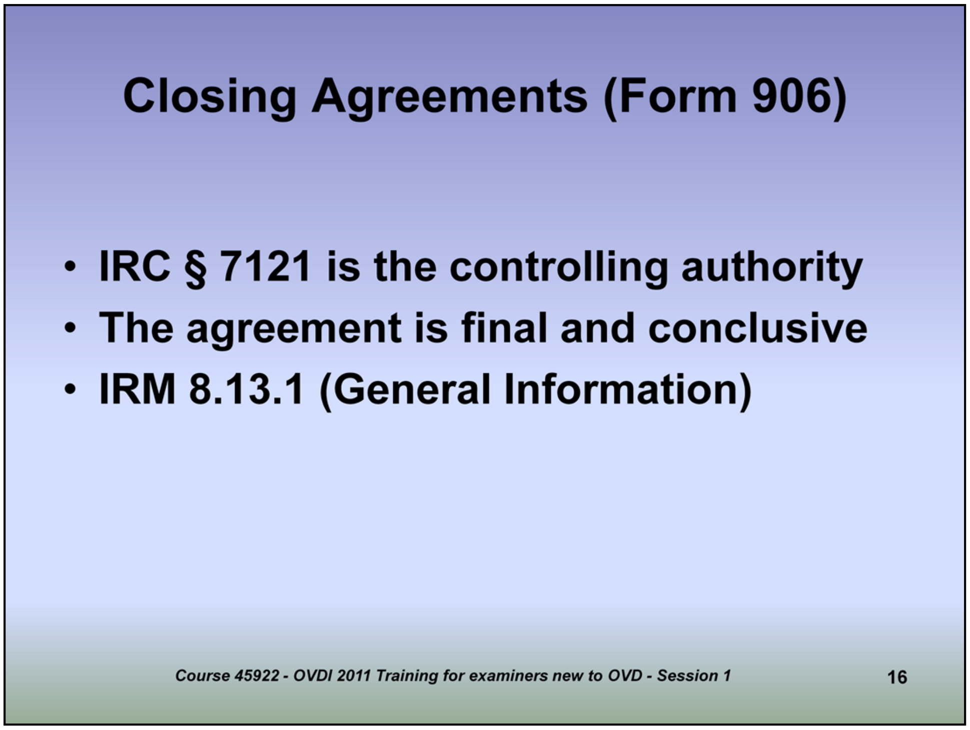
•You will continue to hear the term "Certification" and usually in the phrase "Certifications, not examinations".

•We use the Certification terminology to distinguish the examiner's role in 2011 OVDI from our usual Examination processes.

•Your role in certifying the voluntary disclosure case will be to evaluate accuracy and completeness, as well as obtaining payment for all amounts determined during the process (or ensuring the taxpayer makes acceptable payment arrangements for all amounts due.)

•You will certify two distinct cases for each taxpayer :

•You will be evaluating the accuracy and completeness of both the income tax-related disclosure and the offshore penalty amount as submitted by the taxpayer.



•After your certification, you will incorporate your findings into a Closing Agreement, Form 906.

•IRC Section 7121 provides for the IRS "to enter into an agreement in writing with any person relating to the liability of such person in respect of any internal revenue tax for any taxable period."

• Except for showing fraud, malfeasance, or misrepresentation of a material fact, these agreements are final and conclusive. As such, we must take extreme care in drafting and executing such agreements.

•Using the Closing Agreement, however, allows us to address multiple tax matters and efficiently process 2011 OVDI cases, as later explained.

•IRM Section 8.13.1 provides some general information about Closing Agreements, such as some general characteristics:

•---Some of the attributes of a contract, but not strictly subject to the laws of contracts (legal consideration is not required, for instance.)

•---Because of the finality, these agreements need to be drafted with great caution. If a closing agreement contains an ambiguity, the ambiguity is resolved against the drafter.

•Generally, IRS signature authority is delegated to the Technical Services manage for SBSE cases. As you will later learn, your cases will be closed through Technical Services.

Common Terminology

- **Current FAQs found at irs.gov**
  - **Search for “2011 OVDI”**
- **Other topics**
  - **Quiet disclosures – FAQ’s #15 and #16**
    - **Taxpayer submits amended returns outside of the voluntary disclosure practice process**
  - **Opt Outs – FAQ #51**
    - **Taxpayer withdraws from 2011 OVDI**
    - **Regular, complete, examination ensues**

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•Throughout this training session we will continue to discuss and refer to the FAQ’s. The best source to find the most current revisions are at irs.gov. Search for “2011 OVDI” to locate.

•Quiet disclosures refer to those taxpayer’s who do not utilize the VDP process and file amended returns to correct non-compliance without full disclosure.

•Opt Outs refer to the taxpayers who have been accepted into 2011 OVDI and later withdraw from the program.

OVDI 2011 Terms

IR-2011-14, February 08, 2011

- **2011 OVDI Announcement from the Commissioner**
- **Referenced to 2009 OVDP with penalty changes**
- **Applied to tax years 2003 through 2010**
- **Offshore penalty rate increased to 25%**
- **Original due date of August 31, 2011**
- **Frequently-asked Questions (FAQ's) issued specific to 2011 OVDI (updates June 10, 2011, August 29, 2011 and on-going)**

•Now that we have introduced you to the general processes, procedures, and terminologies used in 2011 OVDI, here are the Terms of the Program.

•The program was initially announced on February 08, 2011. This announcement explained the conditions and requirements for taxpayer participation

•The announcement also explains the benefits of the program: "This is a fair offer for people with offshore accounts who want to get right with the nation's taxpayers . . .This initiative offers them the chance to get certainty about how their case will be handled. Just as importantly, those who truly come in voluntarily can avoid criminal prosecution as well."

•The announcement explained the Terms of 2011 OVDI in reference to the 2009 OVDI program.

•The disclosure had to address tax years 2003 through 2010 (2009 had included 2003-2008)

•The 2011 offshore penalty rate increased to 25% (from 20% for 2009)

•One condition very different from 2009 was the required submissions of documents. These documents were due August 31, 2011

•Like 2009, FAQ's were the rules for the program and the source to which taxpayers and their representatives were to look to for guidance.

•In subsequent postings at irs.gov, the FAQ’s were updated and clarified as questions from taxpayers and the tax professional community were posed.

Penalty Framework Memo
March 01, 2011

- Field Directive from Deputy Commissioner for Services and Enforcement
- Effective for all offshore voluntary disclosures received after the close of 2009 OVDP
- Taxpayers required to file or amend all returns for 2003-2010, including information reports and FBAR's
- Assess all taxes and interest due for 2003-2010
- Assess accuracy-related penalty on all years and delinquency penalties, if applicable
- Assess Offshore Penalty at 25% (or 12.5% or 5%, if required conditions met)
- The 12.5% and 5% criteria for 2011 OVDI could be applied to 2009 OVDP cases

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•After the Commissioner's announcement in February, the field received the Penalty Framework. RA's participating in 2009 OVDP were familiar with this document to rely upon it as the "short-version" of the FAQ's.

•For 2011 OVDI RA's, it again provides an overview of the penalty structure within the program with the goal that similarly-situated taxpayers are treated fairly and consistently within the program.

•This field directive applies to all offshore voluntary disclosures received after the close of 2009 OVDI. That program closed in late 2009. Offshore disclosures received after that date would be considered under the Terms of 2011 OVDI.

•The taxpayers are required to file or amend all returns for 2003-2010, as well as filing information returns (such as Forms 5471, 3520, 3520-A), FBAR's (TD F 90-22.1), and providing all other documents set forth in the Submission Requirements of FAQ #25

•The years included in the disclosures are 2003-2010 and additional income taxes, income tax penalties and interest are to be assessed.

•The income tax penalties to be assessed are accuracy and delinquency, if the originally filed return was subject to delinquency penalties

•Reasonable cause exceptions do not apply to cases within this program

•In lieu of all other penalties that may apply, including FBAR and information return penalties, we will assess an offshore penalty equal to 25% of the amount in foreign financial accounts and entities plus the value of foreign assets acquired with untaxed funds or producing untaxed income in the year with the highest aggregate account/asset value. One penalty only based on the highest aggregate balance of assets and accounts for any one year. FAQ #35 fully explains this general rule, as we will later discuss

•If special conditions are met, the taxpayer may qualify for a lower offshore penalty rate, either 12.5% or 5%

•The 2011 criteria for the reduced penalty rates could be applied to resolve 2009 OVDI cases.

Penalty Framework Memo
March 01, 2011 (continued)

- **Examiners and their managers have no authority to negotiate different offshore penalty percentages**
- **Penalty structure and 2011 OVDI terms only available to taxpayers who made voluntary disclosure requests and who fully cooperate with the IRS, both civilly and criminally**
- **Similarly-situated taxpayers are to be treated in a fair and consistent manner**

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•Simply explained: The offshore penalty rates can not be negotiated.

•This program’s availability is strictly limited to the taxpayer’s who meet the terms of the initiative and who cooperate with the IRS, both civilly and criminally.

•The goal of treating similarly-situated taxpayers in a consistent manner is not a quality of the Voluntary Disclosure Practice as used outside of 2011 OVDI. So, this is a major benefit for taxpayers choosing to apply to participate in this program-certainty as to the applicable penalties.

Updated Terms

- News Release reminder of due date of August 31, 2011 (IR-2011-84, August 08, 2011)
- Update on August 26, 2011 extending due date to September 09, 2011 (Hurricane Irene) for information to CI
- 90-day extension for required submission of documents to Austin campus could be requested
- August 29, 2011 FAQ update

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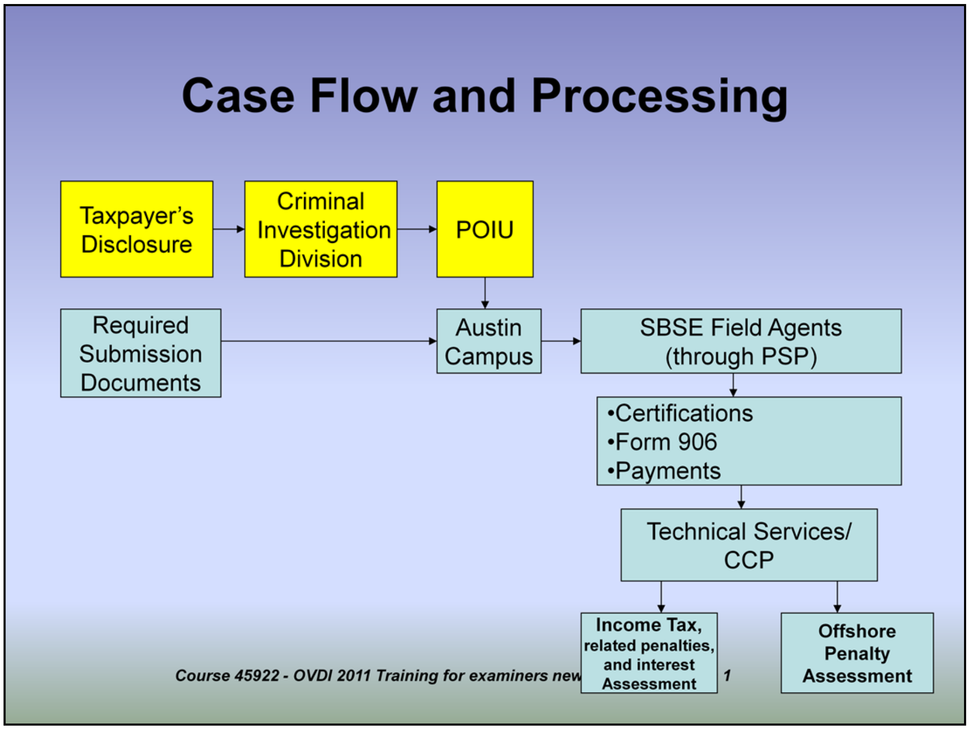
•Later in 2011, the dates for participation were revised, due to Hurricane Irene, and the revised due date for application to CI was now September 09, 2011

•Also, the taxpayers could now apply for an extension to submit the required documents to the Austin Campus.

•The FAQ's were updated with the revised due dates.

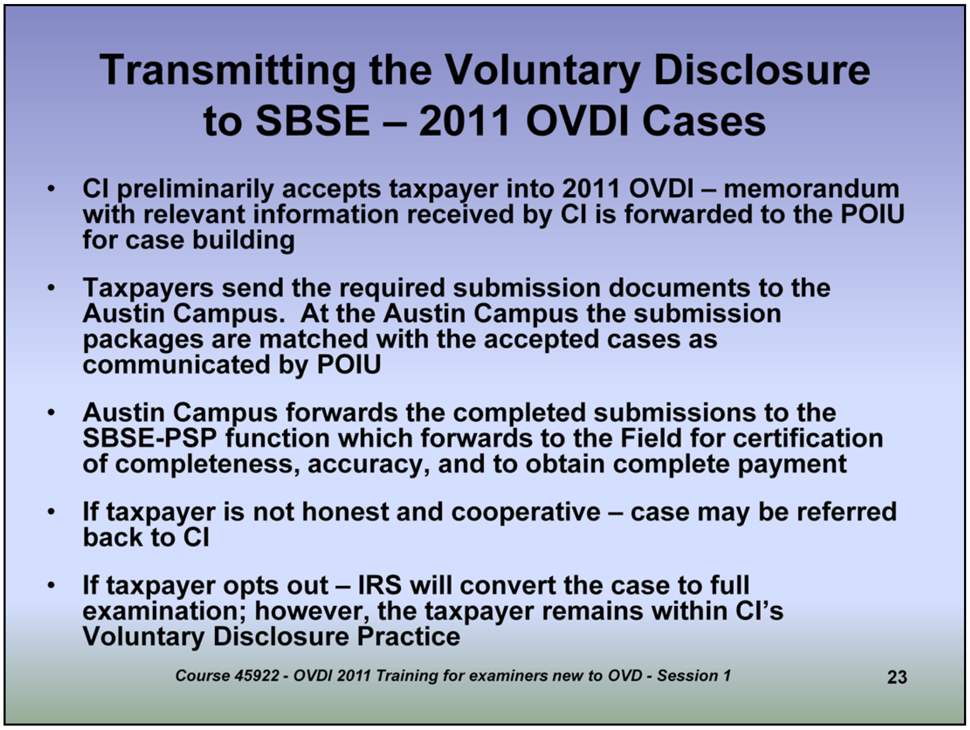


•Now we want to discuss how the voluntary disclosures make their way from the taxpayer's to you. The first step:

•Based on the program announcements, taxpayers were instructed to send their voluntary disclosure to the Philadelphia VDP Coordinator. From there, CI received the information and provided preliminary acceptance into the program.

•POIU is the Philadelphia Offshore Identification Unit. From CI they were notified of the preliminary acceptance and communicated with the taxpayer to instruct them on the submission of the required documents.

•POIU also maintains the database of taxpayers preliminarily accepted in the 2011 OVDI program, as well as other taxpayer's with offshore assets, such as 2009 OVDI and UBS Treaty cases.



•The complete sequence of the voluntary disclosures from the taxpayer to closure, in general terms, involves the following:

•CI remains the gatekeeper to start the process to get the cases to the field .

•After CI has determined the taxpayer qualifies to enter the program, they will notify the Philadelphia Offshore Identification Unit. And the taxpayer is then notified of the preliminary acceptance.

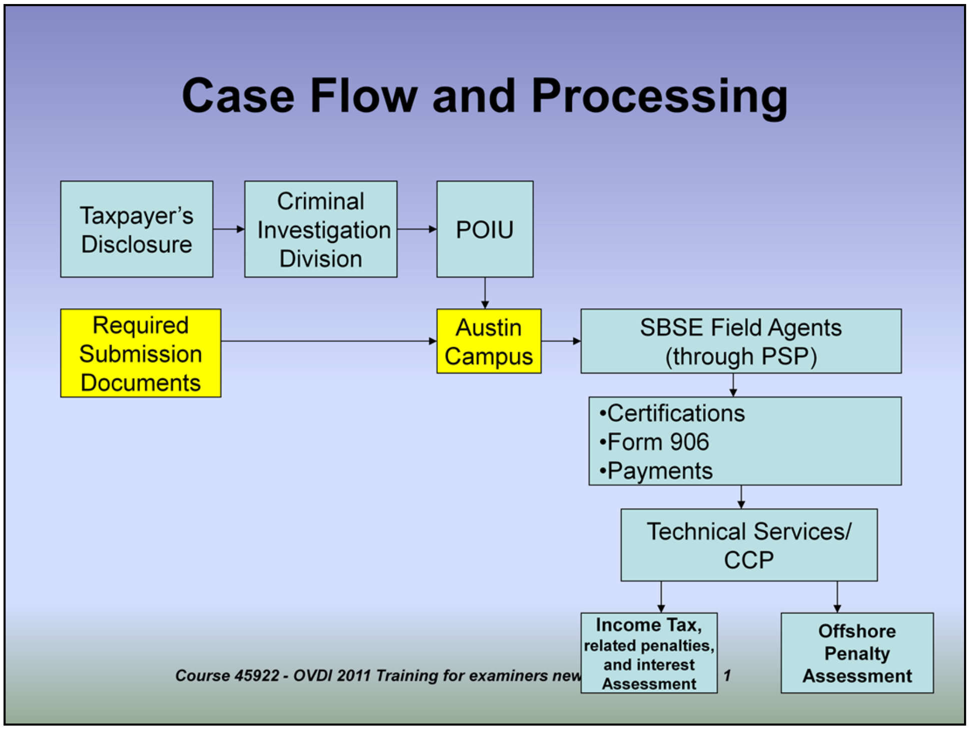
•With this preliminary acceptance, the taxpayer is instructed to send the submission documents directly to the Austin Campus.

•At the Austin Campus, the disclosure packages are assembled with the submission documents, POIU correspondence and the CI information, including the initial taxpayer disclosure correspondence. Austin ships the completed packages to the SBSE- Area-PSP function. From there, PSP forwards the cases to the examination groups designated to work the 2011 OVDI cases.

•During the certification process, the taxpayer is expected to continue to cooperate with the civil, IRS Agent. Also, if the disclosure is determined to be not honest or illegal income is identified, the case may be referred back to CI.

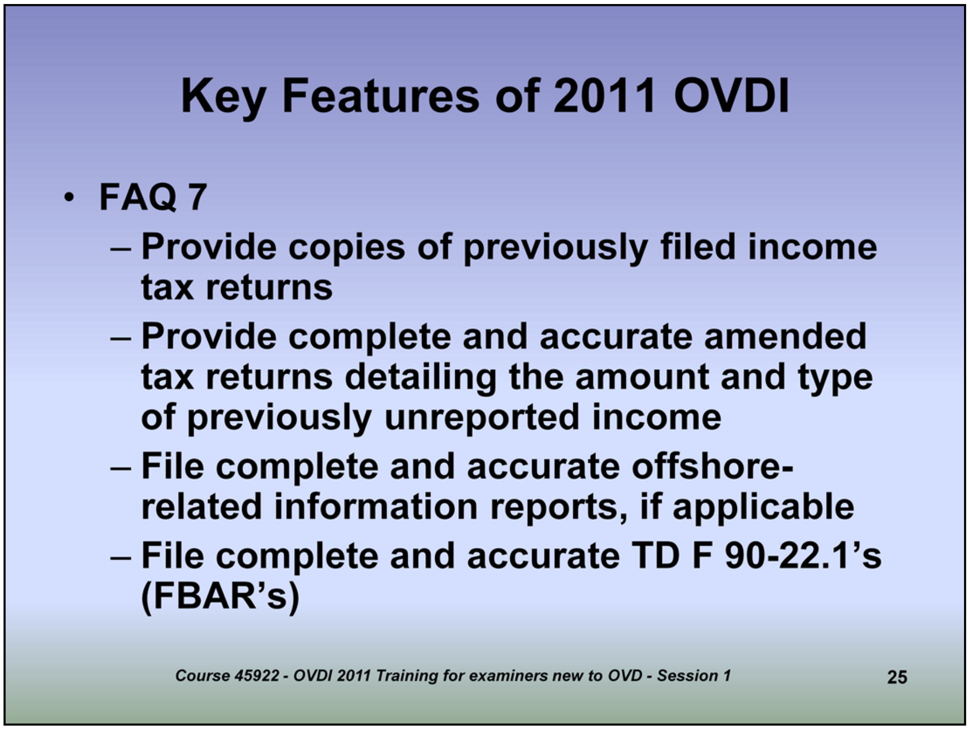
•The taxpayer retains the right to opt out of the program, but the case will be converted to a full examination.

