

Quiet Amended Return Issues

Training 2013



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Background and Purpose

Presenter: (b) (6)

(b) (6)



Definition

- A Quiet Amended Return (sometimes called a silent return or a taxable amended return) is a 1040-X or other amended return filed outside of any of the offshore disclosure initiatives, i.e. “silently.”



Program Purpose

- IRS's offshore initiatives provide taxpayers with the opportunity to return to compliance under very favorable terms, but they must also pay reduced penalties
- Taxpayers with undisclosed offshore accounts or assets who file amended returns quietly avoid penalties



Program Purpose

- Taxpayers with undisclosed offshore accounts or assets who file amended returns quietly avoid penalties should not receive a better resolution than taxpayers who come in under an initiative
- Therefore, this program is intended to treat all taxpayers consistently



Commissioner Shulman

- “At the same time, we have also provided guidance to our agents who have cases of unreported offshore income when the taxpayer did not come in through our voluntary disclosure practice. In these cases, we are instructing our agents to fully develop these cases, pursuing both civil and criminal avenues, and consider all available penalties, including the maximum penalty for the willful failure to file the FBAR report and the fraud penalty.”



Examination Issues – Examiner’s Role

- Insure the 1040-X has been assessed
- Insure the 1040-X is accurate
- Review the original return for LUQs
- Consider penalties
 - Accuracy-related penalties
 - Civil fraud penalties
 - Offshore information return penalties
 - FBAR penalties



Years Assigned: AIMS/ERCS Controls

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Upon Assignment:

- Review case and IDRS transcripts to determine how many years of “Quiet Disclosures” were filed



AIMS/ERCS Statute Considerations

- Consider establishing additional years on ERCS with form 5345D (using project code 1160) after careful review of statutes, discussing case with manager and FTA(as appropriate), and using statute exceptions including:



AIMS/ERCS: Statute Exceptions

- Fraud/ and IRC §6501(e) [25% omission]
- FATCA – IRC §6501(e) for \$5,000 omission of income
- IRC §7609(e)(2) – unresolved 3rd party summons
- IRC §6501(c)(8) FTF Information Returns
- F906-to assess tax on barred years
- “YY” memo (discussed later) or



AIMS/ERCS: FBARs

- Research CBRS (F10509) for prior FBAR filing history
- Prior FBAR violation –
 - submit RSM (F13535) to TM,
 - contact FBAR coordinator for assistance (if necessary)
 - add FBAR years to ERCS
 - Complete and forward FBAR Monitoring Document(F13536) to DCC



Legal Authority

Presenter: Dave Breen, SBSE
Counsel



Reminder

- The entire tax year is subject to scrutiny, not simply the amended return
- Deficiencies in income tax and penalties are applicable



Authority to Examine

- United States v Powell, 379 U.S. 48 (1964) - An examination undertaken by IRS to determine if an exception to IRC § 6501(a) is present is not an unnecessary examination
- Put another way, proof of an exception to the 3 year statute of limitations is not a condition precedent to starting an audit



United States v Powell,
379 U.S. 48 (1964)

- The Court did not require IRS to prove fraud before issuing the summons
- IRS can initiate an examination of a tax year to determine if there is an open statute of limitations



Powell, 56, n.15.

The present three-year limitations on assessment of ordinary deficiencies relieves the taxpayer of concern for further assessment of that type, but it by no means follows that it limits the right of the Government to investigate with respect to deficiencies for which no statute of limitations is imposed.



Statute of Limitations – Law

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Counsel



Powell

- IRS can examine a taxpayer who filed a quiet amended return to determine if there is an open statute of limitations
- And if there is
- IRS can conduct an audit so long as the statute of limitations on assessment is open



Quiet Amended Scenarios

- Examinations started while the SOL is still open may be continued after the SOL expires to see if an exception exists
- Examinations may even be started after the SOL has already expired to see if an exception is present to keep the SOL open



General Rule

- IRC § 6501(a) states that tax must be assessed within three years of the date a return is due or filed whichever is later.
- Typically an assessment of tax on a timely filed 2010 return whose original due date was April 15, 2011 must be assessed by April 15, 2014.



Exceptions to IRC § 6501(a) General Rule

- Fraud
- 25% omission of gross income
- FATCA \$5,000 unreported income from offshore source
- Late filed or non-filed offshore information returns



False or Fraudulent Return

- IRC § 6501(c) (1)-(3)
- No return
- False return
- Fraudulent return
- NO SOL!



