

International Tax Enforcement and Compliance

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Background

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▶ How It Began

▶ UBS Investigation/ Bradley Birkenfeld

- ▶ Criminal investigation

- ▶ Beginning of the extraordinary focus on foreign holdings (2009)

▶ Offshore Investigations/ Swiss Bank Program

▶ Fines

- ▶ UBS - \$780,000,000

- ▶ Credit Suisse - \$2,600,000,000

- ▶ Bank Leumi - \$270,000,000

- ▶ Bank Julius Baer - \$547,250,000

Background - Swiss Bank Program

- ▶ Swiss Bank Program (completed December 2016)
 - ▶ Enormous source of information
 - ▶ Provided Swiss banks with a mechanism to resolve U.S. tax related offenses
 - ▶ Banks disclosed certain information to DOJ in exchange for penalties and non-prosecution agreements
 - ▶ There were 4 categories of banks depending on culpability
 - ▶ 106 Swiss banks identified themselves as Category 2 banks; provided the bulk of information on U.S. held accounts
 - ▶ 78 Non-prosecution agreements entered into

Background (Cont'd)

- ▶ What is impacted by these foreign reporting requirements – **(1) Foreign holdings of (2) U.S. Persons**
 - ▶ **(1) Foreign Holdings**
 - ▶ Bank and Financial Accounts
 - ▶ Interest in Foreign Corporations, Partnerships and Other Foreign Entities
 - ▶ Interests in Foreign Retirement Plans and Trusts
 - ▶ Inheritances/Gifts from Foreign Sources
 - ▶ Cryptocurrency (no FBAR but other reporting obligations) (possibly)

Background (Cont'd)

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- ▶ Some foreign assets are exempt from IRS reporting requirements
 - ▶ Foreign real estate – no income/ no “wrapper”
 - ▶ Foreign currency (not held in a bank or financial account)
 - ▶ Directly held precious metals
 - ▶ Safe Deposit Box
- ▶ **(2) US Person**
 - ▶ Citizen/Resident/Entities/Trusts/Estates

Required Foreign Information Returns

- ▶ Most Common Forms
 - ▶ FBARs – Report of Foreign Bank and Financial Accounts
 - ▶ FinCen Form 114 and 114a
 - ▶ Title 31, Not 26/ Real SOL
 - ▶ Forms 8938 – Statement of Specified Foreign Financial Asset
 - ▶ Forms 3520 – Annual Return to Report Transactions with Foreign Trusts or Receipt of Foreign Gifts
 - ▶ Form 3520-A – Annual Information Return of Foreign Trust with U.S. Owner

Required Forms (Cont'd)

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▶ Forms (Cont'd)

- ▶ Forms 5471 – Information Return of U.S. Person with Respect to Certain Foreign Corporations
- ▶ Forms 5472 – Information Return of 25% Foreign Owned U.S. Corporation
- ▶ Form 8865 – Return of U.S. Persons with Respect to Certain Foreign Partnerships
- ▶ Form 8858 – Information Return of U.S. Persons with Respect to Disregarded Entities
- ▶ Form 8621 – Information Return of a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund (*foreign mutual funds*)
- ▶ Form 926 – Return of a U.S. Transferor of Property to a Foreign Corporation

Why Important?

- ▶ Penalties/ Criminal Prosecution
 - ▶ Range from \$10,000 per failure to 50% of account balance/35% value of gift/interest, etc. / 5% of trust corpus/ Continuation Penalties
 - ▶ Potentially catastrophic penalty computations
 - ▶ **BUT** – U.S. v. Colliot, 121 A.F.T.R. 2d 2018-1834 (WD TX) (FBAR Penalty Cap)
 - ▶ Norman v. United States, 1:15-cv-00872 (Fed. Claims)
 - ▶ Successful criminal prosecutions
 - ▶ U.S. v. Sarshar - \$21 million unreported income, \$8.4 million restitution, \$18.2 million FBAR penalty