•The terms of the 2011 OVDI program will no longer apply, but the taxpayer remains under the CI Voluntary Disclosure Practice and must continue to cooperate.



•Once CI has preliminarily accepted the taxpayer into 2011 OVDI, the taxpayer is instructed to send the required submission documents directly to the Austin Campus. Those documents are listed within FAQ # 25 and will be discussed in further detail in subsequent training session.

•The Key Features of 2011 OVDI, FAQ #7, give you an overview of the document submissions and other actions required of the taxpayer.



Per the slides:

Key Features of 2011 OVDI

- FAQ 7 (continued)
  - Provide information on offshore financial accounts, institutions, and facilitators
  - Sign agreements to extend the period of time for assessing tax and penalties
  - Pay 20% accuracy-related penalty, delinquency penalties (if applicable), and the Offshore Penalty

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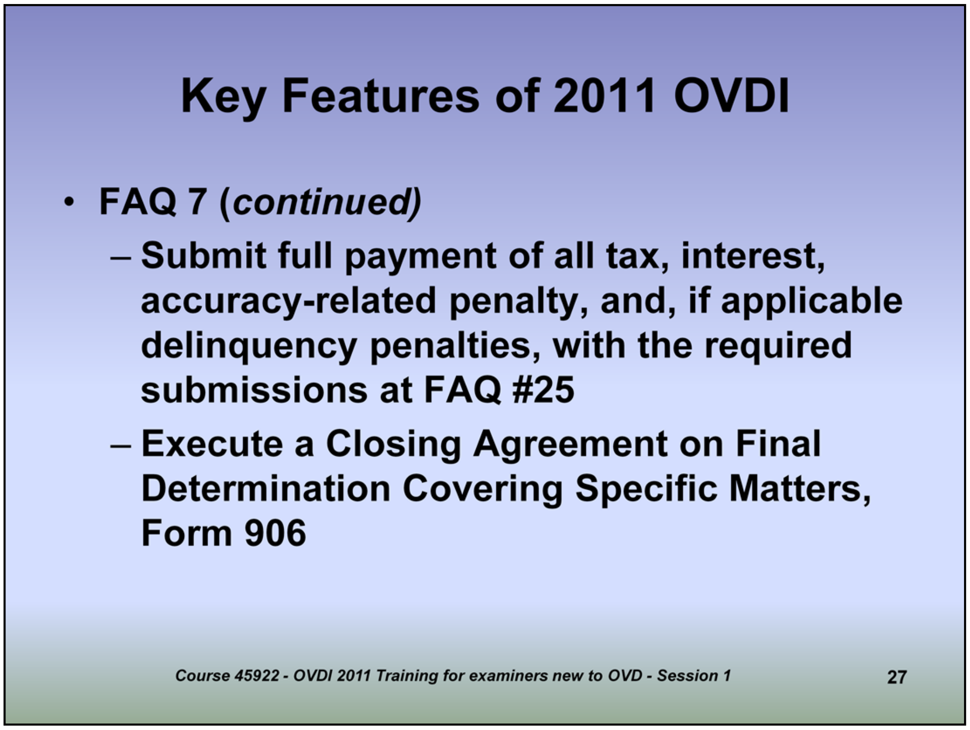
Per the slides:



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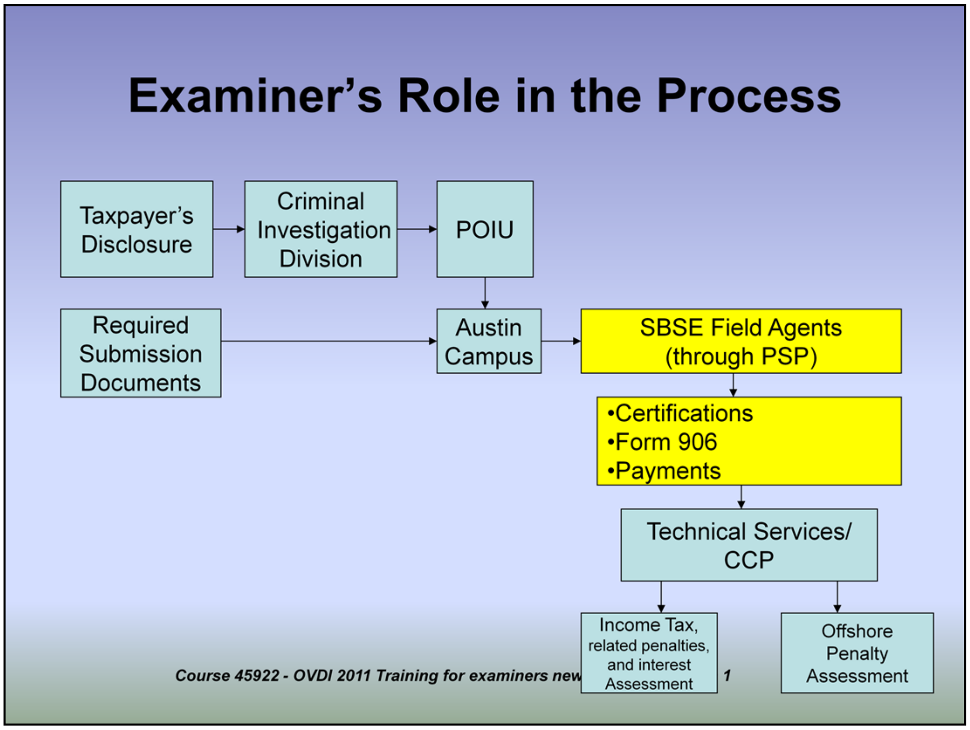
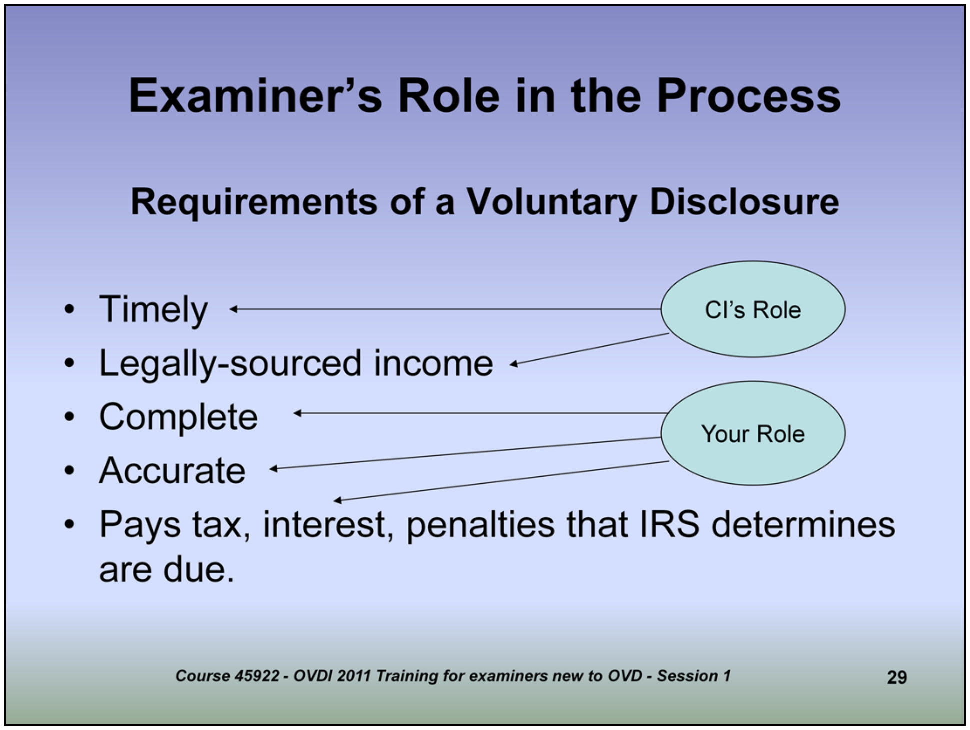


•Now we come to your role in the process.

•After you receive cases from PSP, your role begins

•You will perform the certification, prepare and issue Form 906 for the taxpayer's signature, and obtain full payment for the income tax, income tax penalties, interest, and the offshore penalty

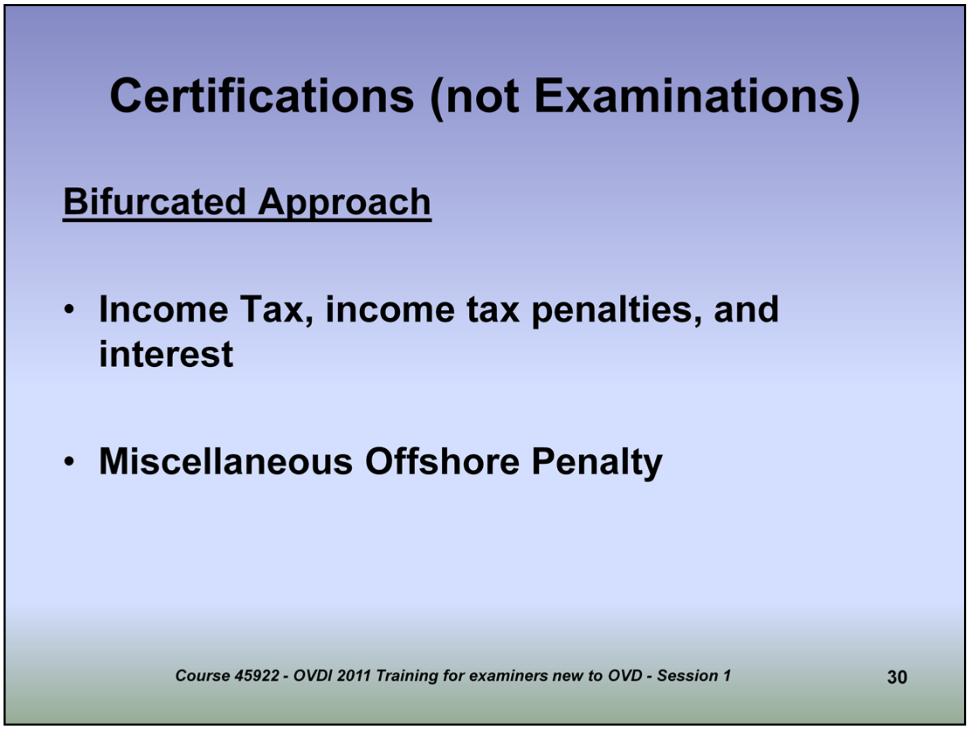


•The certification process is how you fulfill the responsibilities of your role in the voluntary disclosure process

•CI has been responsible for determining the acceptability of the disclosure for the first two requirements, timeliness and, on a preliminary basis, that the disclosure relates to legally-sourced income.

•Your role in the Certification of the disclosure is be the evaluator of the completeness and accuracy of the taxpayer's submissions, and to obtain payment for the amounts determined to be due.

•Also, during your certification process you will continue to share responsibility to identify any evidence of illegal income.



You will be certifying two distinct aspects of the taxpayer’s disclosure:

Income Tax Certifications

- Minimal testing of taxpayer's assertions as reported in 1040X's
- **<u>But</u>**, expected and required to use auditing skills to evaluate the reasonableness/overall accuracy and completeness of the disclosure
- No required workpapers or leadsheets, but must document actions performed to certify
- This process is not considered an exam; no reopening procedures required; the taxpayer has no Appeal Rights in the process
- Form 4549-A prepared and adjustments/issues incorporated into Form 906

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The emphasis should remain at all times that this process is not an examination. You will be evaluating the accuracy of the disclosure by reviewing the documents the taxpayer is required to submit.

In the amended returns submitted by the taxpayers, they should be providing the calculations of income tax. They also have the responsibility to provide the necessary supporting documentation and any explanatory workpapers or schedules.

You will not be expected to make any but the most minimal computations to test accuracy.

But, you are still required and expected to use your auditing skills in this process. Although you will be evaluating some new issues, like PFIC, don't lose sight of the reasonableness of the overall disclosure.

Critically compare the income reported with the account and asset balances in the bank records. Also remember that even though CI has preliminarily accepted the taxpayer's voluntary disclosure, you have a shared responsibility to identify questionable, possibly illegally-sourced income.

You will not perform income probes or evaluate internal controls; there will be limited workpapers.

You should, however, document the actions performed and how you verified the taxpayer's numbers and how you arrived at the conclusion that those numbers were accurate within the limited scope of your certification process.

Once you have certified the income tax amounts you will prepare F 4549-A to show the additional income tax, income tax penalties, and interest due from the taxpayer.

You will incorporate that information into a Closing Agreement on standard Forms 906 from the OVDI SharePoint site.

Offshore Penalty Certifications

- Miscellaneous civil penalty in lieu of FBAR penalties and penalties for failure to file information returns disclosing offshore entities/transactions
- Based on Highest Aggregate Balance of offshore accounts and assets
- Penalty rates are not negotiable

•Your certification process will also include determining the correct Offshore Penalty amount.

•The Offshore Penalty is a miscellaneous civil penalty which is in lieu of other offshore issue-related penalties, such as the failure to file FBAR penalty or failure to file information returns disclosing offshore entities or transactions with those entities

•You will certify the Highest Aggregate Balance of offshore accounts and assets for any one tax year in the disclosure

•The applicable offshore penalty rate will be applied to that balance to arrive at the offshore penalty amount

•The offshore penalty will be assessed in the 2009 year, no matter in which year the highest aggregate balance occurs. For example: If the highest aggregate balance occurs in 2007, you will apply the applicable penalty rate to 2007's highest aggregate balance to arrive at the offshore penalty amount. However, the offshore penalty will be addressed in the Form 906 for the 2009 year and the assessment will be made in 2009.

Offshore Penalty Certifications

- 25% of Highest Aggregate Balance (HAB) of offshore accounts/assets
- 12.5%, if HAB did not surpass $75,000 in any calendar year covered by 2011 OVDI
- 5%, if certain conditions met

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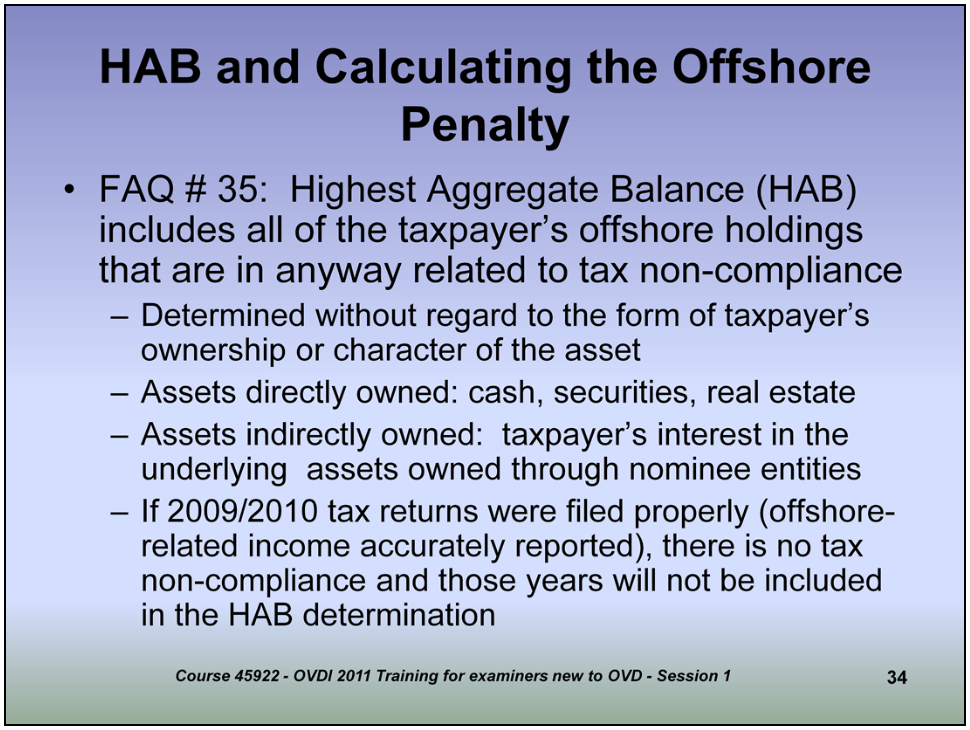
•As with the Income Tax certification, you will begin with the taxpayers assertions as to the Highest Aggregate Balance of offshore accounts and assets. The taxpayer is to include a computation of the Offshore Penalty with the submission documentation.

•You will make the determination as to which of the available rates to apply to the Highest Aggregate Balance of offshore accounts/assets based on the facts of the disclosure and the guidance in the FAQ's. You do not have the discretion to use rates other than these 3. For the use of the 5% penalty rate, you will need to involve your Area Technical Advisor for guidance and written approval before that rate is used.



•To certify the accuracy and completeness of the HAB amount and the applicable penalty rate you will use the guidance found in the FAQ's.

•FAQ #35 provides the general definition for the HAB. Remember that whether an asset or account is included in the HAB is determined by whether or not there was tax non-compliance with respect to that asset.

•If the taxpayer is compliant for 2010, then the penalty will be based on the HAB for the 2003-2009 years.

•If the taxpayer is compliant for 2009 and 2010, then the penalty will be based on the HAB for the 2003-2008 years.

HAB and Calculating the Offshore Penalty

OFFSHORE PENALTY COMPUTATION

	2003	2004	2005	2006	2007	2008	2009	2010
Acct #1	$1,000,000	$1,100,000	$800,000	$800,000	$800,000	$700,000	$600,000	
Acct #2			$400,000	$500,000	$600,000	$500,000	$400,000	
Total	$1,000,000	$1,100,000	$1,200,000	$1,300,000	$1,400,000	$1,200,000	$1,000,000	$0

Highest Aggregate Year		2007
Highest Aggregate Balance		$ 1,400,000
	x	25%
Computation of 25% Offshore Penalty		**$** 350,000

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•Let’s look at a simple example to note the general rule for determining the Highest Aggregate Balance and calculating the Offshore Penalty.

•In this example the taxpayer has 2 accounts. The highest aggregate balance of the two accounts occurs in 2007.

•Therefore, the 2007 aggregate balance is multiplied by the general rate of 25% to arrive at the Offshore Penalty amount.

•Note in this example that there are no account balances shown for 2010. This would occur if the taxpayer is tax compliant in 2010---the account balances for that year would be excluded from the highest aggregate balance determination.

HAB and Calculating the Offshore Penalty

- FAQ #31: Use foreign currency exchange rate at the end of the year; value each account separately
- FAQ #32: Include **individual and business** accounts in the HAB
- FAQ #33: No amount of unreported income is considered *de minimis* in determining whether there has been tax non-compliance (and, therefore, if the account/asset is included in the HAB)

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Other FAQ's, 31 through 41, provide additional guidance on calculating the Offshore Penalty

HAB and Calculating the Offshore Penalty

- FAQ #34:
  - Gains realized on foreign transactions prior to 2003 are not included in the voluntary disclosure
  - If the proceeds remain offshore during the 2003-2010 period, they will be included in the HAB

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•The transactions prior to 2003 are outside the scope of this program.

•If the proceeds of the pre-2003 transaction were repatriated and were not offshore after December 31, 2002, they will not be included in the base for the 25% offshore penalty.

HAB and Calculating the Offshore Penalty

- FAQ #36: Non-income producing assets located offshore, land and artwork ---
  - If purchased with untaxed funds subject to U.S. tax, will be included in HAB
  - Acquired with after-tax funds and no income produced, will not be included in HAB
  - Taxpayer required to report any current income/gains on disposition that may occur in future periods

Course 45922 - OVDI 2011 Training for examiners new to OVD - Session 1 38

Per slides:

HAB and Calculating the Offshore Penalty

- FAQ # 37: If taxpayer can establish funds were transferred between accounts, any duplication will be removed from the HAB
- FAQ # 38: If the taxpayer has only mere signature authority over an account, it will be treated as unrelated to tax noncompliance and not included in the HAB; be aware of other scenarios related to “signature authority” which will result in a different answer

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A taxpayer may assert that they have only “signature authority” over the account, when they may actually have beneficial control, such as the other scenarios under FAQ #38:

1.The account over which the taxpayer has signature authority is held in the name of a related person, such as a family member or a corporation controlled by the taxpayer;

2. The account is held in the name of a foreign corporation or trust for which the taxpayer had a Title 26 reporting obligation;

3. The account was related in some other way to the taxpayer’s tax non-compliance.

In these cases, if the taxpayer is determined to have a direct or indirect beneficial interest in the account, the taxpayer will be liable for the 25% offshore penalty if there is unreported income on the account. (If no unreported income from the account, then no penalty will be imposed.)