No SOL Where

- Taxpayer files a return which is false or fraudulent with “intent to evade tax.”
- Taxpayer files no return or files a document which is not considered to be a return



Badaracco v. Commissioner, 464 U.S. 386 (1984)

- The filing of a subsequent nonfraudulent amended return does NOT start the 3 year SOL.
- Once a fraudulent return is filed, nothing can be done to remove the fraud



IRC § 6501(c)(4)

- Form 872 is used to extend SOL by consent of the parties
- 872, 872-A, etc
- The agreement must be executed by both parties before the applicable SOL expires



6 Year SOL IRC § 6501(e)

- Taxpayer omits >25% of gross income the SOL is extended from 3 years to 6 years
- A fractional computation must be made: total unreported income over total reported income must be more than 25%



Omitted Items Do Not Include

- Amounts disclosed on the return or in a statement attached to the return
- Disclosure must be “adequate to apprise the Secretary of the nature and amount of the item”



Partnership Impact

- Rev. Rul. 55-415 states that a partner's gross income includes his % of total partnership's gross income
- Rose v. Commissioner, 24 T.C. 755 (1955)
- Roschuni v. Comm., 44 T.C. 80 (1965) applied the same rule to S-Corp shareholders
- See also, Belcher, T.C. Memo 1958-180



Example

Wages, Dividends, Interest		\$200,000
Taxpayer is 50% partner in ABC Partnership		
ABC's Ordinary Loss	(\$1,000) [Ignore]	
ABC's Gross Income	\$1,000,000	
Taxpayer's Allocation	50%	\$500,000
Taxpayer's Gross Income reported on his 1040		\$700,000
An omission greater than \$175,000 triggers the 6 year SOL		



FATCA's IRC §6501(e)

- If a return has an open SOL as of March 18, 2010 FATCA applies to the return
- If a return to which FATCA applies has \$5,000 of unreported income from a foreign financial account or asset
- The Form 1040 has a 6 year rather than a 3 year SOL



Exception

- The longest SOL under this provision is 6 years from the original due date or date filed
- Example: if a timely filed 2003 Form 1040 has a 6 year SOL due to a 25% omission of gross income, the SOL is 4/15/2010 (6 years from 4/15/2004)
- FATCA does **NOT** extend the SOL in this example for another 6 years to 4/15/2016



IRC § 6501(c)(7)

- If a return with
- A balance due
- Is received within
- 60 days of expiration date
- SOL is 60 days from date received



Failure to Notify Secretary of Certain Foreign Transfers - IRC § 6501(c)(8)

In the case of any information which is required to be reported to the Secretary under section 6038, 6038A, 6038B, 6046, 6046A, or 6048, the time for assessment of any tax imposed by this title with respect to any event or period to which such information relates shall not expire before the date which is 3 years after the date on which the Secretary is furnished the information required to be reported under such section.



Applicable Code Sections Forms and Statutes

- Foreign Trust Information Returns, Forms 3520 and 3520-A (IRC § 6048)(Penalties per IRC § 6677)
- Relationships with Foreign Corporations, Forms 5471 and 5472 (IRC §§ 6035, 6038, 6038A, 6046)
- Relationships with Foreign Partnerships, Form 8865 (IRC §§ 6038, 6038B, 6046A)
- Transfer of Property to a Foreign Corporation, Form 926 (IRC § 6038B)



SOL is Extended

- Until the information required to be reported to IRS is furnished, plus 3 years!
- SOL remains open only for items related to the failure to file the information return.



Effect of a Closing Agreement

Issue:

To what extent do the provisions of a closing agreement have on the Service's authority to assess tax after expiration of the statute of limitations?



Constitutional Impact

- Criminal cases – SOL may not be extended or revised
- Civil Cases – Broad authority for parties to negotiate SOL



Dubinsky v. Becker,
64 F.2d 601 (8th. Cir. 1933)

- Taxpayers argued, after the closing agreement was signed by both parties, that the SOL had expired for assessment of additional tax
- Service relied on the provisions of the closing agreement, i.e. valid unless there is fraud or misrepresentation



Dubinsky v. Becker

The Court:

“The statute clearly points out the instances in which the [closing] agreement may be questioned...fraud, malfeasance and misrepresentation. It does not say that such an agreement may be overturned upon a showing that a part, or all, of the taxes paid were assessed after they were barred by limitation...So there can be no recovery unless the agreement is vulnerable for one or more of the above reasons.



Dubinsky

Holding:

1. Closing agreement of March, 1928, was executed voluntarily by parties in accordance with statute.
2. Evidence does not disclose fraud or malfeasance or misrepresentation of fact materially affecting determination or assessment made.
3. The closing agreement is binding absent fraud, etc.
4. Taxpayer has to pay the tax because the closing agreement is valid and binding.



See also,

IRM 8.13.1.7.1 *et seq.* (Closing Agreement Manual) for a discussion of Dubinsky's relevancy today.



ASSESSMENTS

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ASSESSMENTS

Just like it sounds

An assessment of tax is merely the recording of a tax liability in IRS's books and records, but it is *the* critical event in IRS's compliance efforts. IRC § 6203.