Non-Compliance – Available Options (1) OVDP

- ▶ 2009, 2011, 2012 and 2014 (modified)
 - ▶ Thousands of participants and billions of dollars collected, mostly in the form of draconian penalties ranging from 20% to 50% of the highest value of unreported foreign assets (Miscellaneous Title 26 Offshore Penalty)
 - ▶ 2014 OVDP remains open until September 28, 2018
 - ▶ Requires submission of previous eight years of non-compliant income tax returns and FBARs, as well as any unfiled information returns
 - ▶ Payment of tax, accuracy-related penalty of 20% and either 27 ½% or 50% penalty on the highest asset balance, depending on banking institution

OVDP Procedures

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- ▶ OVDP Requirements
 - ▶ Pre-Clearance Fax to IRS
 - ▶ Name/SSN/Address/Bank Info/Entity Info
 - ▶ Pre-Clear Accepted/ Submission of Offshore Voluntary Disclosure Letter and Attachment
 - ▶ Bank account information and approximate tax loss provided
 - ▶ Acceptance into OVDP – 90 days to provide information (extensions provided)
 - ▶ 8 years of amended/unfiled tax returns all missing information returns
 - ▶ Payment of all tax, interest and income tax penalties
 - ▶ Payment of Offshore Penalty – 27 ½ or 50%

OVDP Advantages/ Disadvantages

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- ▶ Cost for Compliance
- ▶ Computation of OVDP Penalty – draconian
- ▶ Number of Years Involved
- ▶ Production of All Bank Records
- ▶ Complete Transparency
- ▶ Actual Closure for Taxpayer
- ▶ Only Protection Against Criminal Prosecution
- ▶ No Certification of Non-willfulness or Reasonable Cause

Non-Compliance - (2) Streamlined Procedures

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▶ 2014 **Streamlined Procedures**

- ▶ Two options – domestic and foreign
 - ▶ Depends on residency for previous three years
- ▶ **Domestic** (U.S. Resident)
 - ▶ 3 years of amended 1040s
 - ▶ Cannot use if unfiled 1040s
 - ▶ 6 years of FBARs
 - ▶ Pay tax and interest due
 - ▶ 5% Miscellaneous Offshore Penalty

Non-Compliance – Streamlined Procedures

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- ▶ Streamlined **Foreign** (Non-Resident)
 - ▶ 3 years of 1040s (Amended or new)
 - ▶ 6 years of FBARs
 - ▶ Pay tax and interest due
 - ▶ NO Miscellaneous Penalty
- ▶ BUT – FOR BOTH, CERTIFICATION OF NON-WILLFULNESS
 - ▶ Both streamlined procedures require submission of a certification by the taxpayer, under penalty of perjury of non-willful actions – reviewed very carefully
 - ▶ However, even gross negligence constitutes non-willfulness

Non-Compliance –

(3) Delinquent Submissions

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- ▶ Delinquent FBAR Submission Procedures
 - ▶ Published guidance on the submission of delinquent FBARs
 - ▶ Must attach certification of reasonable cause
 - ▶ No guidance provided on the number of FBARs to be filed (most comply with those years for which the statute remains open)
 - ▶ No protection from audit or review
 - ▶ Not clear re: additional income issue

Non-Compliance –

(3) Delinquent Submissions

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- ▶ Delinquent International Information Return Submission Procedures
 - ▶ Delinquent information returns may also be submitted outside of the OVDP or streamlined procedures
 - ▶ Can have unreported income and use these procedures according to FAQs
 - ▶ REASONABLE CAUSE CERTIFICATION REQUIRED
 - ▶ No guidance on the number of years to be submitted
 - ▶ NO protection against audit or IRS dismissal of reasonable cause statement

