Five Routes to U.S. Tax Regularization

CHOOSE WITH CARE TO FIT YOUR NEEDS

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The Five Routes

- Delinquent FBAR Submission
- Delinquent International Information Return Submission
- Non-Resident Streamlined Filing
- Resident Streamlined Filing
- Full Offshore Voluntary Disclosure Proceedings

You Get What You Pay For

- Everyone Wants to Pay as Little as Possible to Solve a Problem
- With the Routes to U.S. Tax Regularization, the More you Pay (Taxes, Penalties & Professional Fees), the More Relief you Get
  - All routes other than the full Offshore Voluntary Disclosure Program leave you with potential liability
  - Full OVDP (but no other route) ends with a Form 906 "closing letter" that should settle all items of past non-compliance
  - Payment of the "Offshore Penalty" is intended to settle all other penalties that may apply to the undisclosed foreign accounts, assets and entities and tax liabilities for years before the disclosure period
  - Completing full OVDP also normally results in assurance that taxpayer will not be criminally prosecuted

You Get What You Pay For

- John Ruskin - 19th Century Englishman – said it best:
  - It's unwise to pay too much, but it's worse to pay too little. When you pay too much, you lose a little money - that's all.
  - When you pay too little, you sometimes lose everything, because the thing you bought was incapable of doing the thing it was bought to do.

Two Categories of Non-Compliance

- Two categories of past non-compliance remedied by the five routes to U.S. Tax Regularization:

  - Unfiled delinquent or amended tax returns to report unreported or additional income and pay the resulting tax
    - Perhaps the more obvious type of non-compliance

  - Unfiled Informational Returns
    - Less Obvious, but can cause very large penalties

Unfiled Informational Returns

- Unfiled Report of Foreign Bank and Financial Accounts (FBAR)

- Unfiled informational returns, including Forms:
  - 926 Return by a US Transferor of Property to a Foreign Corporation
  - 3520 Annual Return to Report Transactions with Foreign Trusts & Receipt of Certain Foreign Gifts
  - 5471 Information Return of US Persons Regarding to Foreign Corporations
  - 5472 Information Return of 25% Foreign-owned Corporations Engaged in a U.S. Trade or Business
  - 8621 Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund
  - 8858 Information Return of US Persons Regarding Foreign Disregarded Entities
  - 8865 Return of US Persons Regarding Foreign Partnerships
  - 8938 Statement of Specified Foreign Financial Assets

Unfiled Informational Returns - Penalties

- Unfiled Report of Foreign Bank and Financial Accounts (FBAR)
  - Penalty can be as high as the greater of USD 100,000 or 50% of total balance of account *per violation, per year*
  - Theoretically, you could be assessed one 50% penalty for each account for each year for six years…
    - Or 300% times the highest value in each account during the last six years
    - A federal court in Miami tried this recently and the taxpayer settled with the IRS for 100% of the value of the account

Unfiled Informational Returns - Penalties

- Penalties for unfiled informational returns, including Forms:
  - 926 Return by a US Transferor of Property to a Foreign Corporation
    - 10% of value of fair market value of property transferred (normally limited to USD
  - 3520 Annual Return to Report Transactions with Foreign Trusts & Receipt of Certain Foreign Gifts
    - 35% of value transferred to foreign trust or received from foreign trust
    - 25% of value of gift received
  - 5471 Information Return of US Persons Regarding to Foreign Corporations
    - USD 10,000 per year per corporation
  - 5472 Information Return of 25% Foreign-owned Corporations Engaged in a U.S. Trade or Business
    - USD 10,000 per year per corporation

Unfiled Informational Returns - Penalties

- Penalties for unfiled informational returns, including Forms:
  - 8621 Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund
    - While no specific penalty is stated, due to interactions with other forms can be USD 10,000 per year per PFIC / QEF
  - 8858 Information Return of US Persons Regarding Foreign Disregarded Entities
    - USD 10,000 per year per disregarded entity (increases to USD 50,000 if not filed after IRS mails notice of non-filing to taxpayer)
  - 8865 Return of US Persons Regarding Foreign Partnerships
    - USD 10,000 per year per foreign partnership (increases to USD 50,000 if not filed after IRS mails notice of non-filing to taxpayer)
  - 8938 Statement of Specified Foreign Financial Assets
    - USD 10,000 per year per form (increases to USD 50,000 if not filed after IRS mails notice of non-filing to taxpayer)
  - Failure to file certain of these forms also can cause you to lose all or part of the foreign tax credit