If the IRS doesn't make the assessment of tax before the expiration of the SOL, then the IRS/Gov't loses the money.

ASSESSMENTS

Generally, the IRS is authorized to summarily assess tax reported to the IRS by the taxpayer on a tax return (Form 1040 and 1040-X).

IRC § 6201(a)(1).

For deficiency assessments, the IRS may not assess tax until the taxpayer receives a statutory notice of deficiency (90 Day Letter) and during the 90 days the taxpayer has to decide whether to petition the Tax Court.

IRC § 6213(a).



DEFICIENCY ASSESSMENTS

There are several exceptions to the “No
Statutory Notice = No Assessment” rule
for deficiency assessments

- IRC § 6213(a) – permits IRS to assess tax if a taxpayer waives his right to receive a notice of deficiency prior to assessment (Forms 4549, 870, 870-AD)



DEFICIENCY ASSESSMENTS

- IRC § 6213(b) – permits IRS to assess tax attributable to a math or clerical error on a filed return
- IRC § 6213(c) – permits immediate assessment of tax if a taxpayer does not file a petition after receiving a notice of deficiency
- IRC § 6861(a) – permits IRS to immediately assess tax if assessment and collection of the tax is in jeopardy



DEFICIENCY ASSESSMENTS

- IRC § 7121(a) – permits IRS to enter into an agreement where both the taxpayer and the IRS agree to an assessment



ASSESSMENTS AND THE STATUTE OF LIMITATIONS

When a quiet amended return is received, the IRS should immediately assess the additional tax reflected on it to insure that the Government's interests are protected. However, the additional assessment of tax cannot be made in a tax year otherwise barred by statute.



ASSESSMENTS AND THE STATUTE OF LIMITATIONS

Because the processing Campus has no mechanism for determining if one of the excepted statute of limitations provisions applies (25% omission; FATCA; Failure to notify the Secretary of certain foreign transfers, etc.), they generally process only those amended returns where the IRC 6501(a) statute remains open.

NOTE: A more indepth discussion of the statute of limitations in the context of quiet amended returns is covered later in this presentation



ASSESSMENTS AND EXAMINER

As such, upon assignment of a quiet amended return, the examiner must make sure the additional tax has been assessed in ALL years where there is an open statute, including those where the excepted statute of limitations provisions apply.



ASSESSMENTS AND EXAMINER

If the additional tax has not been assessed, the examiner needs to protect the Government's interest, and forward the amended return for quick assessment.

(See IRM 4.4.25 for Quick Assessment Procedures.)



QUICK ASSESSMENT VS. PROCESSED RETURN

When a Quick Assessment is input into a tax module, only the Tax is adjusted. The Taxable Income, AGI, Exemptions, SE tax, and certain tax credit remain unchanged on the tax module. Failure to recognize and correct this mismatch prior to closing the case will cause it case to be returned to the examiner.



QUICK ASSESSMENT VS. PROCESSED RETURN

The following steps should be taken to recognize a quick assessment and to correct the mismatch in the tax module:

To determine if a quick assessment has been posted, use IDRS to secure:

- an IMFOL/BMFOL "T"
 - A quick assessment can be identified if a TC 370 is posted just prior to a TC 290 tax assessment
- an IMFOL/BMFOL "R"
 - A quick assessment can be confirmed if the Tax per the tax modules matches the amended return, but the AGI and TI still reflect the original return amounts



QUICK ASSESSMENT VS. PROCESSED RETURN (Cont'd)

- If the tax was quick assessed, complete Form 3870, *Request for Adjustment*. The following language should be included:
 - Line 11, Reason for Adjustment
 - “To post and correct AGI and TI from quick assessment on xx/xx/2012”



QUICK ASSESSMENT VS. PROCESSED RETURN (Cont'd)

- Line 29, Assessment, Item or Credit Adjustment Processing Information

Ref. No.	Item Adjustment	Ref. No.	Credit Adjustment
888	AGI		\$12,345
886	Taxable Income		\$1,234

NOTE: Amended returns with adjustments to Exemptions, SE tax, and credits will require additional reference numbers



QUICK ASSESSMENT VS. PROCESSED RETURN (Cont'd)

- Fax the completed Form 3870 to the FORT:

Memphis

SBSE Areas 201 – 207

Fax Number 901-786-7106



ASSESSMENTS AND THE RAR

Once the tax is **fully** assessed/processed, in determining any additional underpayment, the examiner will work from the total tax reflected on the 1040-X. That figure will be the “tax as previously adjusted” on a subsequent Form 4549 or 4549-A.