HAB and Calculating the Offshore Penalty

- **FAQ #39:**
  - Parents who have a jointly owned foreign account on which the children are signatories; HAB determined at the parents' level
  - Only a single 25% penalty
  - Children should file FBAR's

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Per slides

HAB and Calculating the Offshore Penalty

- **FAQ #40:**
  - Multiple taxpayers are co-owners of a single offshore account; each taxpayer who makes a voluntary disclosure will be liable for the Offshore Penalty based on his percentage of the HAB of the account
  - Any co-owner who does not make a voluntary disclosure may be examined under regular examination procedures

Per slides

HAB and Calculating the Offshore Penalty

- **FAQ #41**:
  - Multiple individuals with signature authority over a trust account; only one 25% Offshore Penalty on the HAB of the trust account
  - Penalty may be allocated among taxpayers with beneficial ownership making the voluntary disclosures in any way they choose

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The taxpayers may allocate the penalty between the owners of the account in any manner they choose, but they must account for 100% of the HAB of assets in the trust's accounts.

Reduced Offshore Penalty Rates

- **FAQ # 53: 12.5% rate**
  - HAB in each of the years covered by the 2011 OVDI is less than $75,000
  - Examiners have no authority to negotiate a different offshore penalty percentage

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•Once you have certified the Highest Aggregate Balance of offshore accounts and assets, you must apply the correct penalty rate to arrive at the Offshore Penalty amount.

•25% is considered the general penalty rate, however, there are two other rates available for specified fact patterns, 12.5% and 5%.

•The 12.5% rate applies when the HAB for any of the years is less than $75,000.

Reduced Offshore Penalty Rates

- FAQ #52: 5% rate
  1. Applies to taxpayers who meet all four conditions:
     a. Did not open or cause the account to be opened (unless bank required a new account to be opened, rather than allowing a change in ownership of an existing account, upon the death of the owner of the account);
     b. Have exercised minimal, infrequent contact with the account;
     c. Have, except for withdrawing funds to close account and move assets to the U.S., not withdrawn more than $1,000 from the account in any year covered by the voluntary disclosure; **and**
     d. Can establish that all applicable U.S. taxes have been paid on funds deposited to the account.

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•In the taxpayer's submission, you may see that they have provided an offshore penalty computation using the 5% rate. This will give you advanced notice that you will be discussing the 5% conditions and to look to FAQ #52 for additional examples of how these conditions apply.

•Whether the 5% penalty applies, is more complex than the straight-forward bright-line guidance for the 12.5% rate and before using the 5% rate, you must have your Area Technical Advisor's approval.

•Often, Counsel, as well as the Technical Advisor, will be involved in making the decision to approve the 5% rate.

•The first 5% scenario requires that the taxpayer meet all four of these conditions

•In 2009 OVDI, this rate was most often approved for taxpayers who inherited an offshore account. But, remember to get your TA's approval before applying.

Reduced Offshore Penalty Rates

- **FAQ #52: 5% rate (continued)**

  2. Applies to taxpayers who are foreign residents and who were unaware they were U.S. citizens:

  Example: The taxpayer was born in the U.S. to parents of foreign citizenship; grew up in a foreign jurisdiction, unaware she had been born in the U.S. Taxpayer has never filed U.S. returns or FBAR's. She became aware she was a U.S. citizen when she had to get a birth certificate in order to obtain a passport from the foreign jurisdiction where she resides. She is entitled to the reduced 5% offshore penalty.

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•The second condition under which the 5% penalty will apply impacts foreign residents who are unaware they are U.S. citizens.

•You may hear the term “Accidental Citizen” applied to taxpayers meeting this fact pattern.

Reduced Offshore Penalty Rates

- **FAQ #52: 5% rate**
  3. Applies to taxpayers who are foreign residents who meet these conditions for all years of their voluntary disclosure:
     - Taxpayer resides in a foreign country;
     - Taxpayer has made a good faith showing that they have timely complied with all tax reporting and payment requirements in the country of residence; <u>and</u>
     - Taxpayer has $10,000 or less of U.S. source income each year.

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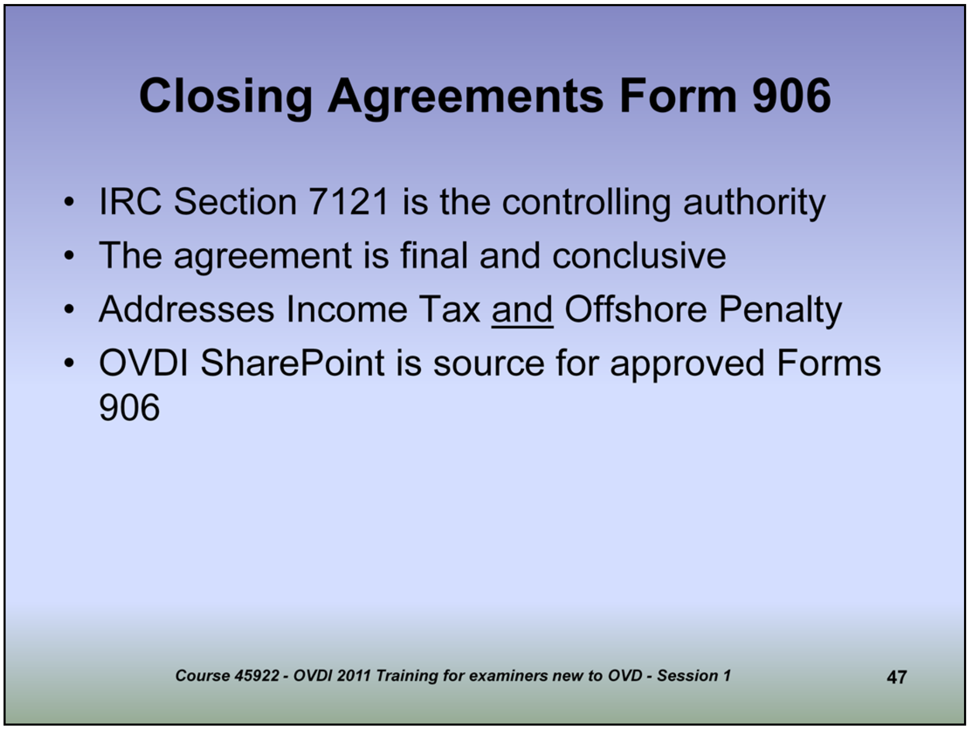
•There is a third condition under which the 5% penalty may apply, if the taxpayer meets the requirements of this 3-pronged test. There are several examples in the FAQ's which will help you determine if this condition applies.



•After you have certified both the income tax aspect of the case and the Offshore Penalty amount, you will prepare a closing agreement to incorporate your findings

•The closing agreement is prepared on Form 906. In the OVDI program, the language in the closing agreement has been standardized and previously approved by Counsel. The approved closing agreements are found on the OVDI SharePoint site and must be used in this program.

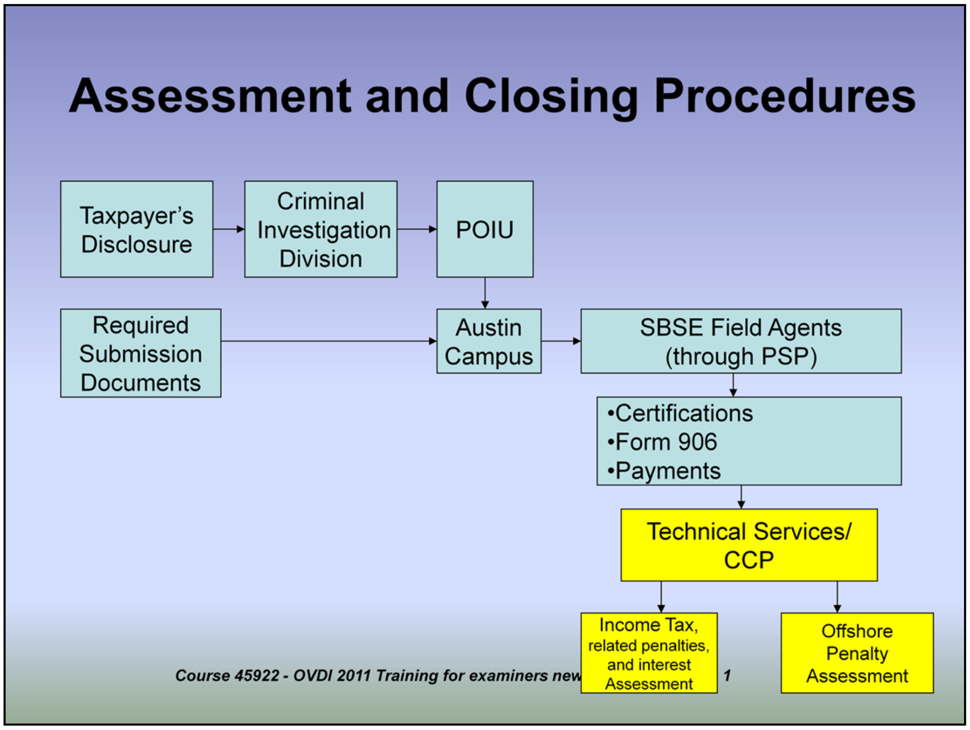
•You cannot use a closing agreement not previously OVDI-authorized nor any closing agreement with additions or deletions from the OVDI-authorized closing agreements language.

•The first and final paragraphs are authorized by the code and related regulations. The first paragraph defines the "person" entering into the agreement. The final paragraph states the finality of the agreement and should be on the same page with both party's signatures.

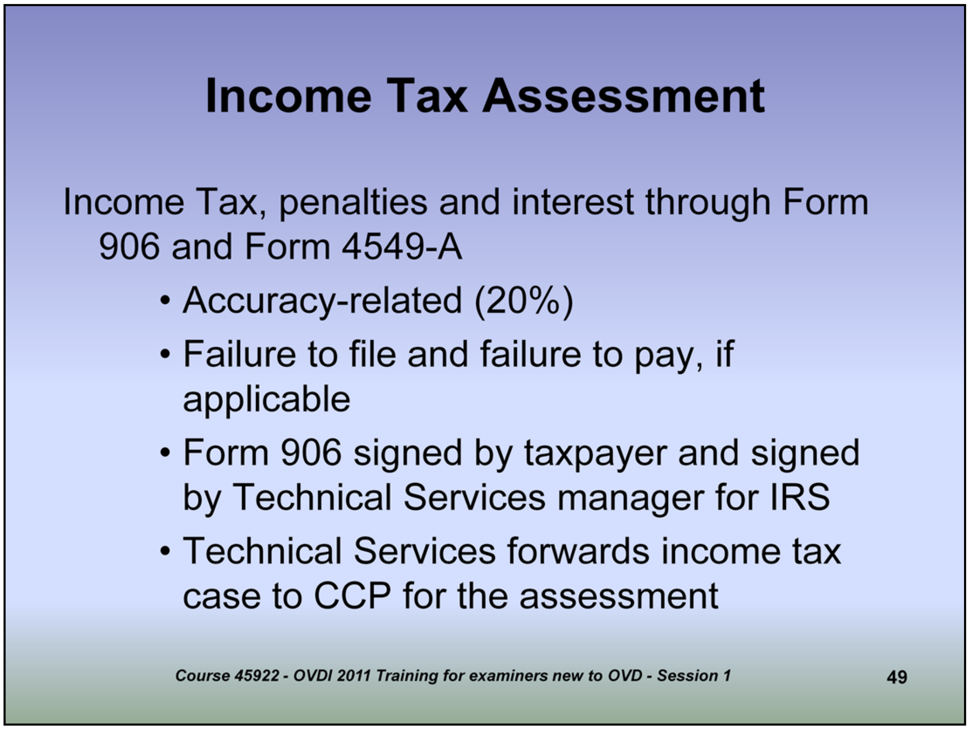
•The customized language between these paragraphs has been carefully constructed to address the terms of the OVDI program and to address the income tax and miscellaneous offshore penalty aspects of these cases.

•Because of the finality of the agreement, it is critical that you use the approved OVDI forms and language on Form 906. And, as you will later learn, special language addressing PFIC's and/or Foreign Tax Credits added to the

Form 906 will have to be approved by your Technical Advisor before issuing to the taxpayer.



Finally some comments about what happens to the case after you have completed the Certification and obtained the taxpayer's agreement/signature on Form 906.



•The signed Form 906 issued to the taxpayer will incorporate the results of your Certification and the information contained on Form 4549-A.

•After the taxpayer signs Form 906 and pays the additional amounts due per the agreement, you will close your case to Technical Services.

Penalty Assessment

Offshore Penalty through Form 906 and Form 8278

- Separate case file (from income tax)
- Sent with income tax file to Technical Services
- Use Miscellaneous Civil Penalty procedures-Form 8278
- Technical Services forwards to CCP for assessment

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•You will prepare a separate case file for the Offshore Penalty. That case will be forwarded to Technical Services with the Income Tax case.

•Technical Services will forward the case for assessment of the Offshore Penalty.

e-trak VDP

- Database used to capture information related to banks, financial institutions, secrecy jurisdiction promoters, and tax professionals assisting taxpayers to move assets offshore
- Maintained by the POIU (Philadelphia Offshore Identification Unit)
- Revenue Agents should update with available case information; do not wait until the case is ready to close

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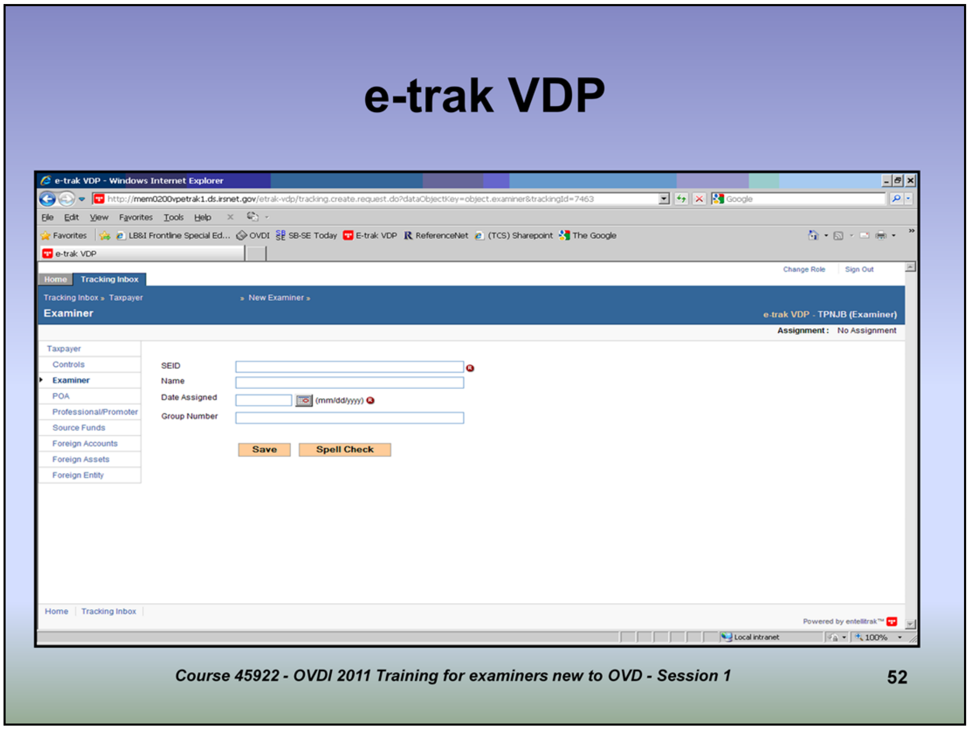
•Some other administrative issues to address:

•Gaining access to e-Trak and recording case information into the database.

•Managers required to review e-Trak information for completeness before cases are closed.

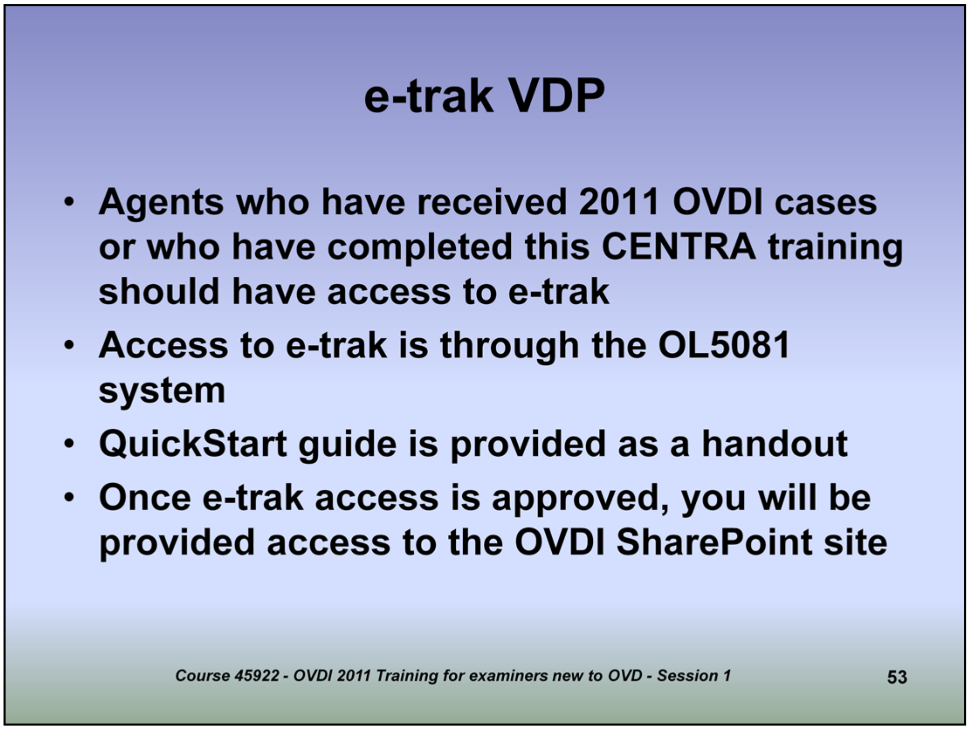


•You log into e-trak with your “LAN” login information: SEID and LAN password, no new password is required.

•As shown on this screen, one of the first e-trak tasks you should undertake includes updating the database for your cases with your information. This information will help AUSTIN, the POIU, and/or other Revenue Agents be able to locate who currently has a case in order to forward additional taxpayer submission information or identify controls on related cases for example.

•If you will look on the left hand side of the screen. You will see the other screens and types of information you will be adding to e-trak. For your cases you will complete the information on POA’s, Promoters, if any, the source of the offshore funds, information on the foreign accounts, and detailed information on foreign assets (other than the financial accounts) and foreign entities, if applicable to your case.

•You should continue to update e-trak with this information as your certification progresses and/or new account and asset information is identified. It should not be a one-time task that waits until your case is ready to close.



If you have received OVDI cases, you should have previously applied for access to e-trak. However, if you do not have access to e-trak, whether you have been assigned cases or not, once you have completed this CENTRA course, you should apply for e-trak access.

You complete an on-line5081 in order to be approved to access e-trak.

Instructions for completing the OL5081 and how to use e-trak were provided in the hand-outs to this presentation, the "QuickStart" guide. You will no longer have access to e-trak if you do not access every 45 days. If that happens, you will have to enter another OL5081 to regain access.

Once you have been approved for e-trak access, you will also be approved for access to the OVDI SharePoint.

Sources of Information for 2011 OVDI

- **OVDI SharePoint**
  - Approved Forms 906 (most current versions)
  - Job Aids
  - Updates on procedures

- **irs.gov : Search "2011 OVDI"**

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•Before concluding this presentation, please note these two sources which will be your primary research sources

Each site has the most current information on 2011 OVDI and should be checked on a routine basis to ensure you are using the most current forms and relying on the most current information.