Non-Compliance

(4) Quiet Disclosure

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- ▶ Correct Past Non-Compliance by Filing Delinquent Returns or Amending Previously Filed Incorrect Returns
 - ▶ Disfavored by the IRS
 - ▶ Penalties for late filing automatically imposed
 - ▶ Possible imposition of accuracy-related (may depend on whether qualified amended return)
 - ▶ No protection from IRS – constitutes an admission
 - ▶ Decreases likelihood of criminal prosecution

Non- Compliance –

(5) Going Forward Compliance

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- ▶ Viable Option Under Certain Circumstances, But Risky
- ▶ Statute of Limitations Issues Must Be Considered
- ▶ Current structure leaves gaping hole for certain types of taxpayers
 - ▶ Non-willful taxpayers who underwent an audit on an unrelated issue
 - ▶ Domestic taxpayers who have not filed returns based on knowledge known at the time

Fundamental Considerations for Non-Compliance

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- ▶ Willful versus Non-Willful versus Reasonable Cause
 - ▶ Very difficult, fact-intensive determination
 - ▶ Should almost always be made by an attorney, and any certifications of reasonable cause prepared by an attorney
- ▶ If willful conduct, should go into the OVDP if protection is desired (until September 2018)
- ▶ Willful blindness can equal willful conduct

Fundamental Considerations (Cont'd)

- ▶ Willful blindness requires proof that
 - ▶ High probability that fact exists
 - ▶ Deliberate actions taken to avoid learning the fact
 - ▶ The “Ostrich Problem”
- ▶ Bad Facts Make Bad Law
 - ▶ Recent court decisions have favored the IRS
 - ▶ Courts have recently determined that checking the box on Schedule B is willful blindness (with really bad facts)

Fundamental Considerations (Cont'd)

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- ▶ Non-Willful/ Reasonable Cause Statements
 - ▶ Must be thorough and carefully crafted
 - ▶ Must include bad facts with the good
 - ▶ “I didn’t know” is not sufficient anymore
 - ▶ Particular concern for accountants
 - ▶ Planners/ Engagement Letters
 - ▶ “I told my accountant and s/he said nothing”
 - ▶ “My accountant never asked about offshore assets”

Issues to Watch For

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▶ Tax Organizers

- ▶ Contents must include identification of foreign interests
 - ▶ Financial accounts
 - ▶ Entity ownership/involvement
 - ▶ Income producing assets
 - ▶ Retirement funds
 - ▶ Gifts/transfers

▶ Compliance Issues

- ▶ Once on notice that client has foreign interests or background – obligation to follow up
 - ▶ Disclosure to return preparer is primary defense to penalties in these cases
- ▶ If concerns about reporting or past honesty; refer to attorney

IRS FOREIGN INFORMATION GATHERING AND ENFORCEMENT

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- ▶ FATCA – Foreign Account Tax Compliance Act
 - ▶ Passed in 2010 – creates new reporting structure for foreign financial institutions and U.S. account holders
 - ▶ Generated new forms discussed above (8938; new FBAR form)
 - ▶ 113 Intergovernmental Agreements (IGAs) as of September 2017
 - ▶ Global efforts to combat unreported assets

FATCA (Cont'd)

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- ▶ Mandates that U.S. account holders provide identifying information to foreign banks (usually Form W-9)
 - ▶ If not provided and bank is FATCA compliant, account will likely be closed
- ▶ FFIs are required to conduct due diligence to identify U.S. holders and report that information to the U.S. annually
- ▶ Enforced via withholding if no compliance with FATCA
- ▶ Lots of new rules and definitions

IRS FOREIGN INFORMATION GATHERING AND ENFORCEMENT

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- ▶ IRS – Significant Weapons in the Arsenal
 - ▶ IRS Summons - Required Records Doctrine
 - ▶ Bank of Nova Scotia Summons
 - ▶ Issued to U.S. branch of foreign bank for info on assets at foreign branch
 - ▶ John Doe Summons – unknown taxpayer
 - ▶ Foregone Conclusion Exception to the Fifth Amendment
 - ▶ Treaty Requests
 - ▶ IRS can make requests of foreign tax authorities if U.S. Income Tax Treaty in effect
 - ▶ Most treaties require the IRS to satisfy certain requirements and establish t/p had right to respond