Examination Aids

- Proforma IDR and Interviews
- Court Reporters
- Summonses
- Formal Document Requests
- Addressing Excess Collections Actions



Pro Forma IDR & Initial Interview

Presenter:

(b) (6)



IDRs / Interviews

- IRM requires examiners to secure information from taxpayers before making third-party contacts
- If taxpayers won't provide it – third-party contacts, including use of summons are permitted



IDRs / Interviews

- In the case of third-parties outside the United States
 - Examiners may never issue a summons
 - Examiners may not call directly
- Tax attaché is the contact point
- But you may summons a witness in the United States for his records he controls regardless of where the records are located



IDRs / Interviews

- Proforma interview topics
- Initial interview may be only opportunity to talk with the taxpayer
- Pre-planning is crucial to a quality interview
- Prepare an outline of questions to ask the taxpayer



IDRs / Interviews

- Types of interview questions
 - **Open-ended** – Invites taxpayer to speak freely
 - **Closed-ended** – used for facts/specific details
 - **Probing** – Dig deeper for clearer more precise answers
 - **Leading** – give a strong indication of a preferred answer



IDRs / Interviews

- Allow periods of silence
- Do not answer questions for the taxpayer
- Listen for the unstated meaning
- Keep an open mind - flow with the conversation to obtain unexpected information



Court Reporters

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COURT REPORTERS

Purpose

- Recommended by Counsel in most taxpayer interviews pursuant to a summons
- The transcript produced by the court reporter becomes an important piece of case development or future trial



COURT REPORTERS

How to secure

- Examiner's responsibility to initiate
- Procurement process should be initiated 30 days (minimum) in advance of interview
- Court Reporter/Arbitrator Request Form

(This is a LR form; can be used for field requests. See the Quiet Disclosure Desk Guide for line-by-line instructions)

<http://awss.web.irs.gov/Procurement/forms/cr-arbitrator-request-form.xls>



COURT REPORTERS

How to secure (cont'd)

- Approval of GM and TM required
- The approved request must be input into the Integrated Procurement System (IPS) by an IPS user (typically the GM or TM's secretary)
- IPS will automatically channel the request through the funding approval process



COURT REPORTERS

How to secure (cont'd)

- A Contract Specialist will enter into a contract with the vendor, and provide vendor info to the examiner so logistics can be arranged
- After a transcript of the interview is provided to the examiner, the IPS user will input Receipt and Acceptance, and the vendor will be paid by Beckley Finance Center.



COURT REPORTERS

- Questions?
 - Procurement Hotline
202-283-1478, Option 5



Summonses & Formal Document Requests

Presenter: (b) (6)

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BACKGROUND

Taxpayers required to file returns must keep permanent books or account or records sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown in any return.



BACKGROUND (cont'd)

IRC § 7602 authorizes examiners to examine any books, papers, records, or other data which is or may be relevant or material to an examination.

- Includes the issuance of a summons



Summons Resources

Internal Revenue Code

- IRC § 6001-Taxpayers are required to keep records.
- IRC § 6201-IRS is authorized to make inquiries, determinations and assessments of tax interest and penalties.
- IRC § 7602-Examination of Books and Witnesses
- IRC § 7603-Service of Summons
- IRC § 7604-Enforcement of Summons
- IRC § 7605-Time and Place of Examination
- IRC § 7609-Special Procedures for 3rd Party Summonses
- IRC § 7610-Fees and Costs for Witnesses
- IRC § 7612-Special Procedures for Summonses for Computer Software
- IRC § 7622-Authority to Administer Oaths and Certify
- IRC § 7210-Failure to Obey Summons

IRM 25.5-Summons Manual



What is an enforceable Summons?

- To be enforceable, a summons must meet the following requirements under the “Powell Test”:
 1. The summons must be issued for a legitimate purpose.
 2. It must seek information that may be relevant to the investigation.



What is an enforceable Summons? (Cont'd)

3. It must seek information that is not already in the Service's possession.
4. All administrative steps required by the code must be followed.



Before Issuing a Summons

- Encourage voluntary compliance with an IDR



Summons the Taxpayer:

- Taxpayer interview is needed to answer questions about the foreign entities
- No records are made available to permit an adequate exam within a reasonable time period.
- Submitted records are known or suspected to be incomplete and additional records may be obtained from 3rd parties.
- Taxpayer will not seriously attempt to provide documentation because they intend to offer explanations at a later date.
- The existence and location of records are in doubt



Summons the Taxpayer **(cont.)**

- Consider having Counsel review the summons (and possibly the IDR) before issued
 - Language should be the same
- Request summons enforcement if the taxpayer fails to comply



Summons Foreign Bank Records:

- May be able to secure the bank records of a foreign branch of a U.S. bank
- May be able to secure bank records of a foreign branch of a foreign bank if the foreign bank has a U.S. branch
- Must coordinate these types of summons with Counsel



Points to Remember when Requesting Foreign Records:

- Foreign records may be available under a tax treaty or a tax information exchange agreement
- Contact the Tax Attaché to handle requests for foreign records
- Do not contact a foreign government
- Do not contact a foreign person
- Do not issue a summons to a foreign person



Formal Document Request

- IRC § 982-Formal Document Request
- Applies to records located outside the U.S.
 - If the records are located within the U.S., attempt to secure the records via a summons.
- Must informally request the foreign records prior to serving a Formal Document Request (Sec. 982(c)(1))
- Must coordinate all requests with Counsel



Contents of a Formal Document Request:

- A Formal Document Request must contain the following information, pursuant to section 982(c)(1):
 - Time and place for the production of the foreign documents;
 - Statement of the reason the documentation previously produced (if any) is not sufficient;
 - Description of the documents being sought; and
 - Consequences to the taxpayer of the failure to produce the requested documentation.



Contents of a Formal Document Request (Cont'd):

- A Formal Document Request must be mailed to the taxpayer's last known address by certified or registered mail.
- Taxpayer may try to quash.



Taxpayer Fails to Comply **with FDR**

- A taxpayer must “substantially comply” with a Formal Document Request within 90 days of mailing of such request.
- If the taxpayer does not substantially comply, then the taxpayer will be precluded from using the requested documents at a subsequent civil trial absent reasonable cause.



Formal Document Request vs Summons

- A Formal Document Request may only be served on the taxpayer. A summons may be served on either the taxpayer or third parties. Thus, a summons should be utilized if the desired records are in the possession or control of a third party witness.



Formal Document Request vs Summons (cont.):

- A Formal Document Request may only be used to secure records that are located outside of the United States. A summons may be used to secure relevant records, wherever located. If the examiner is unsure whether the records are located within the United States, he should serve both a Formal Document Request and a summons.



Formal Document Request vs Summons (cont.):

- If a taxpayer does not substantially comply with a Formal Document Request, the penalty is one of exclusion.
 - The taxpayer will not be able to use the documents in a subsequent civil litigation. The IRS may only request that a court compel the production of foreign records requested in a Formal Document Request if the taxpayer files a Petition to Quash the Formal Document Request.
 - Summonses are routinely enforced to compel the production of documents if the taxpayer does not adequately produce the requested records. Therefore, the examiner may wish to serve a summons if the foreign documents are important in establishing the IRS' position or where the IRS might have the burden of proof at trial (e.g., the issue is fraud or unreported income).



Payment Issues

Presenter: (b) (6)

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EXCESS COLLECTION (XCF)

- What is it?
 - The Excess Collection File (XCF) controls remittances that cannot be applied to a taxpayer account due to the expiration of the statute, etc.
 - It represents conscience money and voluntary contributions to reduce the national debt.



EXCESS COLLECTION (XCF)

- What it means to Quiet Disclosure cases?
 - The Quiet Disclosure taxpayer may have filed taxable amended returns and remitted payment in tax years that *appear* to be barred by statute.
 - The processing Campus, believing the statute was barred, may have moved the payment to XCF.
 - Payments moved to XCF can be found on an IMFOLT or TXMOD, TC 672 followed by the notation “EXCESS-COLL”



EXCESS COLLECTION (XCF)

- How to get the XCF monies back?
 - Complete Form 3870, Request for Adjustment
 - “Reason for Adjustment” box
 - Request payment be credited back to the taxpayer’s tax module from XCF
 - Include a statement justifying the open statute of limitations
 - » IRC 6501(e)(1)(A)(ii) or IRC 6501(c)(8)
 - Secure GM’s approval
 - FAX to CCP
 - 901-786-7106 (for SBSE)



ERRONEOUS REFUNDS

- It can happen if your taxpayer received a refund and you determine they shouldn't have...
 - When a payment posts to the tax module, but the taxable amended return doesn't (i.e. its sent to the field for examination)



ERRONEOUS REFUNDS (cont'd)

- You can fix it if
 - the taxpayer didn't cash the refund check(s)
 - IRM 21.4.3.4.4 – Returned Check Procedures
 - Input TC 570 on the tax module to insure the monies aren't refunded again
- You can't fix it, if
 - The taxpayer cashed the refund check(s)
 - The taxpayer must resubmit payment
 - Input TC 570 on the tax module to insure the monies aren't refunded again



Estate and Gift Tax Considerations

Presenter: (b) (6)

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Three Possible Scenarios

There are three possible scenarios that your taxpayers may attempt to utilize:

- I received the account(s)/asset(s) as a gift from...
- I inherited the account(s)/asset(s) from...
- I don't know what you're talking about...



Gifted Accounts

- Who was the donor (gift giver)?
- What was the date of the gift?
- What is the address of the donor?
- What was the amount of the gift?
- What was the form of the gift (cash, securities, etc.)?