On the OVDI SharePoint you will find the most current versions of approved Forms 906-the only versions you should be using. You will also find Job Aids to help with the preparation of Forms 906, and information on PFIC's and foreign tax credits, for example. Using this site should become a habit and the first place to look for answers to your questions about OVDI cases.

•The National OVDI SharePoint directory also includes a contact list of each Area's Technical Advisors and OVDI Coordinators. In addition to the required approvals and reviews that the Technical Advisors are required to perform, they are also a resource to you to help you reach answers on unusual fact patterns or other types of cases where you are unable to find the answers through these resources.

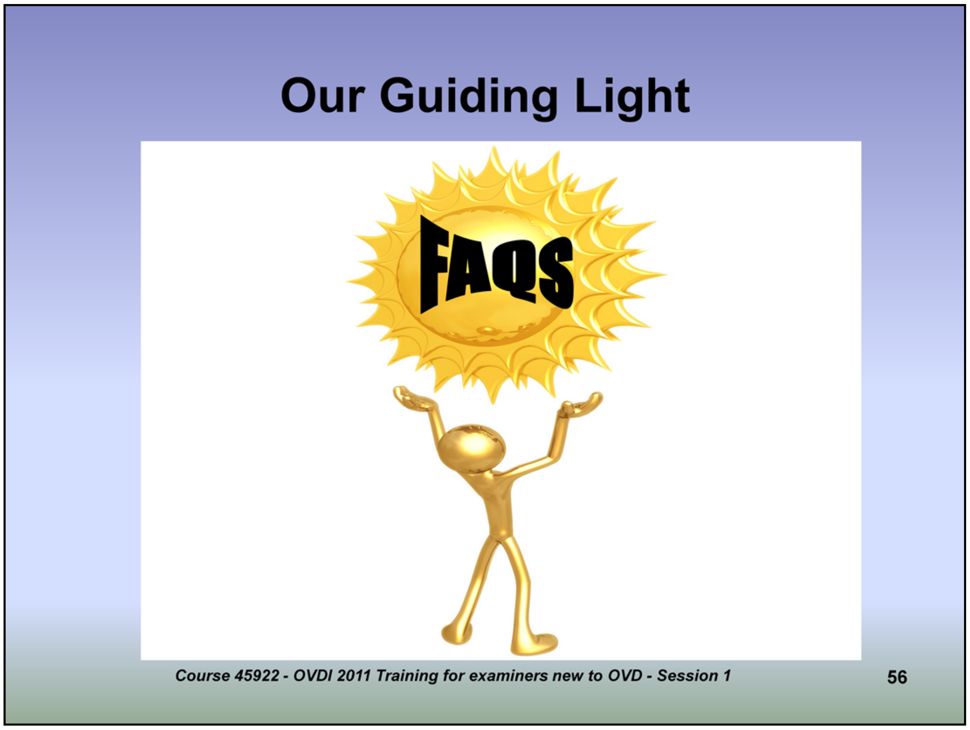
•Irs.gov is where you should go to find the most current, updated FAQ's, as well as archived and current public information and announcements about the OVDI programs.

•This concludes theTerms of the 2011 OVDI program presentation. The next presenter is (b) (6) [redacted] who will be discussing the FAQ's.

(b) (6)

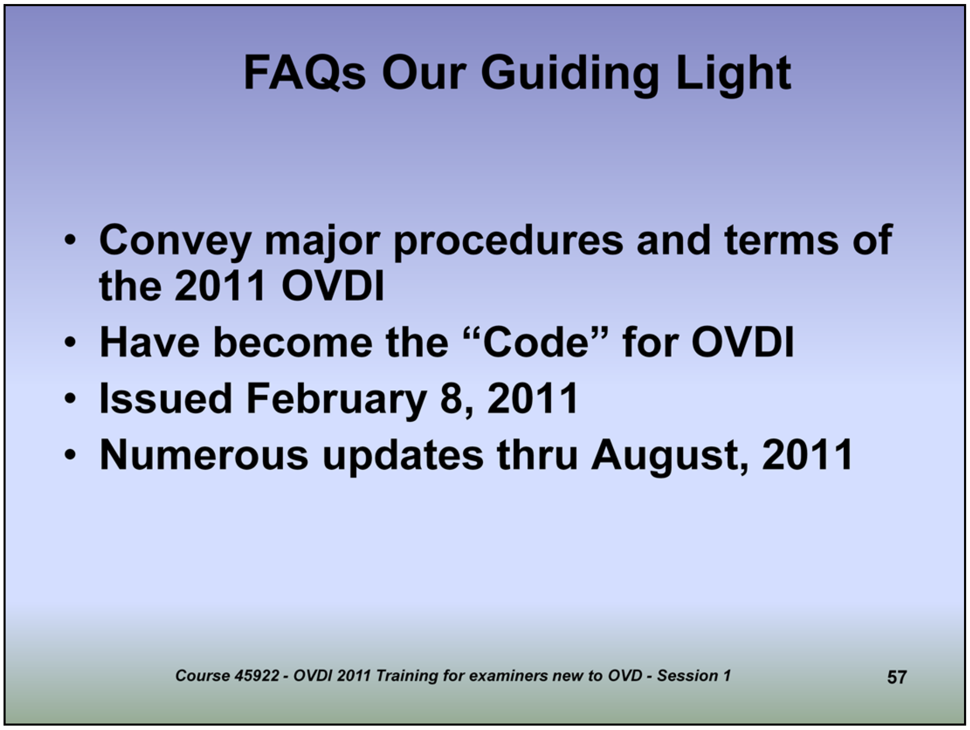
[redacted]

Western Exam Area



I'm (b) (6) [redacted] in Western Area…

We will now be discussing the FAQs for the 2011 OVDI program. Hopefully you have read over these FAQs and have a basic understanding of what they contain. We will spend the next little while going over the FAQs so that you have a working knowledge of what they contain.



The FAQs for the 2011 OVDI are in place to help convey the major procedures and terms of the program.

The FAQs have become for the Voluntary Disclosure program what the Internal Revenue Code is for your regular audits. You and the representatives will be citing these FAQs continuously throughout your certifications. The more familiar you are with the FAQs the better you will be able to discuss these cases with the representatives. A lot of these FAQs were used in the 2009 OVDP, so the representatives are familiar with them, so now it is up to you go learn these FAQs and apply them to your cases.

The 2011 OVDI was announced on February 8, 2011. Simultaneously, the FAQs were released to help everyone understand the terms of the new program. If you look at the first page of the FAQs, you will see a list of updates that have been made to the FAQs since they were released. You will also be able to see that there were numerous updates with the most recent updates being listed first. Currently the most recent update was August 2011.

Sections of FAQs

The FAQs for the 2011 program have been organized into sections. This should make it easier to locate a specific FAQ. The first section is the

Overview - These questions related to:

•Why was the initiative was announced

•What are the objectives of the initiative,

•How does this differ from the 2009 OVDP

•What are some of the civil and criminal penalties that may apply if the taxpayer does not come into the program

Key features of Initiative- This sections covers:

•What are the terms (what must the taxpayer do) of the 2011 program.

•Penalty framework

•Years covered

•PFIC and Alt PFIC options

Eligibility for this Initiative

•As the heading states this section covers Who is eligible and ineligible to file

•Who should file a Voluntary Disclosure; and

•Who should not file a voluntary disclosure but just file the information returns

2011 OVDI Process

•How to make a voluntary disclosure

•What documents are to be provided

•How to request an extension

•How will it be processed and how long will it take

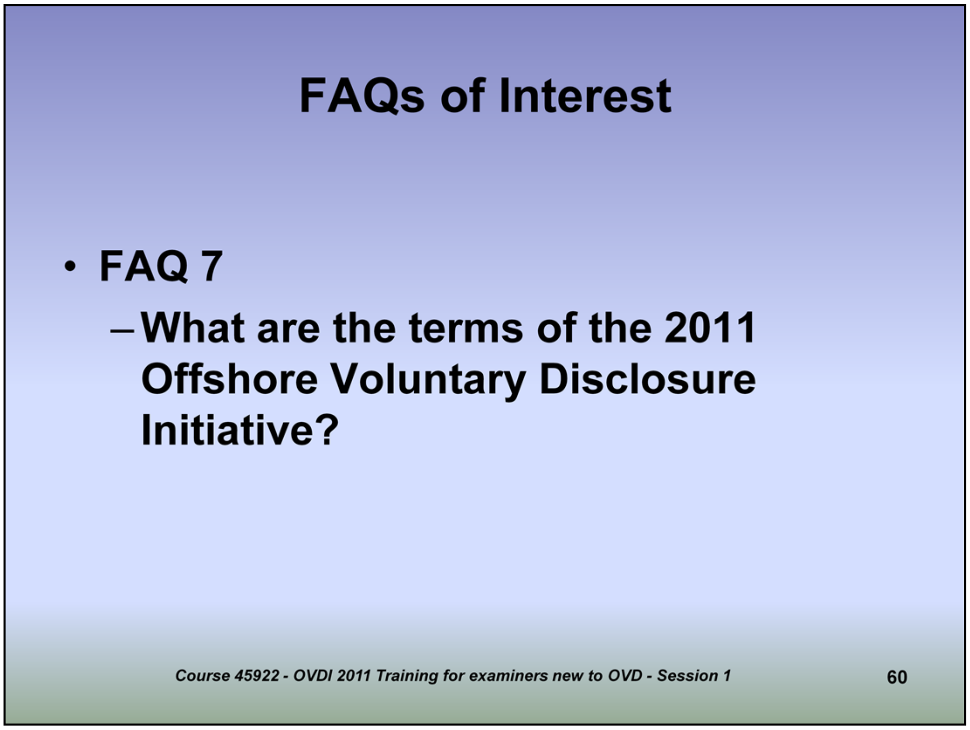
•What to do if records are hard to acquire.

Sections of FAQs

- **Calculating the Offshore Penalty (31-41)**
- **Statute of Limitations (42-43)**
- **FBAR Questions (44-46)**
- **Taxpayer Representatives (47-48)**
- **Case Resolution (49-53)**

Calculating the Offshore Penalty –
•Conversion rate for foreign currency
•Is there an amount of de minimis unreported income?
•What is the lookback period for computing the penalty
•What kind of assets are included in the penalty base
•Transfers and how they effect the HAB
•Jointly held accounts – who is liable for the penalty
Statute of Limitations
•How can IRS make adjustments after 3 year statute has expired
•Do I need to extend the statute
FBAR Questions
•How to file an FBAR
•Where to get answers to FBAR questions
Taxpayer Representatives
•Responsibilities of the Representatives
•How to complete a 2848 – what items are needed
Case Resolution –These FAQs deal with the exception to the standard 25% offshore penalty.
•Can the agents settle the cases for a lower penalty
•What if the taxpayer disagrees - Is appeals an option?
•When is it a good idea for the taxpayer to Opt Out of the program. With examples
•What happens when a taxpayer opts out.
•Criteria for 5% penalty
•Criteria for 12.5% penalty

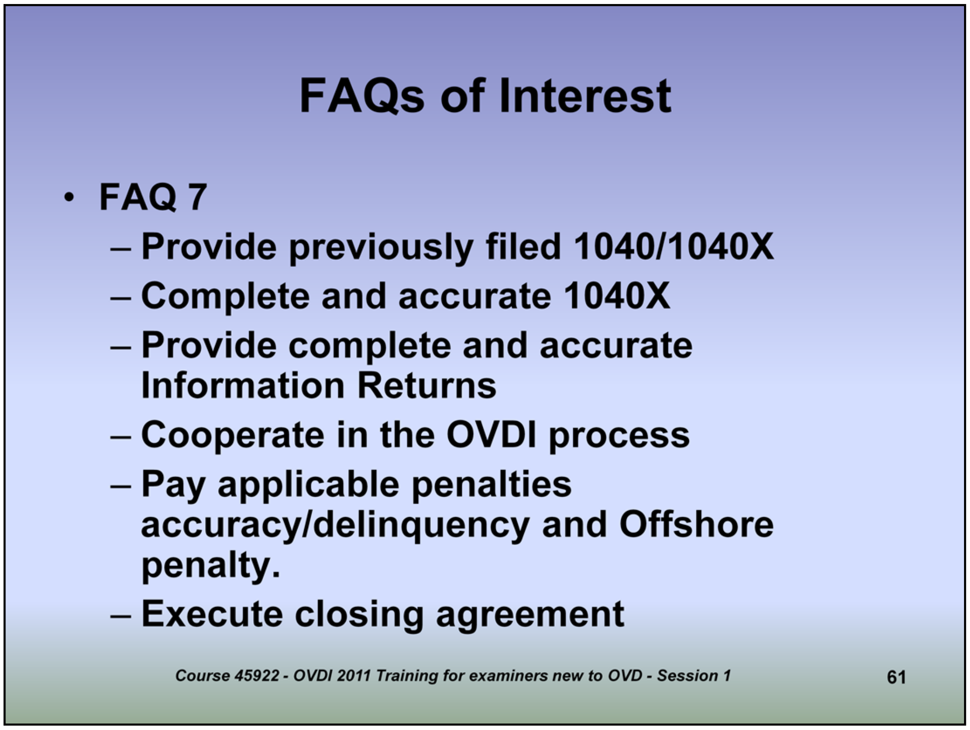
Now that we have discussed the basic outline of the FAQs and how they are organized, let’s look at a the main FAQs that are new to the 2011 program.



FAQ 7

<Read the question>

The content of this FAQ has already been covered by Cassie earlier in the presentation, however, I mention it only to bring your attention to the content of FAQ 7 and not to cover the material again. FAQ 7 explains…



that the taxpayer must:

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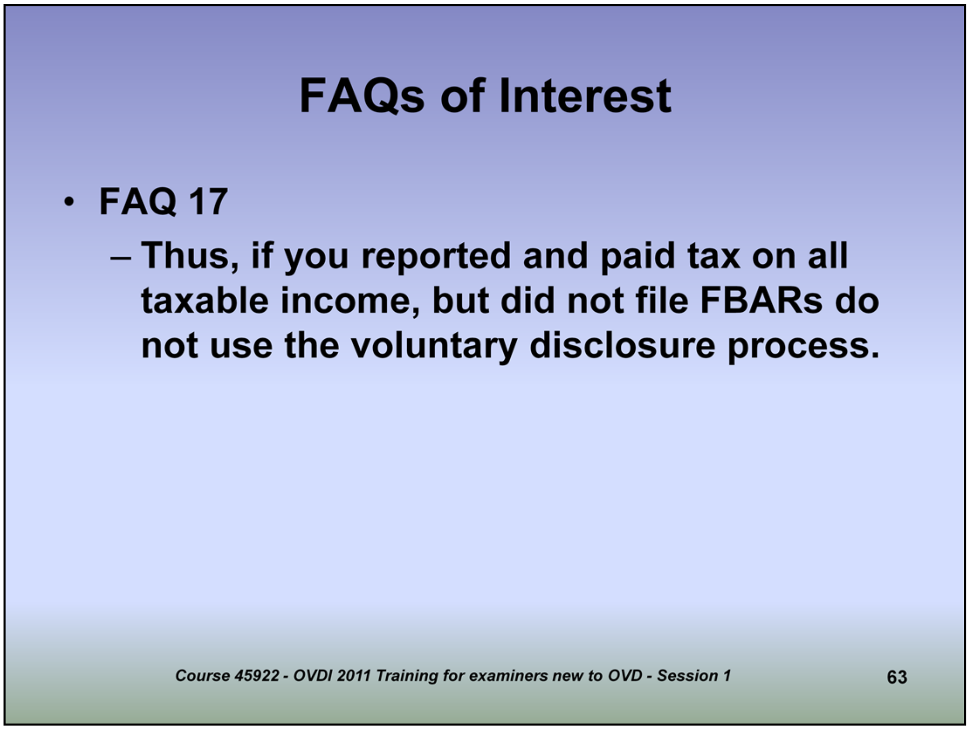
FAQs of Interest

- **FAQ 17**
  - **I have properly reported all my taxable income but I only recently learned that I should have been filing FBARs in prior years to report my personal foreign bank account or to report the fact that I have signature authority over bank accounts owned by my employer. May I come forward under this new initiative to correct this?**

<Read FAQ>

The purpose of the voluntary disclosure is to provide a way for taxpayers who did not report their taxable income in the past to come forward voluntarily and resolve their tax matters.



Since the purpose of the program is to resolve the unreported income tax, the taxpayers who reported their income should not file a voluntary disclosure. In order to correct their FBAR filings the taxpayers should simply file the delinquent FBAR with a statement explaining why the reports are filed late.

If you receive a voluntary disclosure in which all of the income was correctly reported on a timely filed return, then there will be no offshore penalty, however, we will require that the taxpayer file the delinquent FBAR.

The FAQ clearly directs the taxpayer not to file a Voluntary Disclosure, however you might get one of these taxpayers who did come forward and file.

FAQs of Interest

- **FAQ 18**
  - **Question 17 states that a taxpayer who only failed to file an FBAR should not use this process. What about a taxpayer who only has delinquent Form 5471s or Form 3520s but no tax due? Does that taxpayer fall outside this voluntary disclosure process?**

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<read FAQ>

Form 5471 and Form 3520 will be discussed later in this training, but for purposes of this FAQ I will state that these are information returns. The answer to this question is similar FAQ 17 in that these taxpayers should not file a voluntary disclosure, but file the respective delinquent information return along with a statement explaining why the information returns are filed late.