IRS Foreign Information Gathering

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- ▶ Treaty Requests – Problem for Taxpayer
 - ▶ 18 U.S.C. 3506 provides that taxpayers must inform US authorities if they file objections to a request for evidence in a foreign country
 - ▶ Failure to serve this document on the US could be considered part of the ongoing tax offense
 - ▶ If objection filed, no longer eligible for OVDP
- ▶ Mutual Legal Assistance Treaty (MLATs)
 - ▶ Creates a channel for obtaining information on criminal matters
 - ▶ Many in effect cover most U.S. tax felonies, but some have limited coverage at best for tax offenses

Where Is IRS/DOJ Going Next?

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- ▶ The Swiss Banks Divulged Significant Activities in the Following Jurisdictions
 - ▶ British Virgin Islands
 - ▶ Cayman Islands
 - ▶ Channel Islands
 - ▶ Hong Kong
 - ▶ Israel
 - ▶ Liechtenstein
 - ▶ Luxembourg
 - ▶ Panama
 - ▶ Singapore
 - ▶ Isle of Man

Revocation or Denial of Passport

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- ▶ IRC § 7345 authorizes the IRS to certify to the U.S. State Department that a federal debt is seriously delinquent
 - ▶ Tax debt (including interest and penalties) exceeding \$51,000
 - ▶ NFTL filed and administrative remedies under IRC § 6320 have lapsed or been exhausted OR
 - ▶ Levy has been issued
- ▶ State Department may deny issuance of passport or revoke existing passport
 - ▶ Will hold new application for 90 days to allow taxpayer to attempt to resolve with the IRS – challenge certification, pay debt in full or payment plan with IRS
- ▶ IRS is required to notify taxpayer of certification to State Department (Notice CP 508C)
 - ▶ Sent by regular mail to last known address

Revocation/ Denial of Passport

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- ▶ Exempt Taxpayers
 - ▶ Bankruptcy
 - ▶ Victim of Identity Theft
 - ▶ Currently not collectible due to hardship
 - ▶ Federally declared disaster area
 - ▶ Request pending for Installment Agreement/
OIC
 - ▶ IRS accepted adjustment that will pay the
obligation in full
- ▶ Opportunity for error here - challenge to
certification may be required

Revocation or Denial of Passport

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- ▶ Certification will be reversed when
 - ▶ Tax debt is fully satisfied or becomes legally unenforceable
 - ▶ Tax debt is no longer seriously delinquent
 - ▶ Certification was erroneous
 - ▶ IRS is to make reversal within 30 days and notify taxpayer
- ▶ No longer seriously delinquent when
 - ▶ Installment agreement/ OIC entered with IRS
 - ▶ DOJ enters settlement agreement
 - ▶ Collection suspended due to innocent spouse claim
 - ▶ Timely request for CDP hearing
- ▶ No reversal simply because taxpayer pays debt below \$50,000

Revocation or Denial of Passport

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- ▶ State Department cannot be sued for erroneous notification or failed decertifications
- ▶ Taxpayer can sue IRS in Tax Court or U.S. District Court for
 - ▶ Determination whether certification was erroneous
 - ▶ IRS failed to reverse certification when proper
- ▶ IRC §7345 does not provide the court authority to release lien/levy or award money damages in suit to determine erroneous certification
- ▶ Taxpayer is not required to exercise administrative remedies before filing suit in court

Concerns/Hypotheticals

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- ▶ When should an attorney get involved?
 - ▶ “Kip Dellinger” standard (“f” word)
 - ▶ Clear that client has made previous misrepresentations
 - ▶ Any time a determination of reasonable cause/ willfulness/ non-willfulness needs to be made
- ▶ Must be sure that client is compliant in all future returns
- ▶ Must consider collection aspects of these issues as well
- ▶ Hypotheticals