The RA should ask the questions of the taxpayer and/or the POA. We need to ascertain whether there was a gift tax return filed, did the so-called donor have the financial wherewithal to actually give that much, is there a potential gift tax liability?

Even though the amount in question may not result in a gift tax liability for the donor, we need to attempt to secure the unfiled Form 709. The taxpayer is only allowed a certain amount of tax-free gifts during their lifetime, referred to as their Unified Credit Amount, and once this is passed, the gifts made after that become taxable. Plus, any gift tax returns filed, even though non-taxable, will reduce the amount of their estate that is eligible for exclusion from estate transfer taxes.

Gifted Accounts (Cont'd)

- Was there a gift tax return (Form 709) filed?
- If so, do you have a copy or the name of someone who does?



Gift Tax Information

- Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, is used to report transfers subject to the federal gift tax and certain generation skipping tax and to compute the tax, if any, due on these transfers.



Gift Tax Information (Cont'd)

- A gift must exceed the exemption amount, which varies from year to year. For example, for calendar year 2012, the amount exempt from gift tax filing requirements is \$13,000. if the gift is made to a citizen or resident of the United States.



Gift Tax Information (Cont'd)

- Any tax due is imposed on the person giving the gift (donor).
- Refer to workbook for a breakdown of possible taxable gift criteria.



Filing Requirements for Form 709

- Form 709 is due generally no later than April 15 of the year following the calendar year in which the gifts were made. If the donor dies during the year the gifts were made, the executor must file the Form 709 the earlier of the due date (including extensions) of the donor's estate tax return (Form 706) or April 15 of the year following the year the gifts were made.



Delinquent Returns

- If you determine that there should have been a Form 709 filed, solicit the return and, upon receipt, forward for processing.
Or,
- If you receive a delinquent Form 709, forward it for processing to:
Department of the Treasury
Internal Revenue Service
Cincinnati, OH 45999



Maintain a copy of the delinquent return for your casefile.

Inherited Account

- What was the name of the decedent?
- What was the address of the decedent?
- What relationship was the decedent to the Volunteering taxpayer?
- When did the decedent die (date of death)?
- Who was the executor, administrator or personal representative for the decedent?



Inherited Account (Cont'd)

- What was the nature of the bequest or inheritance (cash, securities, partnership interest, closely held business shares, any other asset)?
- What was the value of the bequest or inheritance when received from the decedent's estate?



Inherited Account (Cont'd)

- Was there an estate tax return (706) filed?
- If so, do you have a copy or the name of someone who does (you may have received it due to step up in basis of the assets you received from the estate)?



Filing Requirements for Form 706

- The Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, is used to report the estate tax for a taxable estate and to compute the generation-skipping transfer tax on transfers to skip persons of interests in property included in the decedent's gross estate. The Form 706 is due generally 9 months after the date of the decedent's death.



Filing Requirements

- 2002 = \$1,000,000
- 2003 = \$1,000,000
- 2004 = \$1,500,000
- 2005 = \$1,500,000
- 2006 = \$2,000,000
- 2007 = \$2,000,000
- 2008 = \$2,000,000



Filing Requirements (Cont'd)

- 2009 = \$3,500,000
- 2010 = \$5,000,000*
- 2011 = \$5,000,000
- 2012 = \$5,120,000



Year of Death: 2010

- Technically, there was no estate tax due for decedents in calendar year 2010. However, there was an option provided to those estates in excess of \$5,000,000 for filing a return in order to adjust the basis of the estate's assets as defined under IRC §1022. If your decedent's tax year is 2010, contact the E & G Liaison.



Delinquent Returns

- If you determine that there should have been a Form 706 filed, solicit the return and, upon receipt, forward for processing.
Or,
- If you receive a delinquent Form 706, forward it for processing to:
Department of the Treasury
Internal Revenue Service
Cincinnati, OH 45999



I don't know what you're talking about...

- While this is an unlikely position taken by the taxpayer in light of having filed amended returns, you may encounter situations where the taxpayer denies all knowledge of the existence of what we know, or suspect, as a result of preliminary research conducted to be either an inherited or a gifted account. At that time, there are certain things that can be done.



RA Procedures

- Check IDRS to see if the donor (typically, a parent or other relative) filed any gift tax returns or an estate tax return. This would be done by utilizing the IDRS command code BMFOLI followed by the original donor's SSN, followed by the letter V. For example: BMFOLI123-45-6789V
- If IDRS shows that either a Form 706 (MFT 52) or Form 709 (MFT 51) was filed, contact the E & G Liaison to request the original return (the liaison will order the return and review it for you, you cannot order these returns yourself).
- If no information is available on IDRS, you should contact the E & G Liaison to determine whether a referral to E & G is warranted. If so, then you would continue to work your case and, when the referral is assigned within E & G, you will be contacted by the E & G attorney and will coordinate case actions with him/her.