FAQs of Interest

- **FAQ 28**
  - **How long should the process take before it is completed?**

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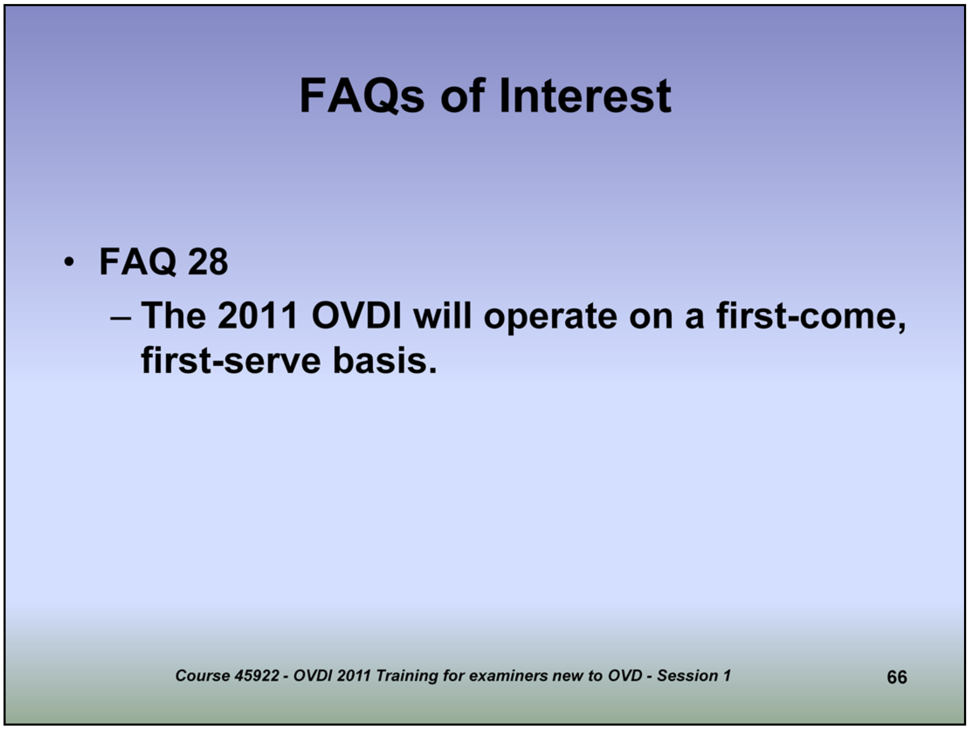
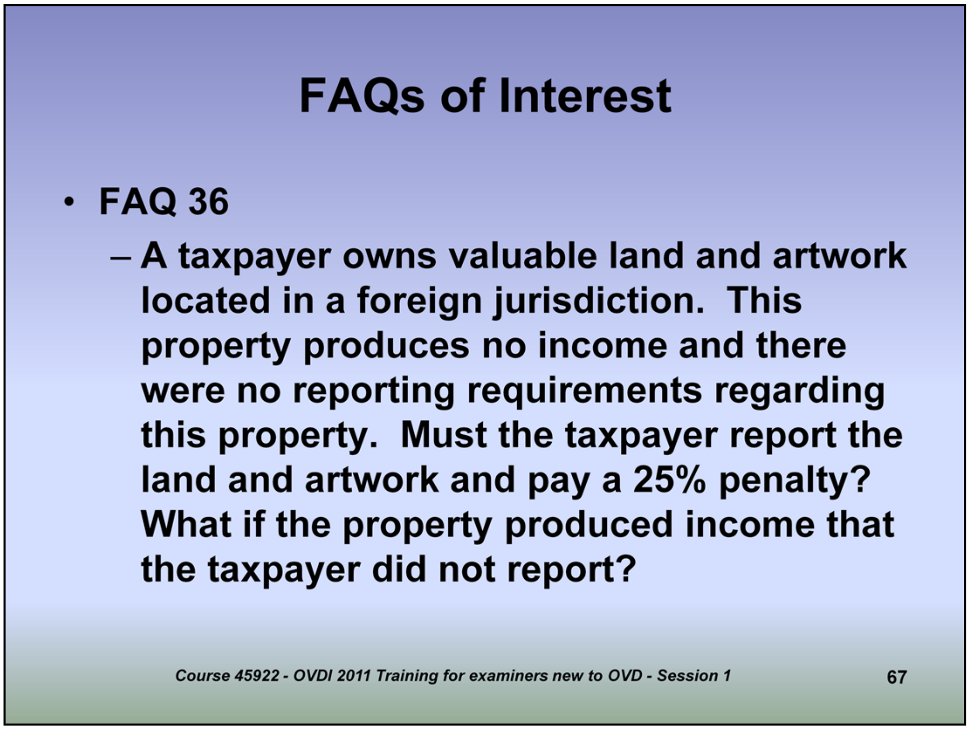


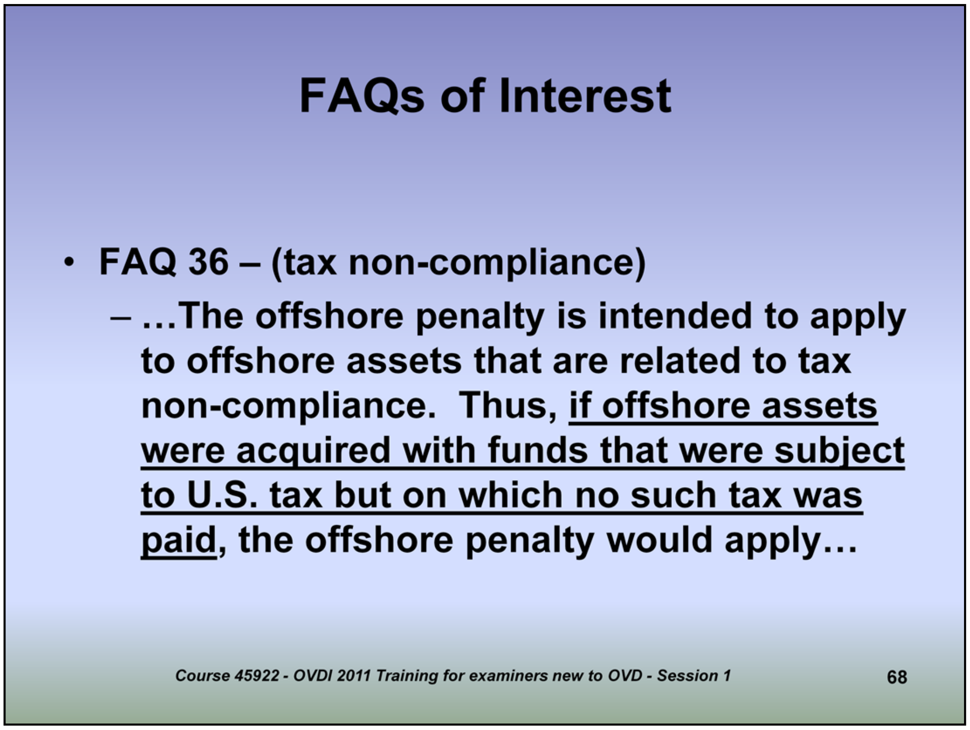
The cases will be assigned to the field in the same order that they were received into the disclosure program.

So the first case you get will be the taxpayers who were the first to file and so on.



<Read FAQ>

I feel that FAQ 36 is important because it lays out the criteria for what is to be included in the offshore penalty. This FAQ provides us with the definition of tax non-compliance. There are two types of tax non-compliance and this FAQ explains both.



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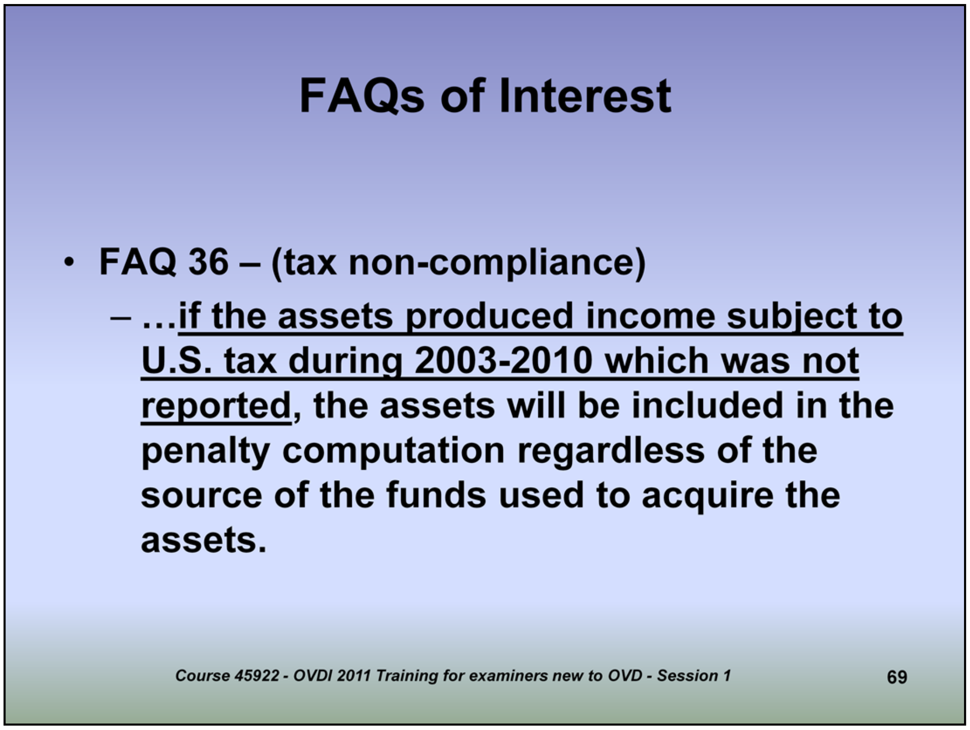
You can see the first part of tax non-compliance as it is underlined on the slide: “if the offshore assets were acquired with funds that were subject to U.S. tax but on which no such tax was paid.”

We first look to the source of the funds to determine tax non-compliance. So if your taxpayer were to purchase a second home located in a foreign jurisdiction, with untaxed funds subject to U.S. tax, then this home would be considered to have tax non-compliance and be subject to the offshore penalty.



The second situation that could cause tax non-compliance is "if the asset produced income subject to U.S. tax during 2003-2010 which was not reported." This will be considered tax non-compliance regardless if the source of the funds had been previously taxed.

So an example of this would be cash. If you taxpayer deposited cash into a foreign bank account, even though the U.S. taxes had previously been paid on these funds, if the interest earned on these funds was not taxed, then the total amount in this account is considered to be tax non-compliant and the offshore penalty applies to the total amont in the bank account.

This two part definition of tax non-compliance is important to understand as it is the basis for determining the offshore penalty. That brings us to our next question…

FAQs of Interest

- **FAQ 35**
  - **What kind of assets does the 25 percent offshore penalty apply to?**

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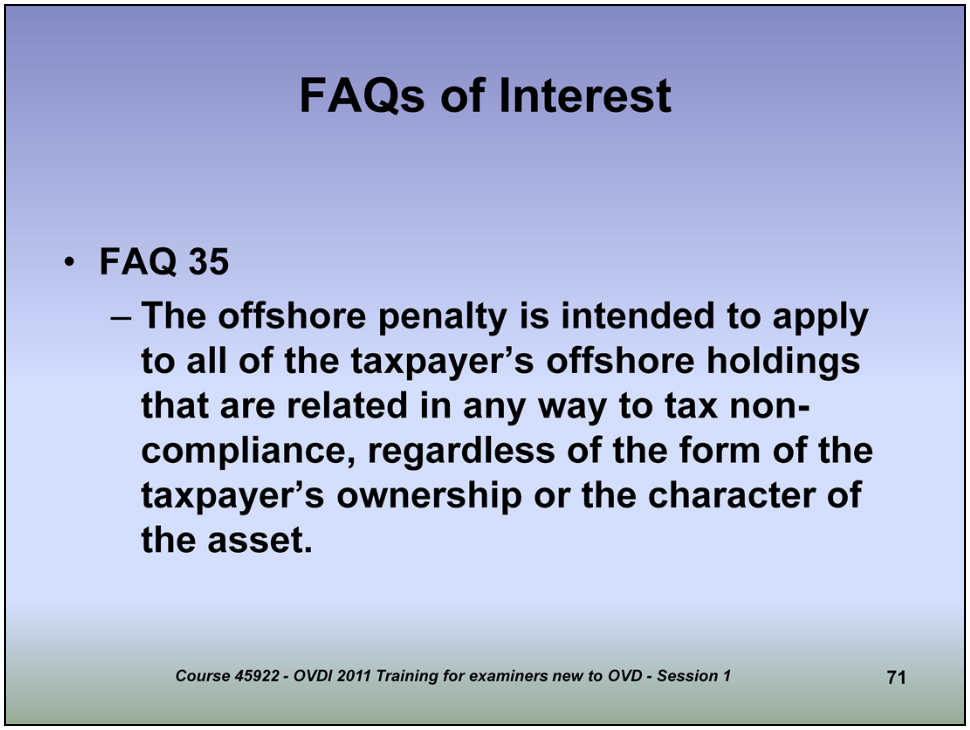
<read FAQ>



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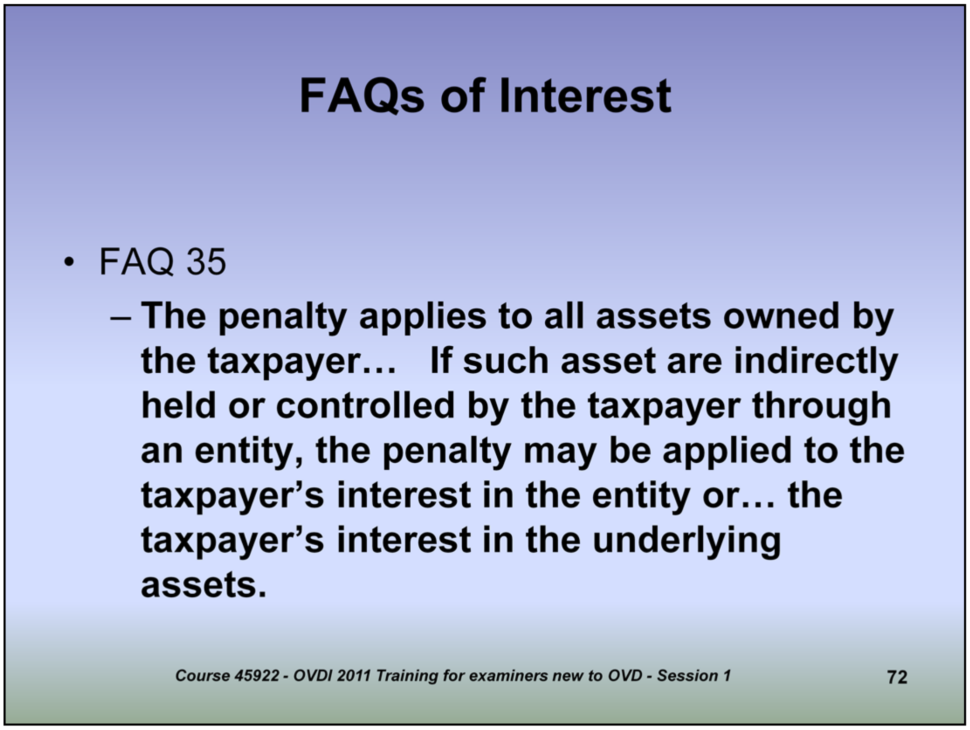
That answer is pretty straight forward. All "offshore holdings that are related in any way to tax non-compliance." Now that we know the definition of tax non-compliance from FAQ 36, we are able to determine which offshore assets are included in the 25% penalty.

The other point this FAQ bring out is the assets are included in the penalty regardless of the form or the character of the asset.



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Let's look at an example to see how this would work.

FAQs of Interest

FAQ 35

- **Example (not in FAQ)**
  - **Rental property located in Germany**
  - **Rental income was not reported on U.S. tax return**
  - **FMV of rental property is $1,000,000**
  - **Mortgage on rental property is $250,000**
  - **What is the penalty?**

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An example to look at for this FAQ would be a rental property located in Germany. The rental property is owned individually by your taxpayer who resides in the United States. The rental property generated revenue that was not reported by your taxpayer on their U.S. income tax return, therefore creating tax non-compliance. Since the asset has tax non-compliance, it needs to be included in the penalty base for the 25% offshore penalty. When I say penalty base, I mean the amount we will multiply by 25% in order to calculate the offshore penalty. The FMV of the property is $1,000,000 and it is subject to a mortgage of $250,000.

What amount do we include in the penalty base? Is it the $1,000,000, or is it something different? (*Theoretically, before we determine the highest aggregate balance we will need the FMV amount for each year, because in determining the penalty amount we have to find the highest aggregate balance of all the assets for each year.)*

For this example, we will only be looking at one year. The FAQ states that we will only include the "**assets owned by the taxpayer.**" In this example, the amount that we would include in the penalty base is the FMV of the property minus any encumbrances on the property, in this case the mortgage. In essence, we would only include the taxpayer’s equity in the property.

FAQs of Interest

FAQ 35

Answer:

FMV	**$1,000,000**
Mortgage	**($250,000)**
Amount subject to offshore penalty	**$750,000**

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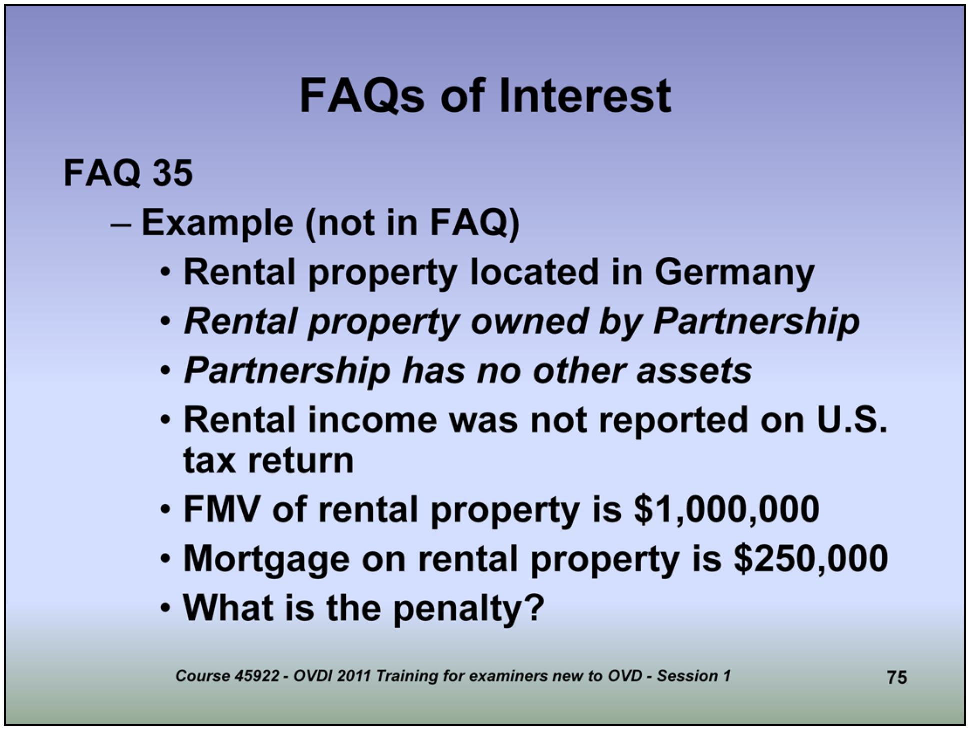
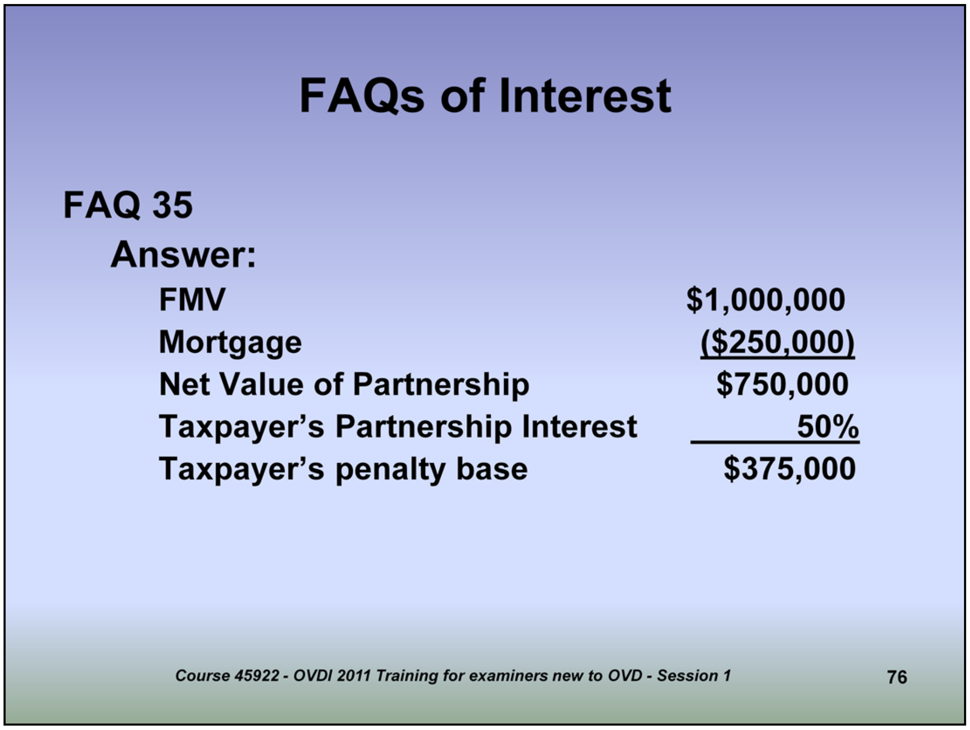
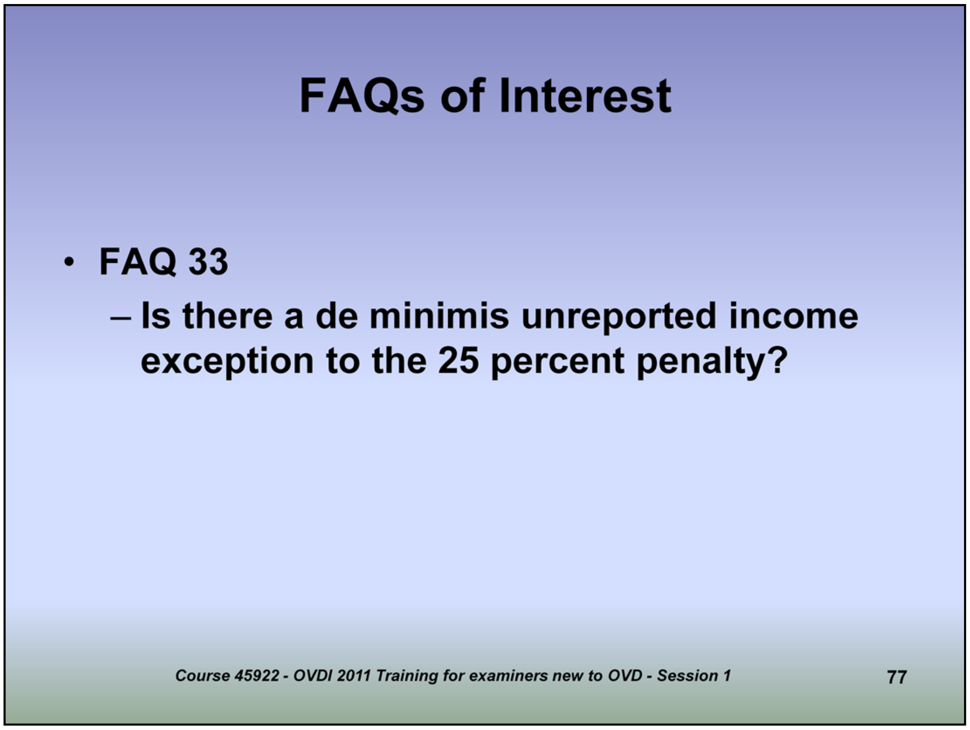
In this example the amount subject to the offshore penalty would be $750,000, since this is what the taxpayer actually owns.