Unfiled Informational Returns - Penalties

- Ultimate penalty for unfiled FBARs & unfiled informational returns
  - Criminal prosecution

Delinquent Tax Returns – Late Payment

- Unfiled delinquent or amended tax returns to report unreported or additional income and pay the resulting tax
  - Perhaps the more obvious type of non-compliance
  - Though in many cases, far less prevalent than non-filing of informational returns
    - Who knew?
  - Regardless, carries severe penalties for:
    - Failure to file
    - Non or underpayment of tax
    - Interest on both of the above
    - Ultimately criminal prosecution

How Long Does IRS Have to Catch Me?

- Normal statute of limitations relative to tax filings, non or under-payments, etc.
  - FBARs
    - The only "simple" statute of limitations – always six years (unless voluntarily extended)
  - Filed tax return with inaccuracies
    - Normally three years
  - Can be six years
    - If you understate gross income (total, overall income) by 25% (e.g., your gross income was really USD 100,000 and you only reported USD 60,000)
  - Can be forever
    - If you did not file
    - If your filings are in any way fraudulent
    - And one more way since 2010…

How Long Does IRS Have to Catch Me?

- Your entire return can be audited forever (well at least back to 2004)...
  - If you fail to file any of the following information returns:
    - 926 Return by a US Transferor of Property to a Foreign Corporation
    - 3520 Annual Return to Report Transactions with Foreign Trusts & Receipt of Certain Foreign Gifts
    - 5471 Information Return of US Persons Regarding to Foreign Corporations
    - 5472 Information Return of 25% Foreign-owned Corporations Engaged in a U.S. Trade or Business
    - 8621 Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund
    - 8858 Information Return of US Persons Regarding Foreign Disregarded Entities
    - 8865 Return of US Persons Regarding Foreign Partnerships
    - 8938 Statement of Specified Foreign Financial Assets

Only Full OVDP Can Cut This Off

- With two exceptions:
  - Only FBARs remain unfiled *and you have no other form of tax non-compliance that needs regularizing*
  - Only delinquent international informational returns remain unfiled, *you have reasonable cause (as the IRS defines such) for the non-filing and you have no other form of tax non-compliance that needs regularizing*
- Only making a full OVDP submission will ever finally close all of the years open before the last three.
  - Why?
    - The streamlined procedures only cover the last three years
    - If in any year back to 2007, and likely to 2004, you are missing any of the informational returns, all the years from 2007 (or 2004) and before the last three will always open to IRS examination (as in forever…)

A Quick Overview of the Five Routes

- Delinquent FBAR Submission
- Delinquent International Information Return Submission
- Non-Resident Streamlined Filing
- Resident Streamlined Filing
- Full Offshore Voluntary Disclosure Proceedings

Delinquent FBAR Submission

- Requirements
  - File all FBARs missing for the last six years
- Review
  - Will not automatically be selected, but are subject to normal audit selection standards
- Advantages
  - If this is the ***only thing*** that is noncompliant and you file before the IRS examines you, no penalties will be imposed
- Disadvantages
  - Will not resolve any other type of tax non-compliance

Delinquent International Information Return Submission

- Requirements
  - You must have ***reasonable cause*** for having not filed the relevant informational returns
  - You are not under civil or criminal examination by IRS
  - File all the delinquent informational returns and describe why you have reasonable cause
- Review
  - Will not automatically be selected, but are subject to normal audit selection standards

Delinquent International Information Return Submission -- Continued

- Advantages
  - If this is the ***only thing*** that is noncompliant and you file before the IRS examines you, no penalties will be imposed
- Disadvantages
  - Reasonable cause is subjective, limited and is determined on a case-by-case basis and IRS will impose penalties if it does not accept your reasonable cause statement
  - Will not resolve any other type of tax non-compliance

