SBSE Offshore Voluntary Disclosure Initiative (OVDI) 2011

CENTRA Course **#45924**

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

SBSE OVDI 2011- training material

If you have not already downloaded the course materials, you may do so now by clicking on or pasting the link below:

http://wsep.ds.irsnet.gov/sites/co/dcse/sbse/srm/hr/hrd/learning/coursedev/35888/default.aspx

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 2

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.

(Click or cut-n-paste)

SBSE OVDI 2011 - CENTRA – Today's Session

- **This Centra training will consist of 2 segments:**
  1. **Case and penalty development**
  2. **Issues**
- **The session will last approximately 2 hours**
- **This session is not pre-approved for CPA CPE credit, you can check with your state board to determine if this session meets their CPE requirements**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 3

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.

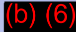
There are 2 topics the instructors will be discussing in this session

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

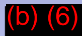


Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 4

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



Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 5

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

(b) (6)

(b) (6) - North Atlantic Area

Case & Penalty Development

1. Reconcile Transcripts
2. Tax & Accuracy/Delinquency Penalty Form 4549A
3. Offshore Penalty Assessment Form 8278
4. Form 906 Closing Agreement
5. Form 906 When to Contact T/A

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 7

In this presentation we will cover Case and Penalty Development in offshore voluntary disclosure cases. My name is (b) (6) (b) (6) for the North Atlantic Area. My telephone number is (b) (6)

In this lesson we will be discussing the importance of reconciling transcripts; entering tax and penalties in RGS; the Offshore Penalty case; Closing Agreements; and when to contact a Technical Advisor.

Reconcile Transcript

- **Secure IMFOLT for each year of the disclosure**
- **Protect SOL**
- **Suggested: use the Transcript Analysis Tool to determine the tax per return or as previously adjusted**
- **Determine if amended returns have posted**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 8

-Upon receipt of your Offshore Voluntary Disclosure case, I would suggest the first thing you do after reviewing the contents of the case file is to obtain an up to date IMFOLT for each tax year included in the disclosure. First and foremost, you must protect all open statutes. Review the IMFOLT for the ASED date. You need to be especially cautious of 2008 returns who statutes could be expiring this year. Review the case file for 872's. If none exist, you must solicit one for any statute that could expire. If a signed 872 is in the case file but the ASED has not been updated, you must do so. If you can not get an 872 to protect an eminent statute, you must do a prompt assessment to protect the Government's interest. You can find the Prompt Assessment procedures on the SharePoint site.

-It is very important to reconcile each module to determine the tax per return or if it has been previously adjusted. Once you've received the IMFOLT, I would either reconcile the transcript by hand if there are a limited number of transactions, or you can use the Transcript Analysis Tool, which can be found on the SharePoint site. With this tool you enter the Transaction Code, dollar amount, and date from the IMFOLT and the spreadsheet will reconcile the module.

-You may find by reviewing your transcript there were prior audit assessments. It may be difficult to reconcile those results to enter them in RGS. I would suggest you obtain an IMFOLZ which will provide you with the audit results, as well as an **IMFOLA** which provides additional information such as adjustment to Taxable Income and AGI and **IMFOLR** to determine what items were changed. Also, a TAXMODA and/or a TAXMODL can provide you with information on transactions that have yet posted to IMFOLT.

-Unless it is readily apparent how you computed the amount shown on Form 4549-A Line 12 (Total Tax Shown on Return or as Previously Adjusted), Technical Services will return

the case to you.

Tax & Accuracy/Delinquency Penalty Form 4949A

- RGS Set Up
- Generating Form 4549-A through RGS
- Inputting return information
- Inputting adjustments

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 9

-You will set up RGS to include every year that will be covered by the Closing Agreement even if there are no adjustments for that year.

-Upon setting up your taxpayer on RGS you will be imputing Work Code 70 in the Case Management Screen. To do this Select the Create a Case tab. Complete all of the fields including Work Unit Code by entering 70. Click add case. If you then copy for new to establish your other years, the Work Unit Code will follow.

-In Offshore Voluntary Disclosure cases we will be generating a Form 4549-A never a 4549.

-How you will enter the return information and the adjustments and penalties that appear on Form 4549-A will depend on if the taxpayer filed an amended or delinquent return, if the return was processed (assessed), and whether you made other adjustments during your certification. You will be computing the Accuracy Penalty and/or Delinquency Penalty if applicable for each year. When we discuss the delinquency penalty, we are referring to the failure to file and failure to pay penalties. It does not include the Estimated Tax Penalty.

RGS & Form 4549A

- **Amended Return(s) posted and additional tax has been assessed**
  - **If no other adjustments required**
  - **For RGS use the figures from the Processed Amended Return for your Return Set-up figures**
  - **Manually compute 20% Accuracy Penalty on the additional tax from the amended return.**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 10

If the Taxpayer's amended return has posted to Master File and the tax is assessed and through your Certification you've accepted all of the figures, you will enter the amended return figures to the RGS set up. This will result in $0 tax due on Form 4549A.

You will then have to manually compute a 20% Accuracy Penalty on the tax reflected on the amended return. You will then enter the penalty amount in RGS under "Return Related Penalties," select the correct year, check off the box for "Manually Computed" and check off the box for "Compute Interest on Penalty," enter "IRC 6662 Accuracy" under the penalty name and enter the amount of the penalty.

One other thing to note: if the total tax figure includes Section 1291 PFIC interest, you will back that figure out from the total tax figure before determining the 20% accuracy penalty.

RGS & Form 4549A

- **Amended Return(s) posted and additional tax has been assessed**
  - If other adjustments required
  - For RGS use the figures from the Processed Amended Return for your Return Set-up figures
  - Enter additional adjustments to RGS
  - A single manually computed Accuracy Penalty will be assessed on the total amended and any additional tax determined

If the Taxpayer's amended return has posted to Master File and the tax has been assessed and through your Certification you determined there are additional adjustments, you will still enter the amended return figures to the RGS set up. You will then enter your Certification Adjustments as your issues.

You will then have to manually compute a 20% Accuracy Penalty on the total tax reflected on the amended return plus the tax from your Certification.

For example, if the amended return posts to the module with an additional $2000 in tax and through your Certification you determine there was an additional $1000 in tax, you would manually compute the Accuracy Penalty on the total tax of $3,000 which would result in a $600 Accuracy Penalty.

RGS & Form 4549A

- **Amended Return(s) have not been Processed and Additional Tax shown on 1040X has not been assessed**
  - No other adjustments
  - For RGS use the figures from the Original Return for your Return Set-up figures
  - Form 4549-A will reflect all of the adjustments on the amended return
  - Categorize the adjustments so RGS will compute the accuracy-related penalty equal to 20% of the tax due

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 12

If the Taxpayers' amended return has NOT posted to Master File and through your Certification you determine that there are no additional adjustments, you will use the original 1040 return figures in your RGS set up. You will enter the amounts from the amended return as your adjustments in RGS.

You will then have RGS compute the 20% Accuracy Penalty by properly categorizing the adjustments.