Let's use the same example, except that we are going to say that the asset was owned by a partnership in which your taxpayer owns a 50% interest. The partnership has no other assets. FAQ 35 states that "**the penalty may be applied to the taxpayer's interest in the entity.**" We would have the same type of computation as in the previous example except this time only 50% of the partnership would be included in the penalty base. Since this rental property is the only asset held by the partnership, the calculation of the penalty base will be very similar.



The underlying interest in the asset would be includable in the offshore penalty base. In this example, the net value of the partnership would be $750,000. The penalty would then only be applied to the taxpayer’s partnership interest. In regards to this asset, the taxpayer’s penalty base would increase by $375,000. From here you would add it to any other assets with tax non-compliance that the taxpayer owns in order to determine the Highest Aggregate Balance and compute the 25% offshore penalty.



<Read FAQ>

On our normal audits we have de minimis amounts that we can overlook and not make the adjustment. We can overlook things based upon materiality and not make income adjustments, however OVDI cases are different. The commissioner made a decision during the 2009 program and it is stated here in FAQ 33.

FAQs of Interest

- **FAQ 33**
  - **No amount of unreported income is considered de minimis for purposes of determining whether there has been tax non-compliance.**

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FAQs of Interest

- **FAQ 50**
  - **Will examiners have any discretion to settle cases?**

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FAQs of Interest

- **FAQ 50**
  - **No. Voluntary Disclosure examiners do not have discretion to settle cases for amounts less than what is properly due and owing… Under no circumstances will taxpayers be required to pay a penalty greater than what they would otherwise be liable for under the maximum penalties imposed under existing statutes**

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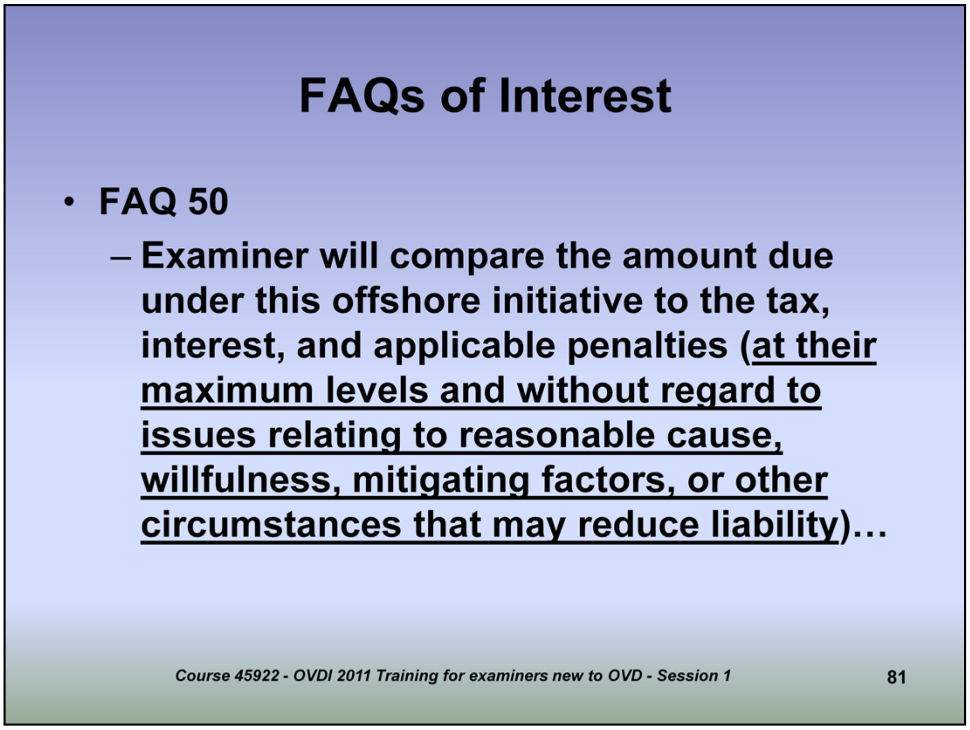
As part of the voluntary disclosure, the 25 percent penalty is a proxy for the FBAR penalty and other penalties imposed under the Internal Revenue Code. The FAQ states that “under no circumstances will taxpayers be required to pay a penalty greater than what they would otherwise be liable.” So how is this done? As has been mentioned earlier in this training, we are doing certifications and not audits. In order to determine what penalties would apply outside this program, there would need to be a determination of willfulness or reasonable cause. It is impossible to gather all of these facts during a certification.



Due to the difficulty of determining reasonable cause, willfulness, and other mitigating factors during a certification FAQ 50 states that the

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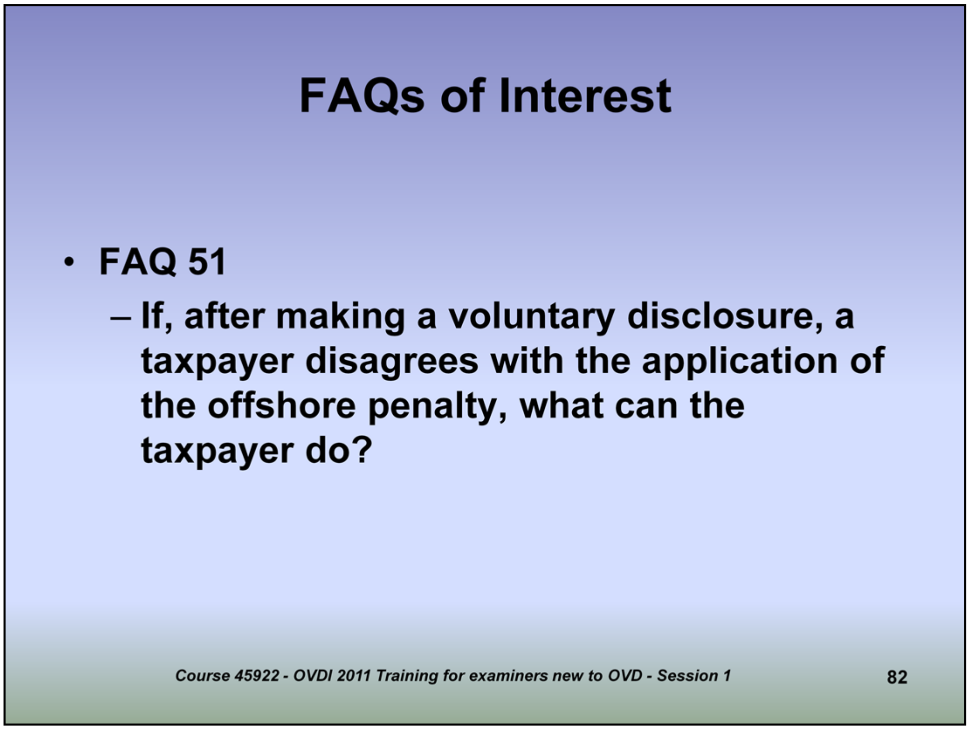
If all of the information return penalties such as FBAR, 5471s, 3520s, etc were computed at their maximum levels, without regard to reasonable cause, willfulness, etc. and they were less than the 25% offshore penalty, then the taxpayer would only be liable pay the lesser penalty under FAQ 50. This penalty, of course, would have to be approved by a Technical Advisor.

If the taxpayer feels that they have reasonable cause or mitigating factors, that would cause the applicable penalties under existing statutes to be less than the offshore penalty, then they have another option. This option is discussed in FAQ 51.



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The taxpayer can opt out of the OVDI penalty structure and be subject to an examination. This way the taxpayer is subject to an examination and therefore all of the facts of the case can be pursued. Penalties can be fully developed in order to determine the actual penalty that would apply to the taxpayer's facts and circumstances. Only in this way can penalties be considered with regard to reasonable cause, willfulness, mitigating factors, or other circumstances that may reduce the penalty. In order for the taxpayer to Opt Out of the Service's Civil Settlement Structure, the taxpayers will need to receive specific closing packages with letters that explain the opt out process and that once made, the decision to opt out is irrevocable.

FAQs of Interest

- **FAQ 51**
  - **…Taxpayers are reminded, that even after opting out of the Service's civil settlement structure, they remain within Criminal Investigation's Voluntary Disclosure Practice. Therefore, the taxpayers are still required to cooperate fully with the examiner by providing all requested information and records and must still pay or make arrangements to pay the tax, interest and penalties they are ultimately determined to owe...**

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Once the taxpayers opt out of the Service's civil settlement structure, they would remain in Criminal Investigation's Voluntary Disclosure Practice.

By remaining in the voluntary disclosure practice, they would be required to cooperate fully. Cooperation is considered to be: providing all the requested information and paying, or making arrangements to pay the tax, interest, and penalties.

If the taxpayers do not cooperate and provide all the information requested, then the case ***may*** be referred back to Criminal Investigations.

Since we are comparing the penalties that would otherwise apply at their maximum levels without regard to willfulness, reasonable cause, mitigating factors, or anything else that would reduce the liability, there are legitimate reasons for the taxpayer to want to opt out of the Service's civil settlement structure. However, there are other taxpayers who would not benefit from opting out of the civil settlement structure and therefore should not opt out.

FAQs 51.1 and 51.2 go on to provide scenarios to illustrate the effect of a taxpayer opting out of the civil settlement structure. Let's look at a few of these scenarios now. We will first start with an example of when it would be beneficial for the taxpayer to opt out of the settlement structure.

FAQ 51.1 Example 2 Unreported Income and Failure to File FBAR

- U.S. citizen who lived abroad in 2007, 2008, and 2009
- In 2007, TP opened foreign account in Country X
- Highest account balance during 2007, 2008, and 2009 was $200,000
- TP filed income tax returns all years
- TP filed FBARs for ’08 and ‘09 but not ‘07

The taxpayer is a U.S. citizen, who lived abroad in 2007, 2008 and 2009. While living abroad, the taxpayer opened an account in 2007 with a bank located in Country X. Assume that the highest account balance during the three years (2007, 2008 and 2009) was $200,000. The taxpayer filed U.S. income tax returns for all years but only filed an FBAR for 2008 and 2009, not for 2007.

FAQ 51.1 Example 2
Unreported Income and Failure to File FBAR

- Taxpayer was unaware of FBAR filing obligations until 2008
- Taxpayer failed to report $2,000 of interest income
- Tax deficiency was $700
- Taxpayer does not otherwise qualify for a reduced penalty

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The taxpayer was unaware of his FBAR filing obligation until having his return professionally prepared in 2008. The taxpayer failed to report approximately $2,000 of interest income from the account, and, is therefore, unable to simply file a delinquent FBAR for 2007 as provided in FAQ 17. (FAQ 17 is similar to FAQ 9 in the 2009 program. FAQ 17 states that if you reported and paid tax on all taxable income, but failed to file FBARs, the do not use the VDP, but file your delinquent FBARs) The tax deficiency was $700. In addition, assume the taxpayer does not otherwise qualify for a reduced penalty under FAQ 52 or 53.

	Civil Settlement Structure	Opt Out and 1 year nonwillful FBAR penalty	Opt out - assume the civil fraud penalty applied
Income Tax Due (not including interest)	$700		
20% Accuracy Penalty	$140		
25% Offshore Penalty	$50,000		
Civil Fraud Penalty	0		
FBAR Penalty	0		
Total	$50,840		

The Offshore Penalty under 2011 OVDI will be $50,000 (i.e., 25% of $200,000). The taxpayer would also be required to pay the tax deficiency for each year, interest on the deficiency, and the 20% accuracy-related penalty on the deficiency.

	Civil Settlement Structure	Opt Out and 1 year nonwillful FBAR penalty	Opt out - assume the civil fraud penalty applied
Income Tax Due (not including interest)	$700	$700	
20% Accuracy Penalty	$140	$140	
25% Offshore Penalty	$50,000	0	
Civil Fraud Penalty	0	0	
FBAR Penalty	0	$10,000	
Total	$50,840	$10,840	

If the taxpayer elected to opt out, the taxpayer will be subject to tax, penalties, and interest on the unreported income and, if, upon examination, IRS determines that the failure to file the FBAR was not willful, the taxpayer will be subject to a non-willful FBAR penalty of no more than $10,000 for failing to file an FBAR for 2007. If IRS determines that the FBAR violation was due to reasonable cause, then no FBAR penalty will be imposed.

	Civil Settlement Structure	Opt Out and 1 year nonwillful FBAR penalty	Opt out - assume the civil fraud penalty applied
Income Tax Due (not including interest)	$700	$700	$700
20% Accuracy Penalty	$140	$140	0
25% Offshore Penalty	$50,000	0	0
Civil Fraud Penalty	0	0	$525
FBAR Penalty	0	$10,000	$10,000
Total	$50,840	$10,840	$11,225

If the civil fraud penalty is determined to be owed, then total amount would increase as the 20% accuracy penalty would not be assessed but the Civil Fraud penalty of $525 (75% of the $700) would apply.

This taxpayer would benefit from opting out of the civil settlement penalty structure, since the 25% offshore penalty would be greater than the penalty would be if a one year nonwillful FBAR penalty and the civil fraud penalty were applied.

FAQ 51.2 Example 4
Large Unreported Gain

- In 2008 taxpayer opened a checking account in Country A with previously U.S. taxed funds
- In 2008 taxpayer failed to report the sale of Apartment building in Country A
  - Sales Price $10 million
  - Unreported Gain $6 million
  - Related tax deficiency was $2.1 million
- $10 million deposited into the foreign bank account.

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The taxpayer, a U.S. citizen, opened a checking account in Country A in 2008 with funds upon which U.S. taxes were previously paid. The taxpayer discloses that he had failed to report the sale, in 2008, of an apartment building in Country A that he owned. The apartment building was valued at $10 million and the taxpayer's unreported gain on the sale was $6 million. The related tax deficiency was $2,100,000. The taxpayer deposited the entire $10 million, from the sale, in the checking account with the foreign bank.

FAQ 51.2 Example 4
– Large Unreported Gain

- $10 Million was the highest aggregate balance during the year and at June 30 of the following year
- A foreign grantor trust was established in 2008
- The building was transferred to the foreign trust prior to the sale in 2008
- The Form 3520 was not filed

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$10 million represented the highest balance in the foreign checking account during the year and was the balance in the account as of June 30 of the following year, the date that an FBAR was due. The apartment building that was sold was held in a foreign trust that was a grantor trust (with the taxpayer as the grantor). The taxpayer established the trust in 2008, just prior to the sale of the apartment building, and transferred the building to the trust. The taxpayer did not file a Form 3520 to report the creation of the trust and the transfer of property into the trust.

	Civil Settlement Structure	Opt Out and 1 year willful FBAR penalty	Opt out - assume the civil fraud penalty applied
Income Tax Due (not including interest)	$2,100,000		
20% Accuracy Penalty	$420,000		
25% Offshore Penalty	$2,500,000		
Civil Fraud Penalty	0		
§ 6677 Penalty	0		
FBAR Penalty	0		
Total	$5,020,000		

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The taxpayer would also be required to pay the $2,100,000 tax deficiency, interest, and a 20% accuracy-related penalty. A 20% penalty on a $2,100,000 deficiency is $420,000. The Offshore Penalty under 2011 OVDI will be $2,500,000 (i.e., 25% of $10 million).

	Civil Settlement Structure	Opt Out and 1 year willful FBAR penalty	Opt out - assume the civil fraud penalty applied
Income Tax Due (not including interest)	$2,100,000	$2,100,000	
20% Accuracy Penalty	$420,000	$420,000	
25% Offshore Penalty	$2,500,000	0	
Civil Fraud Penalty	0	0	
§ 6677 Penalty	0	$3,500,000	
FBAR Penalty	0	$5,000,000	
Total	$5,020,000	$11,020,000	

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If the taxpayer opts out of the civil settlement structure he will still owe tax, penalties, and interest with respect to the $2,100,000 deficiency as the statute is still open on the 2008 tax year. The taxpayer would also be subject to FBAR penalties for all other open years, if the aggregate balance in the checking account exceeded $10,000 during each year.

The IRC § 6677 penalty for failing to file the Form 3520 information return would be an additional $3.5 million (i.e., 35% of $10 million).

If the taxpayer elected to opt out, he could face an FBAR penalty with respect to the 2008 calendar year of $5,000,000 (i.e., a 50% willful FBAR penalty on the balance in the checking account as of June 30, the date that the FBAR was due).

	Civil Settlement Structure	Opt Out and 1 year willful FBAR penalty	Opt out - assume the civil fraud penalty applied
Income Tax Due (not including interest)	$2,100,000	$2,100,000	$2,100,000
20% Accuracy Penalty	$420,000	$420,000	0
25% Offshore Penalty	$2,500,000	0	0
Civil Fraud Penalty	0	0	$1,575,000
§ 6677 Penalty	0	$3,500,000	$3,500,000
FBAR Penalty	0	$5,000,000	$5,000,000
Total	$5,020,000	$11,020,000	$12,175,000

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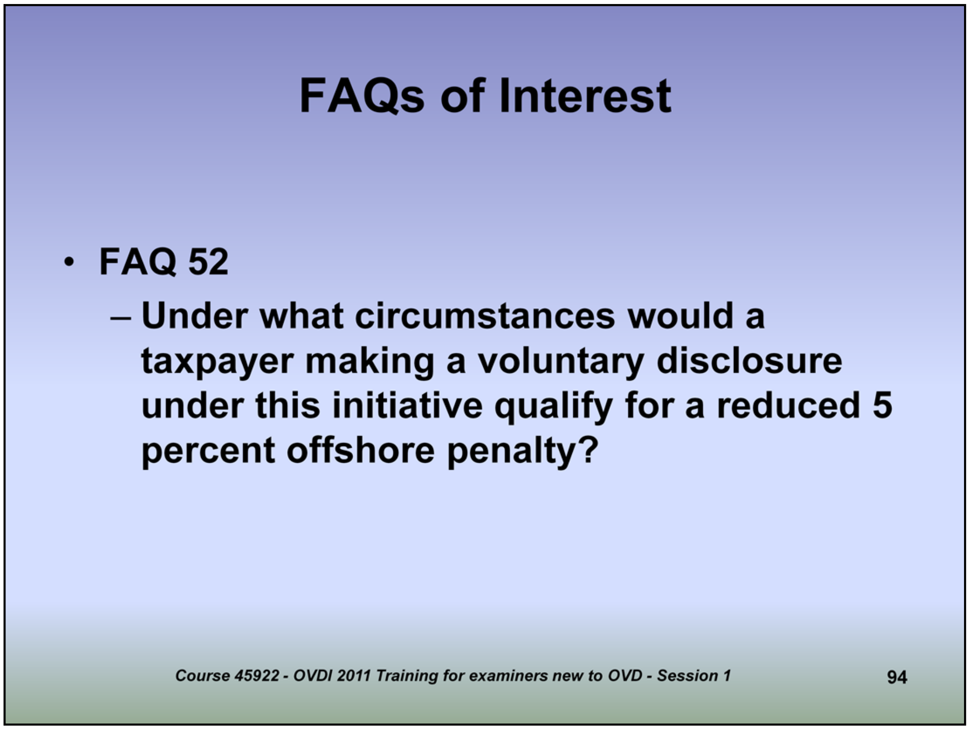
Upon examination, the revenue agent may determine that the nonreporting was due to fraud. In that case, the civil fraud penalty on the $2.1 million tax deficiency attributable to fraud would be $1,575,000 (i.e., 75% of $2,100,000). The IRC § 6677 penalty for failing to file the Form 3520 information return would be an additional $3.5 million (i.e., 35% of $10 million).