E & G Liaison

(b) (6)



Session II

- Civil Penalties
- Offshore Penalties
- Penalty Procedures



Civil Tax Penalties

Presenter: (b) (6)
(b) (6)



Accuracy Related Penalties – Based on Underpayment of Tax

- IRC §6664 defines an underpayment as

Total Correct Tax

Less: Amount of tax shown on return

Equals: Underpayment

- If there is no underpayment, there can be no penalty



Accuracy Related Penalties – IRC §6662 - Negligence

- Penalty is 20% of the underpayment attributable to negligence or disregard of rules or regulations
- Negligence is “any failure to make a reasonable attempt to comply with the Code
- Disregard of rules or regulations must be “careless, reckless, or intentional”



Treas. Reg. § 1.6662-3 Examples of Negligence

- T/P fails to include an amount on an information return
- T/P fails to ascertain correctness of a suspicious deduction, credit or exclusion
- T/P-partner fails to treat partnership items consistently
- T/P “S” Shareholder fails to treat “S” Corp items consistently



Disregard of Rules / Regulations

- Rules/Regulations
- Disregard is careless
- Disregard is reckless
- Disregard is intentional
- A position is frivolous
- Code, temporary or final regulations, revenue rulings and notices
- T/P does not exercise due diligence to ascertain correctness of suspicious item
- T/P makes little or no effort to find out if a rule exists
- T/P knows it exists
- Patently improper



Coleman v. Commissioner, T.C. Memo 1990-511

- T/Ps invested in a tax shelter
- T/Ps relied on private placement memorandum and tax opinion letter
- Tax Court sustained negligence penalty



Coleman v. Commissioner, T.C. Memo 1990-511

Court applied Freytag v. Commissioner, 85 T.C. 849 (1987), which held that reliance on an advisor is only one fact to be considered to mitigate negligence, but “first it must be shown that the reliance was reasonable.”



Reliance

- Taxpayer must provide professional with all relevant information
- Taxpayer must actually rely on the professional
- Reliance must be reasonable
- Filing cannot be delegated to professional
- Taxpayer has duty to inquire to regarding his filing and reporting obligations



Substantial Understatement Penalty

- 20% accuracy-related penalty on a “substantial understatement”
- “Substantial understatement” is one which exceeds the greater of: (1) 10% of the tax required to be shown on the return or \$5,000 [\$10,000 for corporations]

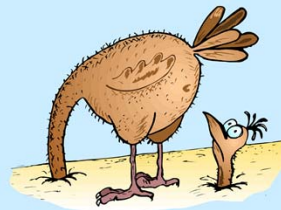


Defenses to §6662(b)(2)

- Substantial Authority



- Adequate Disclosure



Substantial Authority

- Internal Revenue Code
- Treasury Regulations
- Court decisions
- Revenue rulings and procedures
- Legislative history
- Private letter rulings



Adequate Authority is NOT

- Treatises
- Legal periodicals
- Tax opinions



Adequate Disclosure

- Must be disclosed on the return or in a statement to the return
- Form 8275, Disclosure Statement
- Adequate Disclosure does not apply to tax shelters



Valuation Misstatements

- Applies to a “substantial valuation misstatement”
- Applies to overvaluations of value of basis in excess of 200% of correct value
- >400% raises penalty to 40%
- \$5,000 [\$10,000 for corporations] amount still applies



Consolidate Reasonable Cause Exception under IRC §6664(c)

- No penalty shall be imposed under this part with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.



IRC §6663 Civil Fraud Penalty

- 75% of the underpayment attributable to fraud



IRC §6663 Civil Fraud Penalty

- I.R.S. must prove:
- (1) an underpayment exists; and
- (2) the taxpayer intended to evade taxes
- Recklitis v. Commissioner, 91 T.C. 874 (1988)



IRC §6663 Civil Fraud Penalty

- IRC §7454(a) – Burden of proof is on IRS
- Clear and Convincing evidence is required
- Once met, the burden shifts to the taxpayer to prove:
- The portion of the underpayment that is not due to fraud
- Taxpayer needs preponderance of evidence



Badges of Fraud
Spies v. United States, 317 U.S. 492 (1943)

- (1) substantial understatements of income;
- (2) inadequate books and records;
- (3) failure to file tax returns;
- (4) implausible or inconsistent explanations of behavior;
- (5) concealment of assets;
- (6) failure to cooperate with tax authorities;
- (7) filing a false W-4;
- (8) failure to make estimated tax payments;
- (9) significant cash transactions;
- (10) participation in illegal activities; and
- (11) failing to file tax returns.