RGS & Form 4549A

- **Amended Return(s) have not been Processed and Additional Tax shown on 1040X has not been assessed**
  - There are other adjustments discovered during OVDP certification
  - Again, for RGS use the figures from the Original Return for your Return Set-up figures
  - Enter adjustments from 1040X plus certification adjustments
  - Categorize the adjustments so RGS will compute the accuracy-related penalty equal to 20% of the tax due

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 13

-If the Taxpayer's amended return has not posted to Master File and through your Certification you discover adjustments, again, you will use the original 1040 return figures in your RGS set up. You will enter the amounts from the amended return and any adjustments from your Certification to RGS as your issues.

-For example, if the taxpayer discloses an additional $100,000 in interest income and through your disclosure you discover another $25,000 in dividends, you will include both interest and the dividends amounts as your RGS adjustments.

-Another example, if the taxpayer discloses an additional $100,000 interest income on his disclosure and you certify that amount should have been $150,000, then the $150,000 figure will be used as your adjustment.

-Categorize the adjustments so RGS will compute the accuracy-related penalty equal to 20% of the tax due shown on Line 16, Form 4549-A.

Delinquent Returns

- ***Delinquent Return(s) already Processed and Tax Assessed and Posted to Master File***
  - Tax shown on the delinquent return posted to Master File, and
  - No other adjustments
  - For RGS purposes use the figures from the Processed Delinquent Return for your Return Set-up figures

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 14

•If the Taxpayer files a delinquent return and the return posts to the Master File and through your Certification you determine there are no additional adjustments, you will enter the amounts from the delinquent return in your RGS setup.

•You will then determine by reviewing the IMFOLT if the Campus has assessed the delinquency penalty. If the Campus did not assess the delinquency penalty, you must manually compute the penalty based on the “Net Tax Due” and include it in RGS. In most cases, if the delinquent return posts the Campus will also assess the Delinquency penalty.

Delinquency Penalty

- The examiner must review Master File to determine whether the Campus assessed the delinquency penalty (TC160 or TC166). If the Campus did not assess the delinquency penalty, the only entry on Form 4549-A is a manually-computed delinquency penalty based on the "Net Amount Due" as defined in IRC § 6651(b). For further guidance on the definition of "Net Amount Due" see IRM 20.1.2.1.2.5

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 15

To determine if the Delinquency Penalty has been assessed, review the IMFOLT for a Transaction Code of 160 which is a manually computed delinquency penalty or Transaction Code 166 which is a computer generated delinquency penalty. If neither of these transaction codes are present then the Campus did not assess the delinquency penalty. You will then manually compute the delinquency penalty based on the "Net Amount Due" and enter it into RGS.

Internal Revenue Code 6651(b) defines The "Net Tax Due" as the amount of tax required to be shown on the return less allowable credits. This amount is reduced by payments made on or before the prescribed due date of the return (excluding extensions), such as withholding credits, tax deposits, estimated tax payments, overpayments from prior periods, or other payments.

Refer to IRM 20.1.2.1.2.5 for determining the "Net Amount Due" for computing the delinquency penalty.

-If the Taxpayer files a delinquent return and the return posts to the Master File and through your Certification you determine there are additional adjustments, you will use the figures from the processed delinquent return in your RGS set up.

-You will then enter your certification adjustments to RGS as your adjustments.

-In most cases where the delinquent return has posted, the Campus will also assess the Delinquency Penalty but to be sure you will need to check the IMFOLT.

In a situation where the Campus has already assessed the Delinquency Penalty and there are additional adjustments determined through your Certification, you will compute the Delinquency Penalty and an Accuracy Penalty on the additional tax due from your Certification. You will need to make sure you have entered the previously assessed Delinquency Penalty in the Return Related Penalty section. You may also run into a situation where the Taxpayer has filed an original delinquent return which had previously been processed and the delinquency penalty has been assessed and under OVDI the Taxpayer filed a taxable amended return for the previously unreported

offshore income. In this case, you would also be assessing the Delinquency Penalty and the Accuracy Penalty on the additional tax through RGS.

Delinquent Returns

- ***Delinquent Return(s) have not been Processed and Tax shown on Delinquent Return(s) has not been assessed***
  - – No other adjustments
  - – Enter all amounts from the Delinquent Return to RGS
  - – The Delinquency Penalty is computed on the "Net Amount Due"

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 17

-If you have received an original delinquent return or the delinquent return has not posted to Master File, and you have determined through your Certification that there are no additional adjustments to be made, you will enter the all amounts from the delinquent return as adjustments to RGS.

-You will then enter the required information in RGS under the Return Related Penalties specific to the Delinquency penalty and RGS will compute the delinquency penalty on the Net Amount Due.

Delinquent Returns

- ***<u>Delinquent Return(s) have not been Processed and Tax shown on Delinquent Return(s) has not been assessed</u>***
  - Additional adjustments required
  - Enter as adjustments to RGS all amounts from the Delinquent Return plus your additional adjustments
  - The Delinquency Penalty is computed on the "Net Amount Due"

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 18

-If you have received a delinquent return or the delinquent return has not posted to Master File, and you have determined through your Certification that there are additional adjustments, you will enter to RGS all amounts from the delinquent return plus your Certification adjustments.

-You will then enter the required information in RGS under the Return Related Penalties specific to the Delinquency penalty and RGS will compute the delinquency penalty on the Net Amount Due. The additional adjustments you made will also be subject to the Accuracy Penalty by properly classifying the issue in the related penalty section.

Barred Refunds

- **If Form 4549-A reflects a refund that is barred under IRC 6511**
- **The following will be enter in the Other Information section of Form 4549A:**

"Your refund for tax year(s) [ENTER TAX YEARS] is barred pursuant to IRC § 6511(a)."

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 19

-If you certify that a refund is due to the taxpayer, you must determine first if that refund is barred by statute.

-Under IRC 6511(a) a refund is barred if not claimed within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid.

-If you have determined a potential refund has been barred you will enter in the Other Information section of the 4549-A: "Your refund for tax year(s) [ENTER TAX YEARS] is barred pursuant to IRC Section 6511(a)."

-Anther issue to keep in mind that you may or may not run into: if an overpayment is attributable to the Foreign Tax Credit, there is a 10 year statute of limitations in lieu of the normal three year statute to claim a refund from the year the taxes were actually paid. If you have this issue, you should discuss it with your Technical Advisor.

Offshore Penalty Assessment

Taxpayer is required to submit the Penalty Computation worksheet under FAQ #25

Examiner will:

- Certify its accuracy
- Verify receipt of payment
- Create a separate Offshore Penalty case file

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 20

[Agents should have Form 8278 for reference]

-As part of the Taxpayer's voluntary disclosure, they are required to compute the Offshore Penalty. If the Taxpayer has not computed the penalty you will ask them to do so. You will certify the accuracy of the computation of the penalty. If the Taxpayer has computed a penalty lower than the 25% penalty, you will develop the facts to determine if the Taxpayer qualifies for a reduced penalty. You will need your Technical Advisor to approve any reduced penalty.