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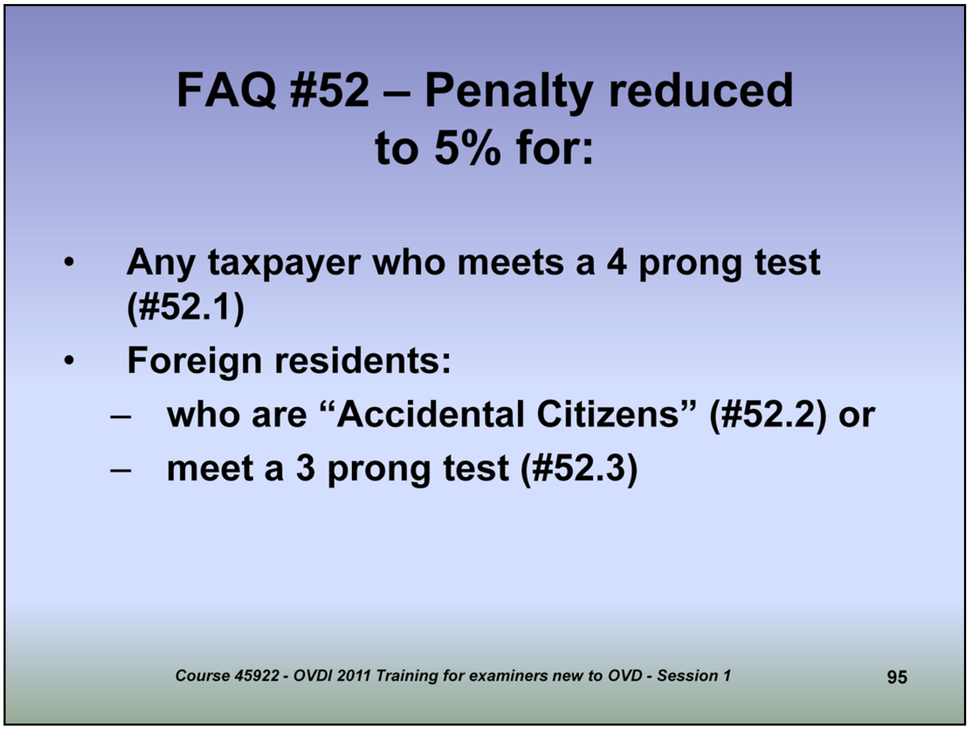
There are three different categories that allow the reduced 5% offshore penalty. If the taxpayer qualifies for any of these categories, then he is allowed the 5% offshore penalty.



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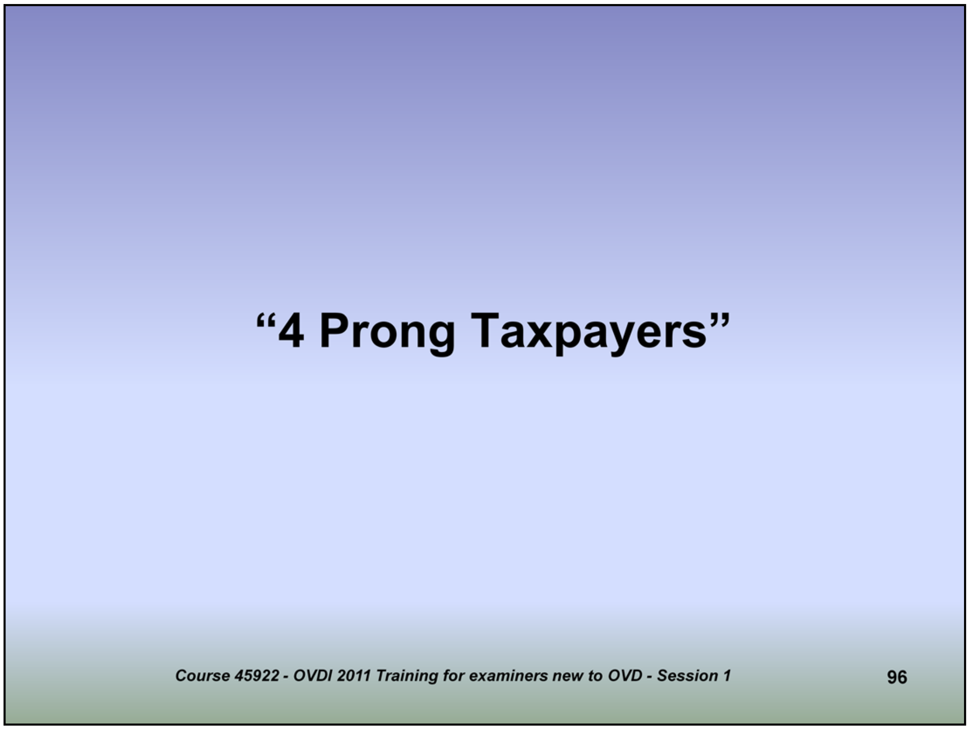
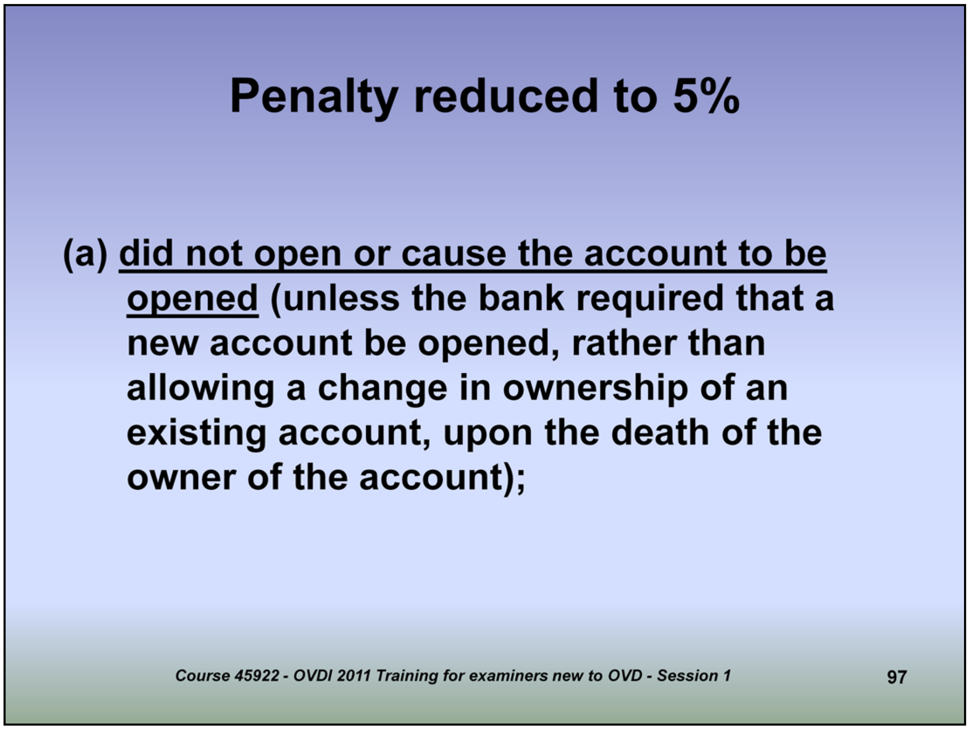
Let's take a look at each one of these in more detail.



The first category that qualifies for the reduced 5% offshore penalty are the taxpayers who meet a 4 prong test



The first test for the taxpayers to meet is that they "did not open or cause the account to be opened."

As you can see on the slide there are some exceptions to this rule. Even if they opened the account they could still be able to get the 5% penalty if the bank "required that a new account be opened, rather than allowing a change in ownership of an existing account, upon the death of the owner of the account."

You will see that this is sometimes the first statement that the representative makes. They automatically states that the new account was opened as a result of a bank requirement. Obviously, if this claim is being made, we need to see some sort of document or be able to "certify" this fact. We need more than just self service oral testimony from the taxpayer or representative. Once we get the documents to show why or how the account was opened, then we can make a better determination concerning this requirement.

Just remember that the normal penalty is the 25% offshore penalty and if the taxpayers feel that they are entitled to the 5% reduced penalty, then that is their burden to prove. They should provide you with the documentation needed. Put it back on them to come up with the documentation needed. You

Technical Advisors will always be there to help you with this issue if the need arises.

That is the first step.

Penalty reduced to 5%

(b) **have exercised minimal, infrequent contact with the account**, for example, to request the account balance, or update accountholder information such as a change in address, contact person, or email address;

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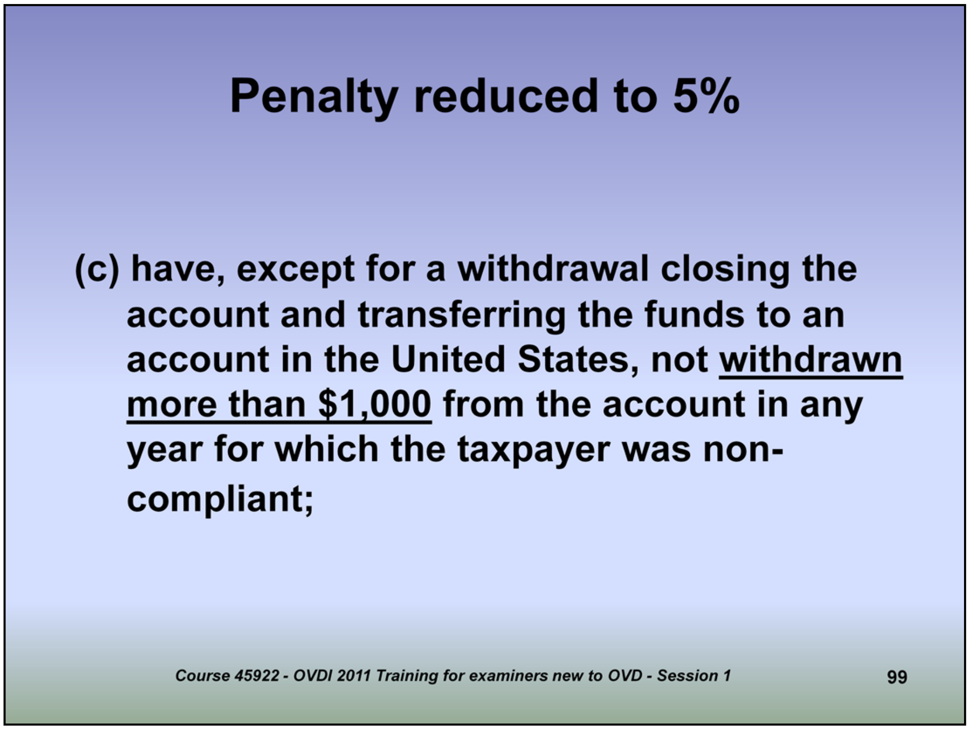
Second test is that they have exercised minimal , infrequent contact with the account. The terms “minimal, infrequent contact” are of course defined very broadly by the taxpayers or the representatives, however, we are holding pretty firm to the examples that are given here.

Minimal contact should be interpreted as contacts only to facilitate communications between the accountholder and the bank. They do not include contacts to exercise control over the account, such as directing the bank to not provide information to the IRS, buy/sell directions, investment strategy or other direct influence over investment decisions.

Otherwise disqualifying acts taken exclusively during periods when the person was not a US taxpayer will not be considered in applying the rules.



The third test is:

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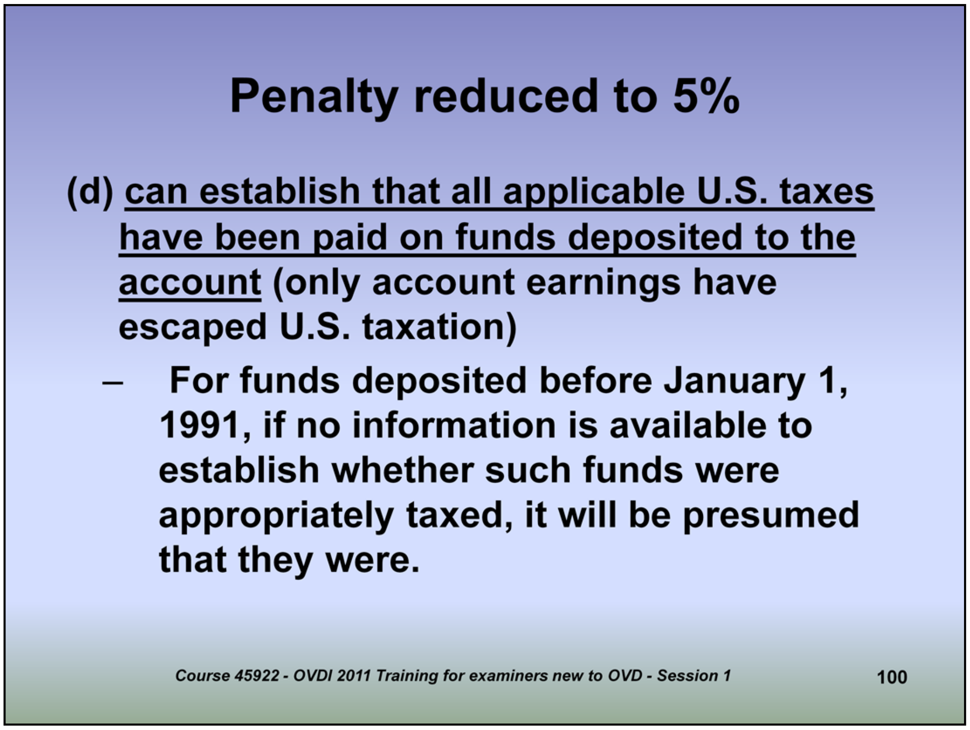
The basic rule for the third test is that they cannot withdraw more than $1,000 in any year with which the taxpayer was non-compliant.

One note to make here is the exception to the $1,000 rule and that is if they closed the account. Not only did they have to close the account, but they had to transfer the funds to the United States. If they closed the account, but moved the funds to another account in a foreign country, then they would not be eligible for the 5% penalty.

We have seen this in the past with UBS clients. They were required by UBS to close their accounts, however not all of them repatriated the money and brought it back to the U.S. Some of them opened accounts in other countries. So if the taxpayer closed the account and did not transfer the money to an account in the U.S., then they do not meet this test.



The fourth test is that the taxpayer

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It states “all applicable U.S. taxes have been paid.” When looking at this criteria, you will need to determine if the source of the funds were taxable in the U.S., if they were, then determine if the applicable taxes were paid. Some of these taxpayers were not always U.S. citizens or resident aliens and therefore the funds might not have been subject to U.S. taxes. If this was the case, then they would pass this test as the “applicable” U.S. taxes have been paid.

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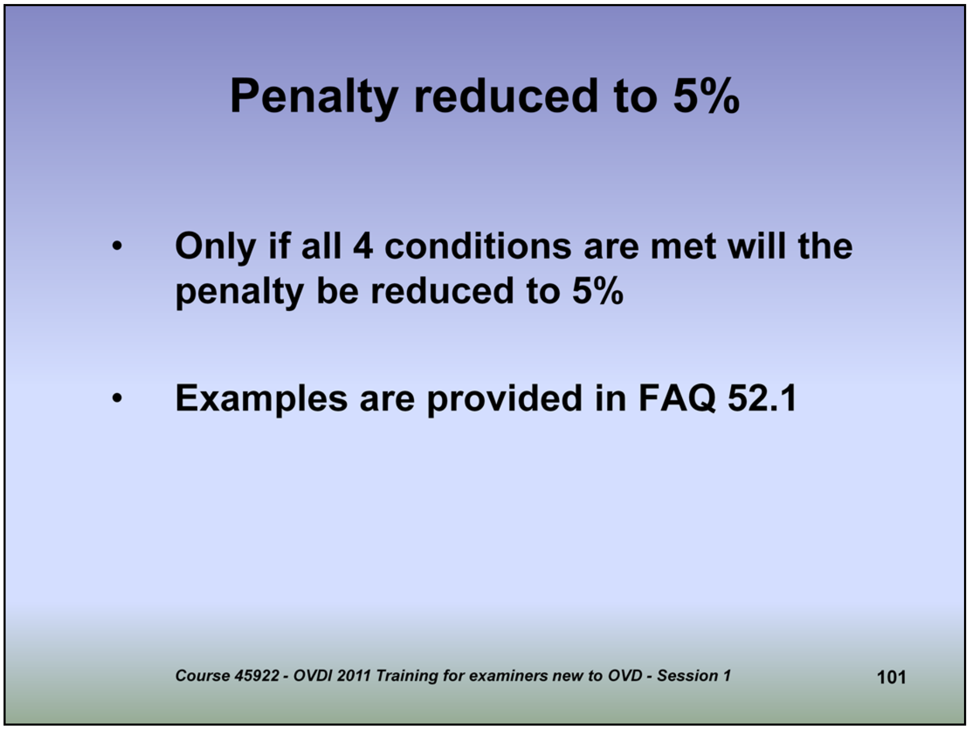
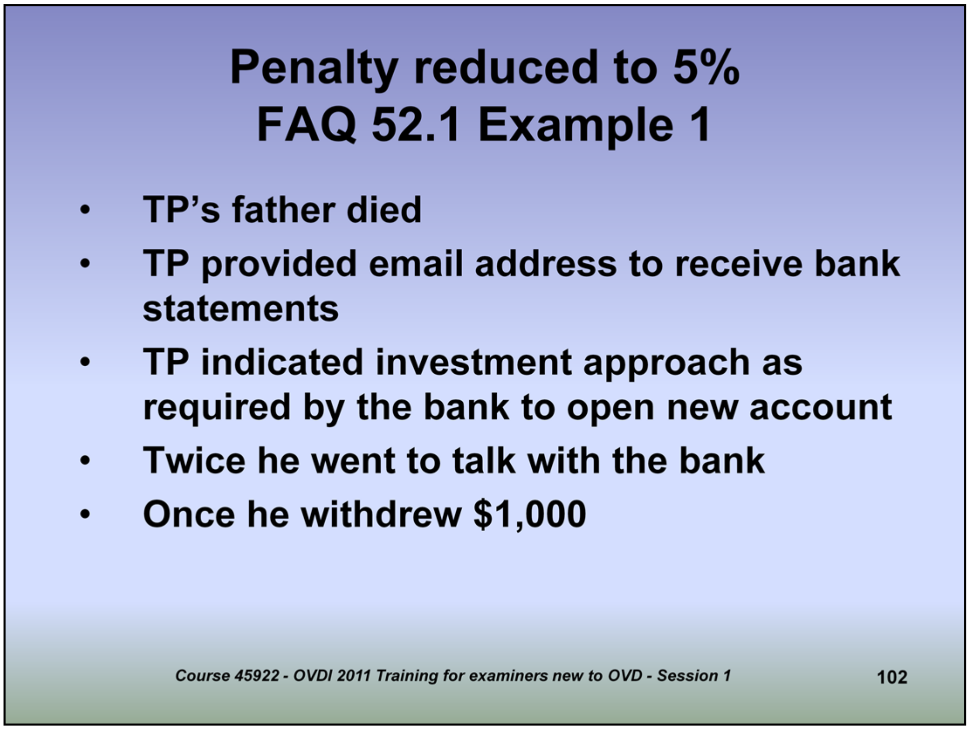
If the deposit was made into the foreign account after December 31, 1990, then the taxpayer would have to show that the funds were appropriately taxed.



All 4 conditions must be met in order to qualify for the reduced 5% penalty. If any of these conditions are not met, then the taxpayer is not eligible for the 5% penalty.