Non-resident Streamlined Submission

- Requirements
  - Only is available to individuals or the estate of a deceased individual
  - Must certify that you are ***non-willful***
    - Non-compliance was due to negligence, inadvertence, or mistake or conduct resulting from misunderstanding the law)
  - Not under civil or criminal examination by IRS
  - Must have a valid Taxpayer Identification Number, and if you do not have one and are not eligible for a Social Security number, it is currently cumbersome and time consuming to get an Individual Tax Identification Number (ITIN)
  - You must be non-resident in the United States
    - In at least one of the last three years you must not have had a U.S. "abode" and were physically outside the U.S. for at least 330 full days
  - You must file missing informational returns, tax returns (or corrected ones)
  - You must pay all resulting taxes for the most recent three years for which the tax return due date (including any filed extensions) has passed, as well as missing FBARs for the last such six years

Non-resident Streamlined Submission -- Continued

- Review
  - Will not automatically be selected, but are subject to normal audit selection standards
- Advantages
  - Generally, no penalties (though all tax and interest thereon must be paid)
  - Because you must file six years of FBARs and the FBAR statute of limitations is never more than six years, you should close the FBAR issue for past years
  - Professional fees (legal and accounting) will be relatively inexpensive
- Disadvantages
  - Non-compliance must have been non-willful and such is subjective, limited and is determined on a case-by-case basis – it's an art not a science
  - MOST IMPORTANTLY – Will not rectify any outstanding tax or informational reporting issues (other than FBARs) for any period other than those disclosed (i.e., the last 3 years)
    - If you did not file any informational return before the last three years, those prior years are subject to complete examination by the IRS outside this program - If examined may result in very significant penalties
  - Once you make a streamlined submission you are precluded from switching to full OVDP

Resident Streamlined Submission

- Requirements
  - Only is available to individuals or the estate of a deceased individual
  - You must certify you are ***non-willful*** (i.e., non-compliance was due to negligence, inadvertence, or mistake or conduct resulting from misunderstanding the law)
  - You are not under civil or criminal examination by IRS
  - You must have a valid Taxpayer Identification Number, and if you do not have one and are not eligible for a Social Security number, it is currently cumbersome and time consuming to get an Individual Tax Identification Number (ITIN)

Resident Streamlined Submission -- Continued

- Requirements -- Continued
  - You DO NOT meet the non-residency requirement of the non-resident streamlined procedure
  - You HAVE filed a U.S. tax return (if such was required) for each of the last three years for which the tax return due date (including any filed extensions) has passed
    - In the presenter's experience, it is not uncommon for this to block a streamlined disclosure
  - You must file missing informational returns, tax returns (or corrected ones) and must pay all resulting taxes for the most recent three years for which the tax return due date (including any filed extensions) has passed, as well as missing FBARs for the last such six years
  - You must pay a 5% Offshore Penalty based on the high-watermark value of all assets that should have been, but were not, reported on either an FBAR or a Form 8938, during their respective disclosure periods (6 years for FBAR, 3 for 8938)

Resident Streamlined Submission -- Continued

- Review
  - Will not automatically be selected, but are subject to normal audit selection standards
- Advantages
  - Because you must file six years of FBARs and the FBAR statute of limitations is never more than six years, you should close the FBAR issue for past years
  - Professional fees (legal and accounting) will be less expensive that with full OVDP
- Disadvantages
  - Non-compliance must have been non-willful and such is subjective, limited and is determined on a case-by-case basis – it’s an art not a science
  - MOST IMPORTANTLY – Will not rectify any outstanding tax or informational reporting issues (other than FBARs) for any period before the last 3 years)
    - If you did not file any informational return before the last three years, those years are subject to complete examination by the IRS outside this program and if examined may result in very significant penalties
  - Once you make a streamlined submission you are precluded from switching to full OVDP