As we have previously discussed, the Offshore Penalty is equal to 25% of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the period covered by the voluntary disclosure. An exception to the 25% rate is the 12.5% rate if in each of the years covered by the 2011 OVDI the highest aggregate balance is less than $75,000; A 5% Offshore Penalty rate would be applicable for those who (a) did not open or cause the account to be opened; (b) have exercised minimal, infrequent contact with the account; (c) have, except for a withdrawal closing the account and transferring the funds to an account in the United States, and not withdrawn more than $1,000 from the account in any year for which the taxpayer was non-compliant; and (d) can establish that all applicable U.S. taxes have been paid on funds deposited to the account

-You will determine if payment has been received on the Offshore Penalty. If payment has yet to be received, you will solicit and process the payment when received. See Job Aid #3 from the SharePoint site for more information on processing payments.

-You will prepare a separate Offshore Penalty Case file.

Offshore Penalty Case File

- **Establish on ERCS**
- **Form 8278 posted on the Voluntary Disclosure SharePoint site.**
- **Refer to Job Aid 2 on the SharePoint**
- **Offshore Penalty will be assessed in 2009 year regardless year of computation**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 21

Prior to preparing the Offshore Penalty Case File, you will establish with Form 5345-D a module on ERCS. See Job Aid #1 to correctly complete the 5345-D. Please note that under this Voluntary Disclosure, the penalty will be established for the 2009 tax year regardless of where the highest aggregate balance is computed. The project code is 1008.

In preparing a separate Offshore Penalty Case File, you will download the latest pro-forma Form 8278 which is posted on the SharePoint web site. This version has been updated to include reference numbers 595, 596, 597, & 598 for the 2011 OVDI penalties Please note the following when completing Form 8278:

-All pages of Form 8278 will be included in the case file.

-In block 6, write in "NO STATUTE" since this penalty assessment has no statue.

-In block 3, check the box for MFT 55 if the assessment is against an individual; check the box for MFT 13 if the assessment is against an entity.

-Leave block 4 blank

-In block 8, check the box for your function.

-Make sure the Remarks section contains the following statement in all capital letters: “INPUT HOLD CODE 3 MUST BE INPUT WITH PENALTY REFERENCE NUMBERS 594, 595, 596, 597, or 598.”

-Enter the number of violations and the dollar amount of the penalty under Reference 595 for the 5% Offshore Penalty, Reference 597 for the 12 ½ % Offshore Penalty, and Reference 598 for the 25% Offshore Penalty. Reference 594 will be reserved for the 27 ½ % Offshore Penalty under the 2012 OVDI. You will need to write this reference number in if Form 8278 has not been updated.

Refer to Job Aid #2 in completing Form 8278.

Offshore Penalty

- If the taxpayer is compliant for 2010 – examiner will compute the penalty based on the highest aggregate balance of the 2003-2009 years
- If the taxpayer is compliant for 2010 and 2009 – examiner will compute the penalty based on the highest aggregate balance of the 2003-2008 years

The Offshore Penalty is to be assessed in the 2009 year even if the Taxpayer is compliant in 2010 and/or 2009. If the Taxpayer is compliant for the 2010 tax year then the penalty will be based on the highest aggregate balance of the 2003-2009 years. If the taxpayer is compliant for 2009 and 2010, you will compute the penalty based on the highest aggregate balance of the 2003-2008 years. You will assess the penalty in 2009.

Offshore Penalty Case File

- Form 8278
- Form 886-A showing the computation of offshore penalty
- OVDP Penalty Computation Workpaper (mandatory)
- Technical Advisor (TA) approved
- A copy of the Form 906
- A copy of Form 3244-A, *Payment Posting Voucher –*

The Offshore Penalty case file will include the following items:

Form 8278 (all 8 pages)

Form 886-A showing the computation of offshore penalty

OVDP Penalty Computation Workpaper (mandatory)

If your Technical Advisor approved a lower penalty, you must include a copy of the email from your TA approving the reduced penalty.

A copy of the Form 906, *Closing Agreement,* signed by the taxpayer (or the representative) with your signature as Receiving Officer.

A copy of Form 3244-A, *Payment Posting Voucher* – if the taxpayer paid the penalty prior to closing the case.

Form 906 Closing Agreement

- Four Closing Agreements
- Which Form to Use
- Multiple Agreements
- Changes require Technical Advisor approval
- Job Aid #7

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 24

[Agents should have the Standard Full Pay for 2011 OVDI Form 906 to refer to]

•In this lesson we will discuss which Closing Agreement to use, who we are making the agreement with, how to complete the Closing Agreement, what changes you are and are not to make, what figures to enter, additional language that may be required, and when to get Technical Advisor approval.

•The term Closing Agreement and Form 906 are synonymous.

•The Four versions of the Closing Agreement are the

Form 906 Standard – Full payment
Form 906 Standard – No full payment
Form 906 Dissolved Entity – Full payment
Form 906 Dissolved Entity – No full payment

You must download from the SharePoint site the current version of the pro-forma closing agreement.

Select the appropriate closing agreement based on whether the taxpayer full pays or makes arrangements to pay and whether or not the taxpayer is dissolving one or more offshore entities as part of their voluntary disclosure.

It is possible you may need more than one closing agreement to resolve your case. If there are different parties to the closing agreement or if a taxpayer is married in some years and unmarried in others, you will prepare multiple closing agreements.

Significant changes to the Closing Agreement will need T/A approval which we will discuss.

Refer to Job Aid #7 to assist you

Form 906 Closing Agreement

Field Examiner's Responsibilities

- Prepare 906 Closing Agreement
- Submit to Taxpayer(s) for signature(s)
- Receive and Review signed 906
- Sign as "Receiving Officer"
- Close case as Agreed (DC 08)
- Forward case to Technical Services

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 25

You will be responsible for preparing the closing agreement. I have encountered a situation where I inherited a case file where the Taxpayer's attorney wrote the closing agreement. Obviously, we could not accept the agreement.

Only the Taxpayer who is making the voluntary disclosure will sign the 906. For example, if you have a married couple filing a joint return and only the husband comes forward under OVDI, then only his name will appear in the Closing Agreement and only his signature is required.

Upon receipt and after you have reviewed the signed Closing Agreements, you will sign it as the Receiving Officer.

An agreed case will use a Disposal Code of 08 and it will be forwarded to Technical Services where it will be reviewed and if accepted, it will be approved.

Form 906 Closing Agreement

Secure & Review up to date Transcripts

- Taxable Income Amount
- Tax Liability
- 1040X filings
- Statutes
- Payments

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 26

Before you prepare your closing agreement, you will again want to get the most up to date transcript for each year to ensure no changes have been made to the modules. You will want to check the Taxable Income Amount, the Tax Liability, Amended return postings, statute dates, and payments.

Form 906 Closing Agreement

Prepare RAR, Form 4549-A to accompany Closing Agreement

- Impute interest 30 days beyond
- Reconcile amounts to Form 906
- Accuracy Related Penalties (20%)
- Verify and Review Computations
- Ensure correct years are addressed
- Make 4 copies (3 - taxpayer and 1- file)

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 27

As we previously discussed, we will be using a 4549-A in RGS and not a 4549. The 4549-A is used for informational purposes to show the amount of tax, interest and the computation of the Accuracy and Delinquency Penalties. We do not enter the amount of tax or the amount of the penalties, except for the Offshore Penalty in the closing agreement.