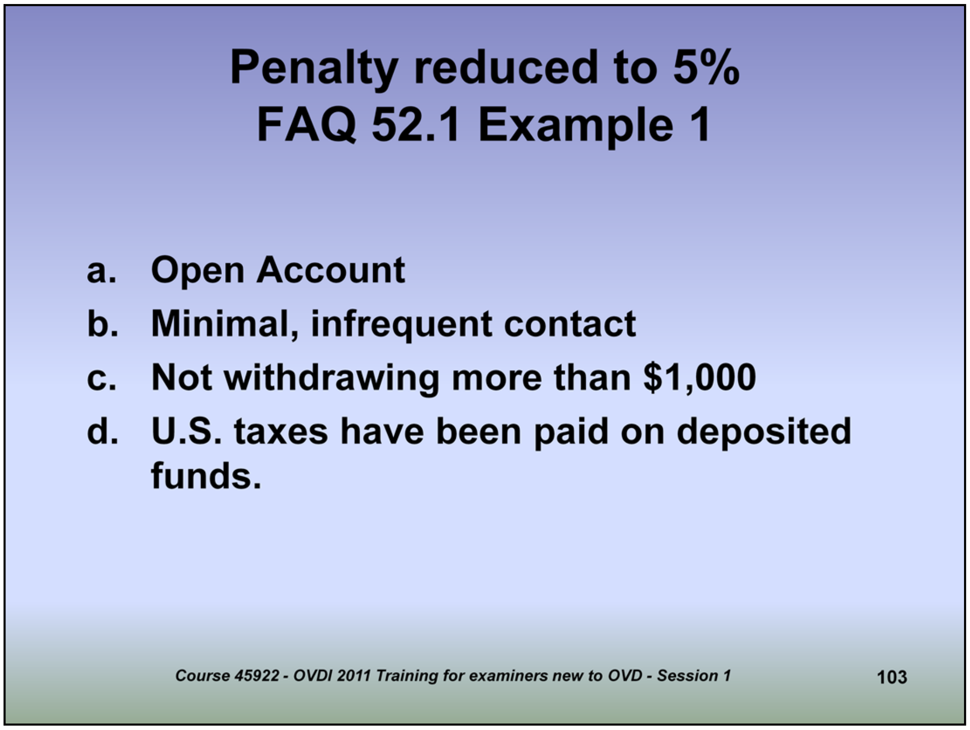
FAQ 52 goes on to provide three examples of how to apply these conditions to either qualify or not qualify for the reduced 5% offshore penalty. Let's look at some examples.



FAQ 52.1 Example 1

When the taxpayer's father died, the taxpayer inherited two offshore accounts. His father's last deposit to the accounts was more than 30 years ago. The taxpayer provided his email address to the bank to receive bank statement by email and indicated an investment approach as required by the bank to open the account in the taxpayer's name. Twice he has been to the foreign jurisdiction and talked to a banker – during one of those visits he withdrew $1,000 from one of the accounts. Otherwise, he did not withdraw any money from the accounts until last year, when he closed the accounts and repatriated the money to a U.S. bank. He never reported earning on the accounts on his U.S. tax returns and he never filed an FBAR.

What do you think… Is he entitled to the 5% penalty?



Open Account - Taxpayer inherited the account, however the bank required him to open a new account.

Minimal, infrequent contact - Taxpayer did provide his email address to the bank to receive bank statement by email and indicated an investment approach, but this was required by the bank.

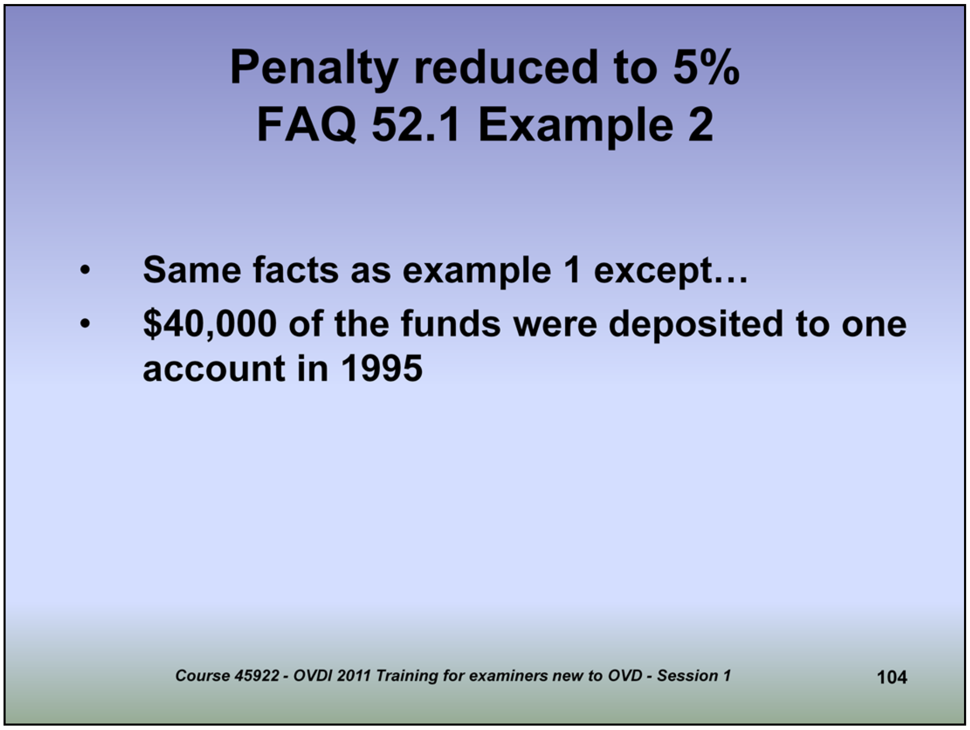
Not withdrawing more than $1,000 - On one visit he withdrew $1,000 from one account

U.S. taxes have been paid on deposited funds.

The last deposit into the account was over 30 years ago. Since the funds were in the account prior to January 1, 1991, then it is presumed that the funds were taxed.

He is entitled to the reduced 5% offshore penalty. If we were to change the facts a little bit you would see that this taxpayer would not be able to receive the 5% penalty. If the taxpayer voluntary provided instructions to the bank concerning the investing of funds, then the taxpayer would not be entitled to the reduced 5% offshore penalty. This sounds pretty straight forward, but sometimes it is not readily determinable.

Obviously the representative and taxpayer are motivated to persuade you that the bank required them to provide an investment approach. Your job in this process is to determine actually what happened. If the taxpayer qualifies for the 5% penalty, then they should receive the benefit of the 5% penalty, but we should ensure that they actually qualify for this reduced amount first. Part of the controls in the program are to ensure that the taxpayer provided sufficient documentation or that the taxpayer truly qualifies for the 5% penalty. This is one of the reasons why the Technical Advisor needs to approve all 5% penalty requests. Example #2 has a slight change in the facts.

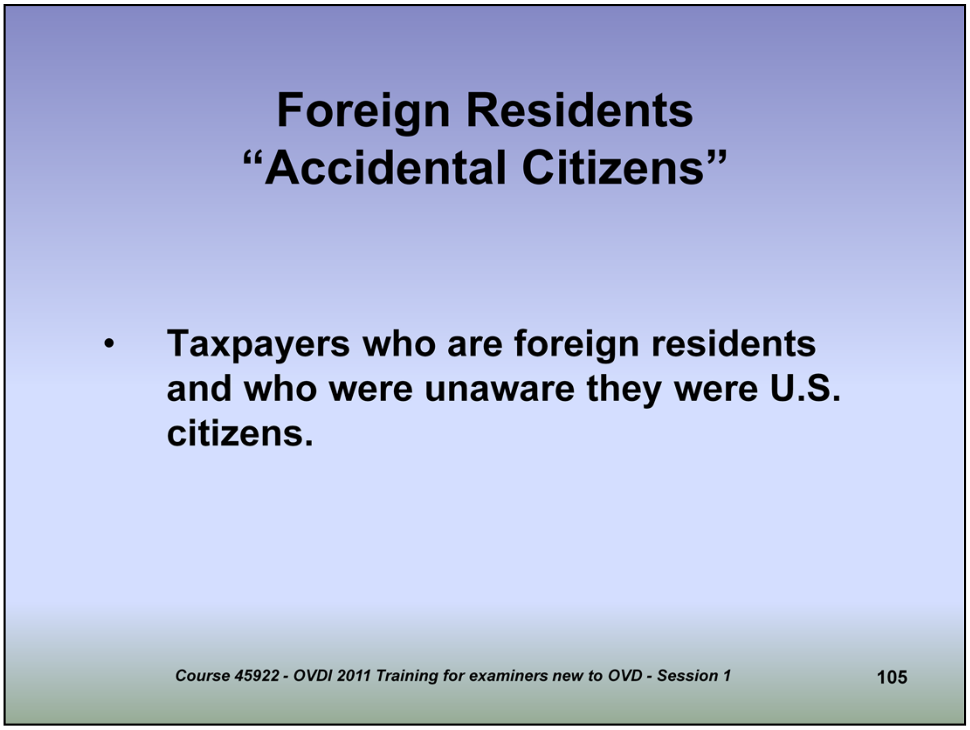


FAQ 52.1 Example 2

The facts are the same as in example 1, except that $40,000 of the funds were deposited to one of the accounts in 1995.

The taxpayer would have to identify the source of the deposit and, if the source was taxable in the U.S., prove that U.S. income tax was paid on those funds. In the absence of such proof, the taxpayer is not entitled to the reduced 5% offshore penalty.

As you can see in this example, the taxpayer needs to show that the funds deposited into the account were previously taxed. In the prior example the funds were deposited to the account prior to January 1, 1991 so they were presumed to have been taxed.



This brings us to the next possible avenue a taxpayer could be eligible for the reduced 5% offshore penalty.

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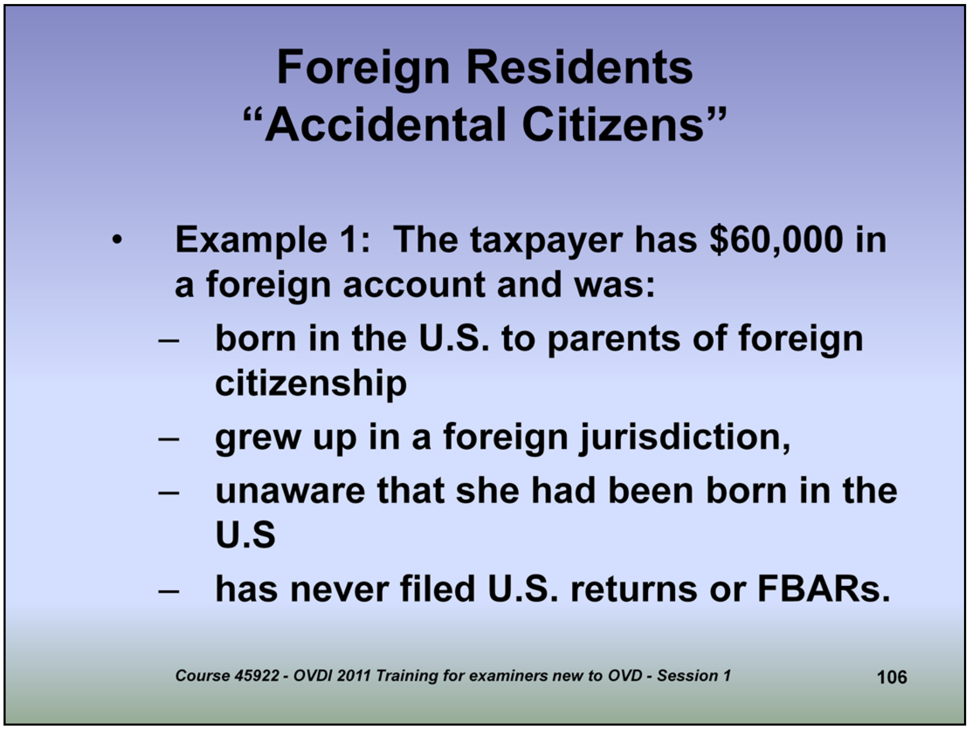
FAQ 52.2 is pretty short.

There are two examples that further elaborate the criteria.



In the first example, the taxpayer was born in the U.S. to parents of foreign citizenship. She grew up in a foreign jurisdiction, unaware that she had been born in the U.S. She has a $60,000 account in the foreign jurisdiction. She has never filed U.S. returns or FBARs.

Foreign Residents
“Accidental Citizens”

Example:

Taxpayer became aware she was a U.S. citizen when she had to get a birth certificate in order to obtain a passport from the foreign jurisdiction where she resides.

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She became aware she was a U.S. citizen when she had to get a birth certificate in order to obtain a passport from the foreign jurisdiction where she resides. She is entitled to the reduced 5% offshore penalty, if subsequent to learning of her U.S. citizenship, the taxpayer took no action with respect to her foreign accounts that would disqualify a U.S. taxpayer from the 5% penalty under the 4 prong test already described in FAQ 52.1.

The key here is that she did not know of her U.S. citizenship and once she did learn of her citizenship she did not disqualify herself from the 5% penalty by doing anything contrary to FAQ 52.1. Now if she always knew she was a U.S. citizen, then FAQ 52.2 would not apply to her and she would have to qualify for the 5% penalty based upon either the 4 prong test or the 3 prong test of FAQ 52.3 which we will now discuss.

3 Prong Test

Foreign Resident Taxpayers

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This is second way a foreign resident taxpayer can be eligible for the reduced 5% offshore penalty. Taxpayers must meet the three prong test, and if this three prong test is met, not only will the offshore penalty be reduced to 5% but the penalty base may be computed differently for these taxpayers.

The three prong test is available to individuals who:

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As long as they made a good faith showing that they complied with all of the tax reporting and payment requirements in the country of residency.

The point of this reduced penalty is that the taxpayer resided in a foreign country, paid taxes on their income in the foreign country and had little to no income in the U.S. Although they did not file and pay their U.S. tax obligation it appears that they tried to do what was correct by complying with the tax laws of their country of residence, so they will receive a reduced penalty as part of the 2011 OVDI.

Additional Break for Foreign Resident 3 Prong Taxpayers only

- **The offshore penalty will not apply to non-financial assets, such as real property, business interests, or artworks, purchased with funds for which the taxpayer can establish that all applicable taxes have been paid, either in the U.S. or in the country of residence**
- **This exception only applies if the income tax returns filed with the foreign tax authority included the offshore-related taxable income that was not reported on the U.S. tax return**

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If foreign residents pass the three prong test they will not only qualify for the reduced 5% penalty but they **could** *(this does not automatically happen if they qualify for the 5% penalty)* also be able to exclude non-financial assets such as real property, business interests, or artworks, from the offshore penalty computation. If the assets were purchased with after tax funds (either in the U.S. or the country of residence) and the income was reported in the U.S. or the foreign tax authority, then these non-financial assets will not be included in the offshore penalty computation.

In order to exclude these non-financial assets the test is very similar to income tax non-compliance except we are also allowing the tax to be paid to foreign tax authorities and not just the U.S.

FAQs of Interest

- **FAQ 53**
  - **Under what circumstances would a taxpayer making a voluntary disclosure under this initiative qualify for a reduced 12.5 percent offshore penalty?**

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FAQ 53 – 12.5% Penalty Criteria

- **Highest aggregate account balance in each of the years covered by the 2011 OVDI is less than $75,000**

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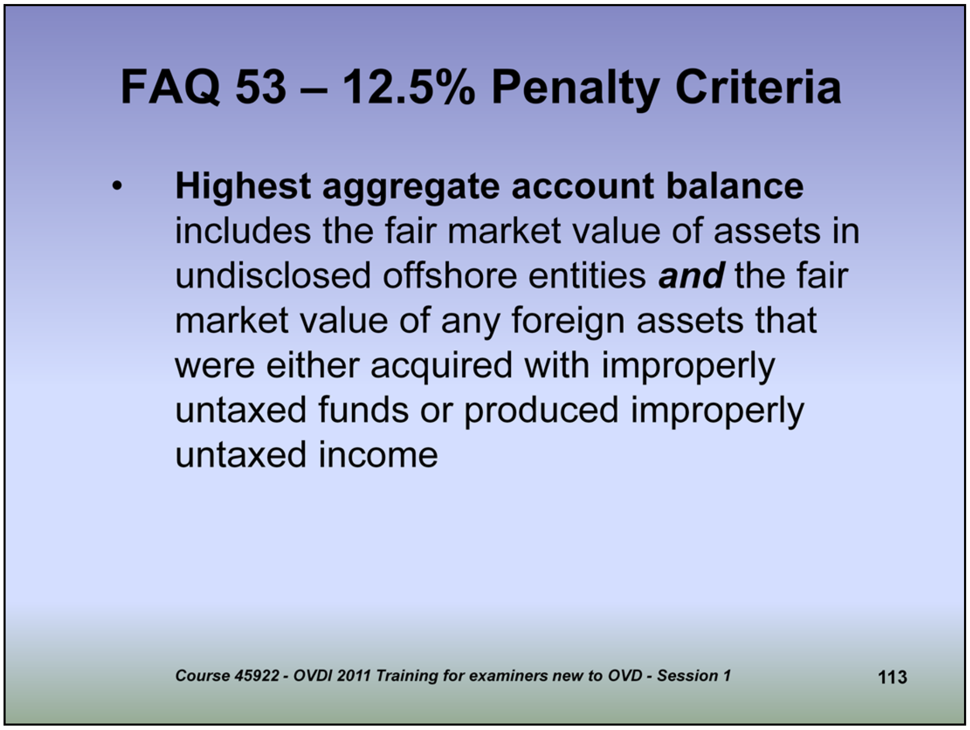
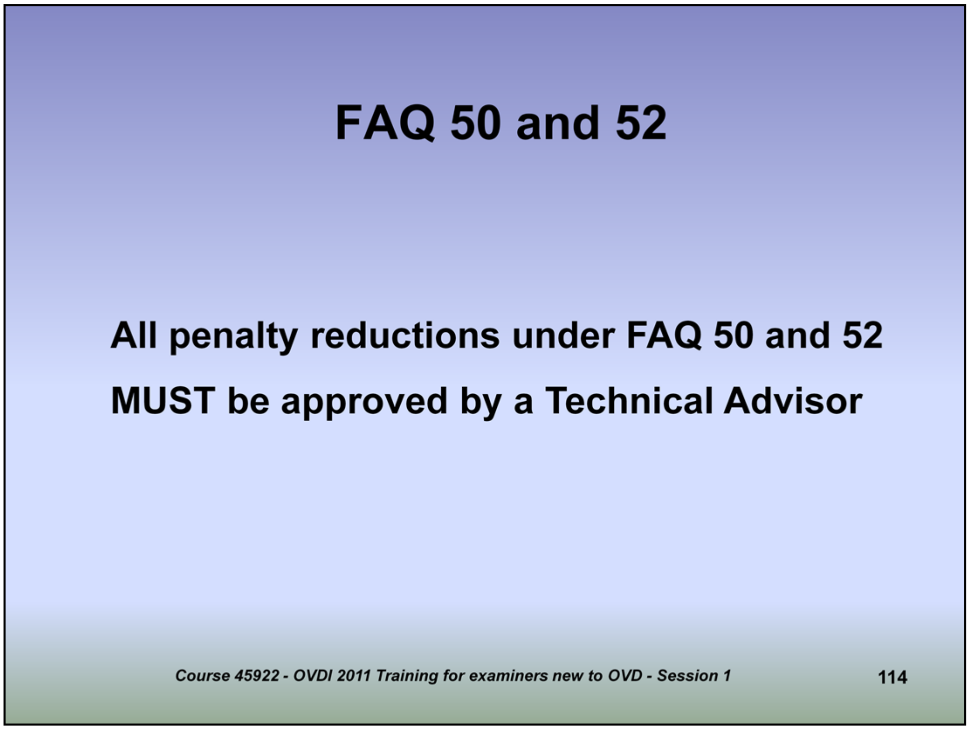
If the taxpayer's highest aggregate account balance in each of the years covered by the 2011 OVDI is less than $75,000, they will qualify for the 12.5% penalty. Even though the taxpayer qualifies for the 12.5% penalty, they still could only qualify for a 5% penalty if they meet all of the criteria under FAQ 52. (the 4 prong test, accidental citizen, or the 3 prong test)



In order to determine the eligibility for the 12.5% penalty, we need to calculate the highest aggregate balance. You would first take the value of assets in undisclosed offshore entities and then you would add any assets with tax non-compliance. You should now be able to recognize the definition of tax non-compliance on this slide – “assets that were either acquired with improperly untaxed funds or produced improperly untaxed income.”

If the highest aggregate account balance is less than $75,000, then they qualify for the 12.5% penalty.



All penalty reductions under FAQ 50 and 52 MUST be approved by a Technical Advisor

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