Full Offshore Voluntary Disclosure Proceedings

- Requirements
  - You are not under civil or criminal examination by IRS
  - IRS has not received information from 3d party alerting IRS to your non-compliance
  - IRS has not received information from a criminal enforcement action (e.g., search warrant, grand jury subpoena, etc.) relative to your non-compliance
  - You must:
    - Cooperate in the voluntary disclosure process, including providing information about all foreign accounts, assets, institutions and facilitators
    - Sign agreement to both the IRS and FinCEN (FBAR) statutes of limitations to cover eight years of filings, plus give the IRS two extra years to examine those eight years
    - File all missing or amended informational and tax returns, as well as FBARs, and must pay all resulting taxes for the most recent eight years for which the tax return due date (including any filed extensions) has passed

Full Offshore Voluntary Disclosure Proceedings Continued

- Requirements -- Continued
  - You must:
    - Pay a 20% accuracy-related penalty multiplied by the full amount of any resulting underpayments of tax from such last 8 years
    - Pay a failure to file penalty of up to 25% (if applicable) multiplied by the applicable amount of any resulting underpayments of tax from such previously unfiled returns from last 8 years

Full Offshore Voluntary Disclosure Proceedings Continued

- Requirements -- Continued
  - You must also:
    - Pay an “offshore penalty” in lieu of all other penalties that may otherwise apply relative to non-compliance
      - The standard offshore penalty rate is 27.5%
      - It increases to 50% if you had a relationship with any institution relative to which the IRS has made a public disclosure such institution is under investigation, is cooperating with the IRS or Department of Justice or has been identified in a court approved summons (a “John Doe” summons) seeking information about its U.S. Person account holders, etc.
      - For a list of such “50% institutions, see: https://www.irs.gov/Businesses/International-Businesses/Foreign-Financial-Institutions-or-Facilitators.
      - Currently there are 62 institutions on such list, with more being added weekly.

Full Offshore Voluntary Disclosure Proceedings Continued

- Requirements – Continued
  - How is the offshore penalty calculated?
    - The offshore penalty is intended to apply to all offshore holdings that are related ***in any way*** to tax non-compliance, regardless of the form of ownership or the character of the asset ("OVDP assets")
    - You multiply the applicable offshore penalty rate against the highest aggregate value of the OVDP assets over the period covered by the disclosure.
    - OVDP assets include all assets directly or indirectly owned by the taxpayer, including financial accounts holding cash, securities or other custodial assets; tangible assets such as real estate or art; and intangible assets such as patents or stock or other interests in a U.S. or foreign business.
    - Due to the fact the above language arguably conflicts with other language contained in the OVDP proceedings frequently asked questions, in certain circumstances it is not crystal clear as to whether some assets are or are not OVDP assets

Full Offshore Voluntary Disclosure Proceedings Continued

- Requirements -- Continued
  - You must also:
    - Pay all of the above-described amounts (or make good-faith arrangements to pay same) at the time you submit your full disclosure package
    - Enter into with the IRS and execute a Closing Agreement on Final Determination Covering Specific Matters (Form 906)
      - Doing so should close with the IRS all past matters that it covers (which should be everything covered by the full OVDP)

Full Offshore Voluntary Disclosure Proceedings Continued

- Review
  - Normally, no examination will be conducted with respect to the disclosure, but the IRS reserves the right to do so
  - Regardless, the disclosure is “certified for accuracy and completeness” by the IRS
    - This “certification” is less formal than an examination and does not carry with it all the rights and legal consequences of an examination
    - However, the examiner has the right to ask any relevant questions and request any relevant documents, including from third parties

Full Offshore Voluntary Disclosure Proceedings Continued

- Advantages
  - You get a closing letter – this should settle all civil matters with the IRS arising before and through the years covered by the disclosure
  - It normally will settle all criminal matters related to the disclosure as well
    - Theoretically in very egregious cases the IRS could still recommend criminal prosecution to the U.S. Department of Justice, but will not normally do so if disclosure is completed
  - As high as the penalties are, it is quite likely they are less than could be assessed in a examination made outside the OVDP proceedings

Full Offshore Voluntary Disclosure Proceedings Continued

- Disadvantages
  - Document intensive and the process is considered by many to be invasive
  - Requires significant competent professional assistance (including legal assistance – normally the lawyers will engage accountants to work under the lawyers to prepare the returns)
  - Generally incur high legal and accounting fees
  - You are precluded from switching to the streamlined procedures