For RGS, interest will be imputed 30 days from the issue date.

You must reconcile the amounts reflected on Form 4549-A to the Closing Agreement. Accuracy penalties, whether computed by RGS or by the you will be at 20%. You will be required to verify and review the Taxpayer's computations. You will need to make sure the correct tax years are included in the Closing Agreement. For the most part you will include the years 2003-2010 unless the Taxpayer can show you they no longer had an undisclosed offshore account or entity for a particular year or they correctly reported their offshore accounts for 2009 and/or 2010.

Once you have an approved Closing Agreement, you will make a copy for the case file and three copies which you will mail to the taxpayer for their original signatures. These signed closing agreements will be placed in the front of the first case file.

Form 906 Closing Agreement

Offshore Penalty Amount computed at 25%

- If 5% Penalty case, you must get approval from Offshore Technical Advisor
- Document in Case History and include emails for verification
- Form 906 will not be executed by Technical Services without documented approval

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 28

The Offshore Penalty will be computed at 25% of the highest aggregate balance of the Taxpayer's offshore accounts and the Fair Market Value of any income producing property that was not previously reported. If the Taxpayer qualifies for a lower penalty including the 12 ½% penalty, you will need Technical Advisor approval first.

If approved changes will be made to the closing agreement you should document the activity records and make a copy of the email you received from the Technical Advisor approving the changes. Technical Services will not approve any changes to the closing agreement unless there is written verification from a Technical Advisor.

Form 906 Closing Agreement

Secure 906 from VDP SharePoint

Form 906: Full Pay or Not Full Paid

- Standard or Dissolution of Foreign Entity
- Major changes to 906 must be approved by Offshore Technical Advisor and Counsel (i.e. PFIC or FTC)
- Document approval in Case History

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 29

•As previously mentioned, there are two primary versions of the Closing Agreement. The Full Paid version will be used if the Taxpayer will be making full payment to all of the taxes, interest, and penalties, including the Offshore Penalty. The second version is the No Full Paid. Obviously, you will need to discuss with the Taxpayer or his representative prior to preparing a closing agreement, how they will be paying. I would suggest you discuss the payment arrangements upon your first contact with the Taxpayer or their representative. Once you've determined that the Taxpayer will not be making full payment, you must contact your Collection OVDP coordinator for your area and request a Revenue Officer to assist you. The Collection OVDP coordinators are listed on the SharePoint website.

•The closing agreements can be found on the SharePoint site under the 2011 Voluntary Disclosure Program folder which will lead you to the 2011 906 folder. Each of these Closing Agreements come in either the Standard or Dissolution of Foreign Entity versions.

•In most cases, adjustments to Foreign Tax Credits will require additional paragraphs to the Closing Agreement. Refer to Job Aid #10 to determine if the additional language is required. In addition, if a change is made to the Foreign Tax Credit and your taxpayer is subject to Alternative Minimum Tax, additional language is required. You can find the correct language to use for your Closing Agreement on the SharePoint site. These changes require written approval from your Technical Advisor and must be documented in the case history.

•If your taxpayer has PFIC transactions, additional paragraphs to the Closing Agreement are required. There are separate paragraphs on the SharePoint site depending on if your taxpayer is using the method under IRC 1291 or is using the Alternative Mark to Market Method. Again, written approval from your Technical Advisor is required and must be documented in the case history.

Form 906 Closing Agreement

Prepare and complete 4 copies of the Closing Agreements

- 3 copies for Taxpayer(s) to sign and date
- 1 copy for case for comparison use later

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 30

As previously mentioned, you will prepare one copy of the Closing Agreement for your case file and three will be mailed to the Taxpayer to be returned to you with their original signature. You will use your copy as a comparative to the signed Closing Agreements to ensure no alterations have been made. Another safeguard you can take is to put your initials in blue ink in the corner on the back of each page of each closing agreement. This will ensure you've received the originals back from the Taxpayer.

Form 906 Closing Agreement

If Joint Disclosure:

Enter the Taxpayer's first name & last name, SSN, spouse's first name & last name, SSN and "current address"

If Single Disclosure:

Enter the Taxpayer's first name & last name, SSN, and "current address".

Note: regardless if joint return was filed

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 31

In completing the 906, In the first paragraph of the Closing Agreement, who the closing agreement is being made with depends on who is making the disclosure.

For example, if only the husband comes forward, then the closing agreement will only contain his name in the first paragraph. The 4549-A will be in both the husband and wife's name so that the tax will compute correctly. To determine who is making the disclosure, review the CI folder documents.

For the most part, you will alter the "WHEREAS" paragraphs only to use the correct pronouns and the correct years being disclosed.

Form 906 Closing Agreement

Determination paragraph #1 – Income Adjustments

- Unreported Offshore Income for all years involved
- Expenses Related to Offshore Assets
- Domestic Adjustments increasing Taxable Income in expired statute years
- Do not include automatic or statutory adjustments

Complete header section on Page 2 with taxpayer information

Enter Offshore Penalty Amount in Determination Paragraph #3 of Closing Agreement

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 32

•Determination paragraph #1 of the Closing Agreement states:

"Taxpayer had additional unreported income and overstated deductions and/or losses during 2003 through 2010 relating to the voluntary disclosure as follows:" You will eliminate the statement "and overstated deductions and/or losses" if there were no overstated deductions and/or losses.

•You will notice a grid following the first Determination paragraph. In that grid you will enter the type of the adjustments and the dollar amount under the corresponding tax year. You will include all unreported offshore income such as interests, dividends, capital gains and losses, wages, rental income and losses, etc. You will also include any expense adjustments being claimed relating to the offshore assets such as investment fees. You will include Non-Offshore adjustments being claimed that increase taxable income in those years where the Statute of Limitations has already expired. Do not include any statutory or automatic adjustments.

•In Determination paragraph 2, eliminate the Delinquency Penalty statement if applicable.

Enter the amount of the Offshore Penalty you are certifying in Determination Paragraph #3.

•Complete the header information on page two of the Closing Agreement so that the Taxpayer's name appears on the top of each page of the closing

agreement.

Form 906 Closing Agreement

Formatting Form 906

- Applicable years….
- 2nd Whereas.....[his/her/its]
- Stmt 2 & 3.....[or delinquent-related penalties, as applicable]
- Stmt 8.....[his/her/its]
- Keep Stmt 8 with signature page
- Use Z line if necessary on prior page

Formatting the Closing Agreement.

You should ensure the correct years of the disclosure are listed in WHEREAS Section and the grid in Determination Paragraph 1. Be sure you use the correct verb and pronoun tenses. In Determination paragraphs 2 and 3 be sure to eliminate the Delinquency penalty if applicable. You should also make sure that the last Determination paragraph #8 is on the same page as the Taxpayer signature page. We do not want the Taxpayer signature page separate from the body of the closing agreement. You should “Z” out any additional space to ensure nothing can be added after the fact.

In addition if numbered determination paragraphs are added to the 906, the Determination paragraphs will have to be renumbered and the paragraph reference numbers in Determination Paragraphs 3 and 6 will need to be adjusted accordingly.

Form 906 Closing Agreement

- You may correct grammar
- Delete the phrase "overstated deductions and/or losses" if applicable.
- You may not add or remove determination paragraphs without the Technical Advisor's permission

As a reminder

- You may correct grammar (i.e. "the taxpayer(s) is/are" may be changed to "the taxpayer is")
- Delete the phrase "overstated deductions and/or losses" if there are no overstated deductions and/or losses.
- You may not add or remove determination paragraphs without the Technical Advisor's permission

Form 906 Closing Agreement

- If necessary, adjust the page breaks so the last numbered Determination paragraph is on the same page as the taxpayer signature lines (the other signature lines and the signature blocks for the receiving and reviewing officers do not need to be on the same page as the taxpayer signature lines).
- If the closing agreement includes substantial changes or additional paragraphs to the closing agreement, send the closing agreement, Form 4549-A, and the computation of the offshore penalty to your Technical Advisor for review using secure email.

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 35

If necessary, adjust the page breaks so the last numbered Determination paragraph is on the same page as the taxpayer signature lines (the other signature lines and the signature blocks for the receiving and reviewing officers do not need to be on the same page as the taxpayer signature lines).

If the closing agreement includes substantial changes or additional paragraphs required to the closing agreement due to adjustments to the Foreign Tax Credit or PFIC, send the closing agreement, Form 4549-A, any applicable workpapers and the computation of the offshore penalty to your Technical Advisor for review using secure email.

Form 906 Closing Agreement

- **The Technical Advisors are listed on the OVDP SharePoint website.**
- **Alert your Technical Advisor to any of the following:**
  - domestic income adjustments not related to the offshore assets
  - changes in filing status
  - additional dependency exemptions
  - changes to taxable income other than statutory adjustments
  - additional tax credits, other than statutory adjustments
  - new elections or changes to existing elections (e.g., itemized deductions)
  - changes to flow-through items
  - married filing separately filing status cases or
  - other unusual adjustments

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 36

Alert your Technical Advisor to any of the following:

•domestic income adjustments not related to the offshore assets

•changes in filing status

•additional dependency exemptions

•changes to taxable income other than statutory adjustments

•additional tax credits, other than statutory adjustments

•new elections or changes to existing elections (e.g., itemized deductions)

•changes to flow-through items

•married filing separately filing status cases or

•other unusual adjustments

Form 906 Closing Agreement

- Prepare Cover Letter 4555
- Send cover letter, 3 Form 906s and Audit Report Form 4549-A, to taxpayer(s) for signature
- Send copy to POA (if POA applicable)

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 37

After your Closing Agreement is completed and approval has been given by the Technical Advisor, if necessary, you will download and complete Letter 4555. This is a cover letter that is mailed to the Taxpayer which accompanies the Closing Agreement. You will include 3 copies of the Closing Agreement and Form 4549-A. I would also enclose a reconciliation of the taxes, penalties, and interest due so the taxpayer knows exactly how much to remit. You will also send a copy to the taxpayer's representative.

Form 906 Closing Agreement

3 original Forms 906 sent back by taxpayer(s)

- Original signatures and dated
- If POA signed instead of taxpayer(s), attach Form 2848 to each Form 906
- Check for alterations or erasures
  - Use copy for comparison purposes
  - Contact Offshore Technical Advisor if any change identified

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 38

When you receive your signed Closing Agreements from the taxpayer, you want to make sure you have original signatures on each one. Make sure that no alterations have been made to the Closing Agreements. If alterations have been discovered, contact your Technical Advisor. If the Power of Attorney signs the Closing Agreement, you should attach a copy of the 2848 to each 906.

You will date stamp the reverse side of each page of each closing agreement. You will sign in blue ink as the RECEVING AGENT. You should download from the SharePoint site and prepare Letter 1595-E addressed to the Taxpayer, using your own contact information. Do not date and sign the letter. Ensure the title of Technical Services Group Manager is the signor of the letter. This letter and your signed Closing Agreements should be place in the first Certification case file.

Form 906 Closing Agreement

No Full Payment – Financial arrangement must be resolved with RO before case is to be closed to Technical Services

- 906 will not be executed until collection matter is resolved (i.e. Installment Agreement, OIC, etc)
- Obtain written concurrence of resolution from Revenue Officer

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 40

•You should contact the Collection OVDP coordinator in your area and request a Revenue Officer as soon as you have determined the Taxpayer will not be making full payment. The Collection OVDP coordinators are listed on the SharePoint website.

•Satisfactory Financial arrangements must be resolved with Collection before Technical Services will accept the Closing Agreement. You must receive written concurrence with Collection for your case file.

•As another note, if you have prepared a Full Pay Closing Agreement and even if the Taxpayer signs the Closing Agreement but does not make full payment, you will have to prepare a No Full Payment Closing Agreement after the Revenue Officer has resolved the financial arrangements to their satisfaction.

Form 906 Closing Agreement

Close both the Certification and the Offshore Penalty case files, to your local Technical Services office

- Update to Status Code 21

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 41

You will be closing your Certification and Offshore Penalty case files to Technical Services and your group secretary will update the case to Status 21.

(b) (6)

Midwest Exam Area

OVDI Specific Issues

- **Passive Foreign Investment Companies (PFIC)**
- **Alternative PFIC issues – special MTM computation**
- **Foreign Tax Credit**

In addition to some of the issues affecting tax computations that are generally encountered in regular examinations, you may encounter new issues that are part of the OVDI certifications. These include issues relating to Passive Foreign Investment Companies, otherwise known as PFICs, special OVDI program specific alternative tax computations relating to PFICs, and issues relating to Foreign Tax Credits.

While a taxpayer's offshore account holdings may generate investment income and tax credits similar to many domestic accounts, these issues have certain offshore elements that need to be considered as you perform the certifications.

PFIC Objectives

- Determine what is a PFIC
- Determine how to recognize a PFIC
- Describe the different tax regimes under PFIC
- Determine how distributions and dispositions of PFIC stock are taxed under IRC § 1291
- Determine how the PFIC is identified on the Closing Agreement

The first part of our discussion on these topics will focus on Passive Foreign Investment Companies (PFIC).

During this module, we're going to discuss the definition of a PFIC, how to recognize in your certifications if you have a PFIC, the different tax regimes that are applicable under PFIC and how distributions and dispositions of PFIC stock are taxed, and how these issues are identified and reflected on the Closing Agreement.

Definition of a PFIC

Definition: A foreign corporation is a PFIC if the foreign corporation has:

- Passive income that is at least 75% of gross income in any single tax year; or
  - Passive income generally is anything considered foreign personal holding company income ("FPHCI") at IRC § 954(c), with look thrus and exceptions that will be discussed.
- Passive assets represent at least 50% of total assets in any single tax year.
  - Whether or not an asset is "passive" is determined by whether or not the asset produces passive income or is held for the production of passive income.
  - The determination of the value of the assets is based on fair market value with respect to (i) publicly traded companies; or (ii) non-publicly traded companies that do not make an election to use adjusted basis.
  - The determination of the value of the assets is based on adjusted basis with respect to (i) CFCs (within the meaning of IRC § 957); or (ii) non-publicly traded companies that elect to use adjusted basis.

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 45

(Discuss the specific attributes above that define a PFIC from an investment in the stock of a regular foreign corporation. Essentially, a PFIC is similar in form to a domestic mutual fund but is registered and operated in a foreign jurisdiction.)

PFICs
Definition of Passive Income

"Passive income" for purposes of determining PFIC status is defined by reference to FPHCI, as set forth in IRC § 954(c). Passive income includes:

- Interest, dividends, rents, royalties, and annuities
- Net gain from the sale of property that produces IRC § 954(c)(1)(A) income or no income
- Net gains from certain foreign exchange and commodity transactions that do not arise in the ordinary course of business or out of hedging transactions
- Income equivalent to interest
- Income from notional principal contracts
- Deemed dividends in "repo" transactions

(Brief discussion of "passive income" for purposes of determining PFIC status.)

Anti-deferral Overview

US persons, such as US citizens and domestic corporations, generally are subject to US income tax on their world-wide income.

In contrast, foreign persons, such as foreign corporations, generally are subject to US income tax only with respect to "US-source income" or income that is "effectively connected with a US trade or business."

US persons include natural persons who are US citizens as well as domestic corporations and other domestic entities recognized under tax law. Subject to US income tax on worldwide income.

Foreign persons include corporations registered and operated in a foreign jurisdiction are taxed only on "US-source-income" or income "effectively connected with a US trade or business". Many foreign corporations do not invest in any US activities or investments and therefore may escape US taxation at the entity level.

Anti-deferral Overview

Thus, if a US person invests in a foreign corporation that earns foreign income the US generally cannot tax the return on that investment until the foreign corporation distributes a taxable amount to the US shareholder.

Moreover, if the foreign corporation did not make any distributions of its earnings to the US person and the US person sold the shares of the foreign corporation at a gain, the gain would be taxable as a capital gain.

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 48

It's important to understand that a US investor in a foreign corporation that invests in assets that produce passive income may escape US taxation under the general rules for corporate stock ownership until the foreign corporation distributes a taxable amount to the US shareholder.

Because shares in a domestic mutual fund that are owned by a US person are subject to a special tax regime to ensure income associated with these investments is afforded timely recognition and proper characterization, US tax law provides for certain anti-deferral provisions relating to investments in PFICs to ensure US taxpayers properly reflect US tax consistent with the treatment for similar investments.

PFIC Tax Regimes

IRC § 1291 Fund

- A "IRC § 1291 fund" is subject to the deferred taxation and an interest charge on "excess distributions."

QEF Election

- The IRC § 1295 QEF election requires the PFIC shareholder to be taxed on the shareholder's portion of the PFIC's ordinary earnings and net capital gains for the year, very similar to the taxation of IRC § 954(c) FPHCI, except long term cap gains can flow thru.

MTM Election

- The IRC § 1296 MTM election taxes the PFIC shareholder on the annual increase in the value of the shareholder's PFIC stock to the extent that the FMV of the stock at the close of the taxable year exceeds the shareholder's adjusted basis in the stock.
- The MTM election losses can be deducted to the extent of prior income inclusions in prior years resulting from the IRC § 1296 MTM election. (See "unreversed inclusions" at IRC § 1296.)

There are three main tax regimes to ensure that PFIC ownership by a US taxpayer produces an equitable treatment of investment income for income tax purposes versus ownership in a domestic mutual fund.

(BRIEFLY discuss all three and a discussion of how the treatment under each is meant to "even the playing field" between investors in foreign securities versus investors in domestic securities. QEF Election and MTM Election are tax regimes that probably have the most familiarity with many revenue agents since the treatment under each is similar to other investment vehicles. Section 1291 Fund and excess distributions will be discussed in more detail in subsequent slides to give a more informed overview (including OVDI Alternative MTM). Detailed coverage should take place in face to face workshops.)

What are “excess distributions”?

Excess Distribution Amount – IRC § 1291(b), Prop. Reg. 1.1291-2(c)

- In most instances for OVDI purposes, excess distributions come about upon the sale of PFIC stock. Any gain on the sale of PFIC of PFIC stock represents a current year distribution, which is characterized as an excess distribution.
- Losses cannot be recognized from the disposition of stock of a “IRC § 291 fund” (Prop. Regs. 1.1291-3, and 1.1291-6) unless otherwise allowed by the Code. Losses are therefore recognized under the normal capital loss rules of the Code.

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 50

(Brief discussion on definition of “excess distributions” for purposes of PFIC tax computations and OVDI.)

Taxation of Excess Distribution

Prop. Reg. 1291-2(e)

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

Continued

Example
Disposition of Section1291 Stock

Facts:

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

Gain on Sale Taxed as Excess Distribution:

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

Tax Consequences in 2004:

- Ordinary Income of $12,500
- Deferred Tax = $14,088
- Deferred Interest = $1,475

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

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

PFIC Taxation
Filing Requirements

Prop. Reg. 1.1291-1(i)

- A US person that is a shareholder in a PFIC must file a Form 8621 with respect to each PFIC of which the person is a shareholder during a year
- Form 8621 is filed by attaching the form to the shareholder's federal income tax return for the year.
- If the PFIC shareholder is not required to file an income tax return, then the Form 8621 must be filed in Philadelphia.

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 53

(Briefly discuss filing requirements of Form 8621 that taxpayers are normally responsible for filing when they hold shares of a PFIC.)

PFIC
How to Recognize in Offshore Cases

- **Taxpayer invests in Investment Funds shown on Offshore Bank Statements**
- **Purchases shares or Units of the Investment Fund; also, the terms "SICAV" and "ICVC" after the name of the fund also indicate the investment is a PFIC**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 54

Generally PFIC holdings on account statements are going to be identified by notations such as "fund", "units", "shares", or some derivation of such that would indicate ownership in a fund that invests in other securities or passive income producing assets. When in doubt, talk to your technical advisor to determine whether you're dealing with a PFIC or not.

PFIC – Audit Tips

- **Look at Statements and look for situations where taxpayer is purchasing "Units" or "Shares" of funds**
- **Gains on Sales of "Units" or "Shares" are subject to Excess Distribution Treatment under IRC § 1291**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 55

Continued from previous slide

PFIC – Audit Tips

IRC § 1291 – Excess Distributions

- **Allocate Excess Distribution over holding period of stock**
- **Allocated Gain to Current Year is treated as Ordinary Income**
- **Allocated Gain to prior years – subject to deferred tax and deferred interest charge**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 56

Under 2011 OVDI, taxpayers or their representative should generally be recognizing when PFICs are present and properly calculate PFIC tax on their amended returns submitted as part of the program. As part of the certification, you'll need to understand how the different elements of the PFIC tax computation work to ensure the taxpayer calculated their tax correctly. You may see some cases where the taxpayer did not properly recognize a PFIC and you'll need to provide adjustments to properly calculate the tax relating to the sale of any PFIC investments.

(Excess distribution should be allocated ratably over the holding period of the stock.)

(Gain allocated to the current year is treated as ordinary tax.)

(Gain allocated to prior years is subject to deferred tax at the highest marginal tax rate and the deferred interest charge.)

PFIC
OVDI Closing Agreement Language

2. During the period 2003 through 2008, Taxpayer invested in one or more Passive Foreign Investment Companies (PFICs) within the meaning of IRC Section 1297(a). Of the unreported income in paragraph 1 above, the following amounts constituted an excess distribution and/or gain on the disposition of PFIC stock subject to the tax treatment imposed by section 1291.

PFIC income	2003	2004	2005	2006	2007	2008
	$	$	$	$	$	$

3. For taxable years 2003 through 2008, penalties under section 6662 of the Internal Revenue Code[*or delinquency-related penalties under I.R.C. § 6651, as applicable*] apply to the underpayments attributable to the aforementioned unreported income and overstated deductions, and PFIC tax under Internal Revenue Code section 1291.

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 57

Cases involving PFICs and PFIC tax computations will require special language to be inserted to the Form 906 to reflect these elements of the closing agreement. Any deviations from the standard language provided above when PFIC income is included require technical advisor approval.

PFIC
Closing Agreement Language (Con't)

Amount to include in the table located in paragraph 1 of the Form 906

- "Distributions from IRC § 1291 Fund"
  - Total amounts from all Form 8621s for the year –Line 10a
- "Gain from the disposition of IRC § 1291 Fund Stock"
  - Total amounts from all Form 8621s for the year –Line 10f (gains only, no losses)

Amount to include in table from the additional PFIC paragraph of the Form 906 (PFIC Income)

- Total amounts from all Form 8621s for the year –Line 10e and 10f (gains only, no losses)

These amounts are included in the table for the year of the disposition of the investment and/or dividend paid.

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 58

(Address each of the items above to explain to participants when the closing agreement special language and amounts are to be included.)

Alternative PFIC MTM

- **Special PFIC MTM for OVDI cases**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 59

For purposes of OVDI, a special PFIC Mark-to-Market methodology for computing the tax amount was developed to help ease the burden on taxpayers when preparing their disclosure and tax computations.

Alternative PFIC MTM Resolution

- **A significant number of cases submitted under the 2009 OVDP involved PFIC investments. A lack of historical information on the cost basis and holding period of many PFIC investments made it difficult for taxpayers to prepare statutory PFIC computations and for the Service to verify them.**
- **As a result, resolution of voluntary disclosure case were unduly delayed. Therefore, for purposes of this initiative, the Service is offering an alternative to the statutory PFIC computation that will resolve PFIC issues on a basis that is consistent with the Mark to Market (MTM) methodology authorized in IRC Section 1296 but will not require complete reconstruction of historical data.**
- **Taxpayers who elect to use the optional method must calculate the gain or loss on every PFIC investment held using this method.**
- **The Form 8621 may not be required for the OVDI period for those taxpayers who elect the optional method, although taxpayers in OVDI 2011 may have used Part III to show the results of the mark-to-market computations. The Form 8621 will be required for periods after 12/31/2010.**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 60

(Briefly discuss the above aspects to give participants and understanding of the origin of the Alt PFIC MTM Resolution and the basic requirements for the program when this election is made.)

Alternative PFIC MTM Resolution

If elected, the alternative resolution will apply to all PFIC investments in cases that have been accepted into this initiative.

- Generally, the first year of the 2011 OVDI application will be for the calendar year ending December 31, 2003.
- This will require a determination of the basis for every PFIC investment –based upon best available evidence.

(Continued from last slide. Discuss concept of "best available evidence" and cite some examples that we used in the 2009 program.)

Alternative PFIC MTM Resolution

- **A tax rate of 20% will be applied to the MTM gain(s), MTM net gain(s) and gains from all PFIC dispositions during the OVDI period, in lieu of the rate contained in the Code for the amount allocable to the current year and for the deferred tax amount(s) allocable to any other taxable year.**
- **A rate of 7% of the tax computed for PFIC investments marked to market in the first year of the OVDI application will be added to the tax for that year in lieu of the interest charge mechanism described in the Code.**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 62

In addition to a relaxation of the requirement to compile a large amount of historical information, one of the primary advantages to taxpayers of the Alt PFIC MTM election is the application of a 20% to the MTM gain(s), MTM net gain(s) and gains from all PFIC dispositions during the OVDI period. This application is in lieu of the rate contained in IRC 1291(a)(1)(B) for amounts allocated to both the current year and to previous years.

In order to compensate for the interest charge mechanism within the regular PFIC computation method, a 7% rate of tax computed for PFIC investments marked to market in the first year will be added to the tax.

Alternative PFIC MTM Resolution

MTM losses will be limited to unreversed inclusions

- Generally, unreversed inclusions are previously reported MTM gains less previously allowed MTM losses
- During the OVDI period, MTM losses will be treated as ordinary losses (IRC § 1296(c)(1)(B)) and the tax benefit is limited to the tax rate applicable to the MTM gains derived during the OVDI period (20%)
- Calculated on an share by share basis in the same manner as IRC § 1296

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 63

When a taxpayer has elected the Alt PFIC MTM method and the FMV of the PFIC investment at the end of the year is less than that of the previous year, MTM losses will be limited to unreversed inclusions which are previously reported MTM gains less previously allowed MTM losses. In other words, taxpayer must have positive Alt PFIC MTM "basis" in order to absorb a MTM loss at year end. During OVDI period, MTM losses are treated as ordinary losses and the tax benefit is limited to the 20% preferential rate applied to MTM gains during the OVDI period.

Example
Alternative PFIC MTM Computation

Facts:

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

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

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

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

Computations:

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

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 64

Continued from previous slide.

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

Example (Continued)
Alternative PFIC MTM Computation

Tax Consequences:

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

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

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

Continued from previous slide.

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

Other Alternative PFIC MTM Issues

- **Other issues including MTM Reduction in Tax (RIT) Carryback and Closing Agreement Language will be included in OVDI workshops**

- **An Alternative PFIC MTM spreadsheet is on the SharePoint site to assist in the certification process**

Additional information pertaining to reflection of MTM losses and the carry back provisions relating to Alt PFIC MTM as well as the closing agreement special language will be included in more depth during OVDI workshops.

Foreign Tax Credit

- **Due to the type of cases in this project, FTC will be an issue on many of these cases**
- **TP files form 1116 that may be incorrect**

Many of you have dealt with issues pertaining to foreign tax credits in the past on other cases. Since most OVDI cases include income from financial accounts in offshore jurisdictions and many times will have foreign tax withholding issues, FTC will be an issue on many of these cases.

You will find on some cases the taxpayer may have included form 1116 that includes FTC, but they're not always correct. There are a few reasons for this and we're going to explore FTC further and how this issue is considered as part of OVDI.

Who can claim the credit?

- US Citizens
- Resident Aliens
- Non-Resident Alien
- A partner in a partnership, or a beneficiary of an estate or trust, may claim their proportionate share of the foreign taxes of the partnership, estate or trust
- A shareholder in a Subchapter S Corporation may claim their proportionate share of the foreign taxes

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 68

(Briefly cover bullet points above on who can claim the FTC.)

What taxes may be credited?

1. Payment must be a tax
2. The tax must be paid or accrued to a foreign country or US Possession
3. Tax must be an income, war profits, or excess profits tax or must be paid in lieu of such a tax)

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 69

(Briefly cover numbered items above to discuss what taxes may be considered in computing FTC.)

What Foreign Taxes Qualify for the Credit?

- **Tax Must be the Legal and Actual Foreign Tax Liability**
- **Taxpayer must determine the amount paid in a manner consistent with a reasonable interpretation of the foreign law, including treaties**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 70

(Further information on what foreign taxes actually qualify for the credit.)

What Foreign Taxes Qualify for Credit?

- **In Lieu of Taxes:**
- **You are likely going to see this in withholding taxes where the foreign tax is on gross income**
- **See Regs Section 1.903-1(b)(3) – Example #2**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 71

It's likely in most of the OVDI cases where FTC may be an issue that withholding taxes have been withheld at the source under the applicable laws of the jurisdiction in which the account is located. When this is the case, the total amount of the withholding is considered taxes paid. However, there may be further limitations on the FTC based on tax treaties with foreign nations.

Elections – IRC § 901

- Must Elect to use foreign tax credits
- Election is Annual
- Election can be made or changed at any time before expiration of the period for making a claim for refund or credit
- IRC § 6511(d)(3) allows 10 years from the date the return is due for claiming a refund of taxes related to foreign tax credits

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 72

Elections must be made to use foreign tax credits and is made annually.

Election can be made or changed anytime before expiration of the period for making a claim for refund or credit, which for foreign tax credits is 10 years from the date the return is due.

Elections – IRC § 901

- **Election is made by actually claiming the credit – no statement or other election required**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 73

(Briefly cover method by which election is made as outlined above.)

(Briefly cover above points.)

When is a Credit Allowed?

- Any taxpayer can determine to use either accrual (regardless of its method of accounting) or cash – IRC § 905(a).
- If accrual is elected, then it needs to be used for all subsequent years

(Briefly cover above points. For purposes of OVDI, the vast majority of taxpayers use the cash method for purposes of FTC.)

Proof of Credits

- For OVDI purposes, agents and group managers have discretion either to accept the foreign taxes claimed as filed or to request backup documentation as described below.
- We may accept secondary evidence such as a copy of a check, draft or other form of payment only if original is "impossible" to get.
- If withholding at source, can accept secondary evidence based on taxpayer's books of accounts and the foreign country and their withholding rates

For most cases in OVDI, evidence of the taxpayer's payment of foreign tax is withholding at source and we can accept secondary evidence based on taxpayer's books of accounts and the foreign country and their withholding rates.

Foreign Currency and Exchange Rates

- **Cash Basis for Foreign Taxes – Temp. Reg. 1.905-3T(b)(2)**
  1. Use date paid
  2. For withholding tax – use date tax withheld
- **Accrual Method – Use average exchange rate for the tax year to which the taxes relate (IRC § 986(a)(1))**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 77

(Briefly cover the issues on the slide to determine how to value the taxes paid for OVDI FTC purposes.)

FTC Audit Issues

- **Election – Did taxpayer make an election to take credit?**
- **Regulations Section 1.901-2(e)(2) – Tax does not meet definition of creditable foreign tax to extent it is "reasonably certain" that it will be refunded**
- **Tax Treaties put limits on tax rate allowed on certain types of income**

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 78

When working OVDI cases, some of the issues you need to consider include whether the taxpayer made a proper election to take the credit. The election is made by actually claiming the credit and there is no need for taxpayer to file an additional statement or disclosure in order to make the election.

FTC will not be allowed when it's "reasonably certain" the foreign tax paid will be refunded to the taxpayer in the future.

Tax treaties between the U.S. and other nations limit the tax rate allowed on certain types of income. See example on next slide.

FTC Table

Instructions for OVDP agents:

Please provide the amount of ***foreign taxes paid or accrued*** ***(not FTC)*** from Form 1116, Part 3, Line 9 (this amount also comes from the last column in Form 1116, Part 2, Line 8) and insert those amounts in the following table. If there were no foreign taxes paid or accrued in a given year, enter "$0.00" so the Technical Advisor knows that the box was not overlooked.

Foreign taxes paid/accrued	2003	2004	2005	2006	2007	2008
Form 1116, original return	$ 0.00	$	$	$	$	$
Form 1116, amended	$ 3,500.00	$	$	$	$	$
Enter the correct amount of foreign taxes paid/accrued per the Certification (see "Examples" below) **	$ 1,500.00	$	$	$	$	$

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 79

** ***Example #1*** - TP reported $3,500 of foreign taxes paid or accrued on $10,000 of dividends received from Switzerland on the amended return. Since the treaty rate for Swiss dividends is 15%, the actual foreign taxes paid/accrued to Switzerland which is eligible for the foreign tax credit is $1,500 ($10,000 x 15%). The $3,500 amount reported on the amended Form 1116 was incorrect and represents the 35% withholding tax on Swiss dividends, of which $ 2,000 is not foreign taxes paid/accrued that is eligible for the foreign tax credit. The foreign taxes paid/accrued that should have been reported on the amended return is $1,500. This scenario can be illustrated with the filled-in amounts for year 2003 above. (The $1,500 of foreign taxes paid/accrued is the amount that should be used in the FTC calculation.)

** ***Example #2*** - TP reported foreign taxes paid or accrued of $8,500 on the amended return. No changes were made to foreign taxes paid or accrued per the certification (foreign taxes were not increased or decreased). The amount entered on the line for "Form 1116, amended" would be $8,500; and the amount entered on the line for the "Correct amount of foreign taxes paid/accrued per the Certification" would also be $8,500.

Name of country to which taxpayer paid or accrued foreign income taxes:_______________________________________

Does AMT FTC apply?_________________ (if so, added paragraph language for Form 906 is required)

Closing Agreement Language

WHEREAS Paragraph should read as follows: Taxpayer paid or accrued foreign income taxes to (insert country name(s)) during taxable years 2003 through 2008;

(New determination paragraph)

Taxpayer paid or accrued foreign income taxes to (insert country name(s)) eligible for foreign tax credit under section 901 of the Internal Revenue Code as follows:

Item / Year	2003	2004	2005	2006	2007	2008
Foreign income taxes paid or accrued	$	$	$	$	$	$

Course 45924 2011 OVDI Training for Examiners New to OVD - Session 3 80

The correct amount of foreign tax paid (or accrued) is reflected on the 906 using modified language. The following reflects how the closing agreement is modified to properly reflect the amount of foreign tax paid that is used to compute the credit on the 4549-A.

Conclusion

- Topics relating to OVDI Specific Issues are complex. This presentation is intended as an overview. Technical advisors are available to assist with questions as they arise and Area Technical Advisors will cover the issues in-depth during training workshops.

ELMS Learning History

- **Please update your ELMS Learning History when you complete this CENTRA course using the job aid provided in the Handouts Folder on L&E's SharePoint site**

Your Feedback is Important

- When you exit CENTRA (File, Exit), the online evaluation screen will pop up
- Type 45924 in the Course Number box
- Enter the requested information. Items with * are required fields
- Click SUBMIT, then provide your feedback

Thank-you for completing the evaluation!