Qualified Amended Return

- Treasury Regulation 1.6664-2 provides that if a taxpayer voluntarily files an amended return to correct an error the occurrence of certain events, the amount of additional tax in the 1040-X will not be included in the amount of underpayment for purposes of an accuracy-related penalty



A “qualified amended return” is an amended return filed before the date:

- Taxpayer is first contacted by the Internal Revenue Service (IRS) concerning any examination (including a criminal investigation) with respect to the return;
- Any person is first contacted by the IRS concerning an examination of that person under section 6700 (relating to the penalty for promoting abusive tax shelters) for an activity with respect to which the taxpayer claimed any tax benefit on the return directly or indirectly through the entity, plan or arrangement described in section 6700(a)(1)(A) ;
- (C) In the case of a pass-through item (as defined in § [1.6662-4\(f\)\(5\)](#)), the date the pass-through entity (as defined in § [1.6662-4\(f\)\(5\)](#)) is first contacted by the IRS in connection with an examination of the return to which the pass-through item relates;
- (D) (1) The date on which the IRS serves a summons described in section 7609(f) relating to the tax liability of a person, group, or class that includes the taxpayer



Burden of Proof – IRC §7491

- IRS has original burden of production in court for any penalties asserted
- Taxpayer bears the burden of proving any defenses or exceptions to penalty applications



Offshore Penalties – Law

Presenter: (b) (6)

(b) (6)



Focus of Quiet Disclosure Initiative

The primary focus of the Quiet Disclosure Initiative is on undisclosed foreign financial accounts and on unreported foreign sourced income.



However, taxpayers have accomplished the same ends by...

- Creating a foreign trust and transferring assets into it...
- Creating an arrangement whereby a foreign person makes “gifts” to a US taxpayer...
- Creating a foreign corporation and transferring assets into it, or...
- Creating a foreign partnership and transferring assets into it.



Foreign Trusts & Foreign Sourced Gifts

- In 1962, Congress enacted IRC 6048, related to foreign trusts.
- In 1996, Congress enacted IRC 6039F related to foreign gifts.



Three Provisions to IRC 6048

- **IRC § 6048(a): Requires a Form 3520 for any of three “Reportable Events.”**
- **IRC § 6048(b): Requires a Form 3520-A for a U.S. person who owns a foreign trust, under the Grantor Trust rules of IRC § 671 - § 679.**
- **IRC § 6048(c): Requires a Form 3520 for any U.S. person who receives a distribution from a foreign trust.**



Additionally...

- **§ 6039F(a) requires a U.S. person who receives gifts from foreign persons whose aggregate value in a tax year is over \$10,000 to report the gifts on Form 3520 Part IV.**



IRC § 6048(a) “Reportable Events”

- **Requires Form 3520 for “reportable events”:**
 - **Creation of foreign trust by U.S. person**
 - **Transfer of money or property by U.S. person**
 - **Death of U.S. citizen or resident if:**
 - **decedent is treated as an owner of a foreign trust, or**
- **any portion of a foreign trust is includible in the decedent’s estate**



Exceptions to Reportable Events

- Fair market value sales or exchanges
- Certain transfers to deferred compensation or charitable trusts



Additionally...

- **A Form 3520 is required each year even though there were no transactions involving the foreign trust.**



IRC § 6048(b)

- **U.S. person treated as an owner of a foreign trust (Grantor Trust Rules of § 671 - § 679) is responsible for ensuring such trust:**
 - **Files Form 3520A**
 - **Designates a U.S. agent and reports same to IRS**
 - **Provides income information to owners**
 - **Provides distribution information to beneficiaries**



IRC § 6048(c)

- **Requires Form 3520 from any United States person who receives distributions from a foreign trust**
- **Inadequately documented distributions may be included in income by the Secretary**



IRC § 6677 Penalty Structure

- **Civil penalty (in addition to any criminal penalty)**
- **Applies if any notice or return required to be filed by IRC § 6048:**
 - **Is not filed on or before due date, or**
 - **Does not include all required information, or**
- **Includes incorrect information**



Penalty:

- **35% of “gross reportable amount”, plus \$10,000 for each 30-day period failure continues after notice**
- **Maximum = “Gross Reportable Amount”**



Gross Reportable Amount

- **Re IRC § 6048(a): Gross value of property involved in the event, as of the date of event**
- **Re IRC § 6048(b): Gross value of trust's assets treated as owned by the taxpayer, as of the end of the year**
- **Re IRC § 6048(c): Gross amount of distributions**



IRC § 6039F(c) Penalty

Foreign Gifts over \$10,000 Not Reported on Form 3520 Part IV

- **5% of amount of certain foreign gifts per month failure continues**
- **Not to exceed total of 25%**
- **Amounts purported to be gifts may be re-characterized based on the available evidence**



IRC § 6677(d)

“Reasonable Cause” Defense

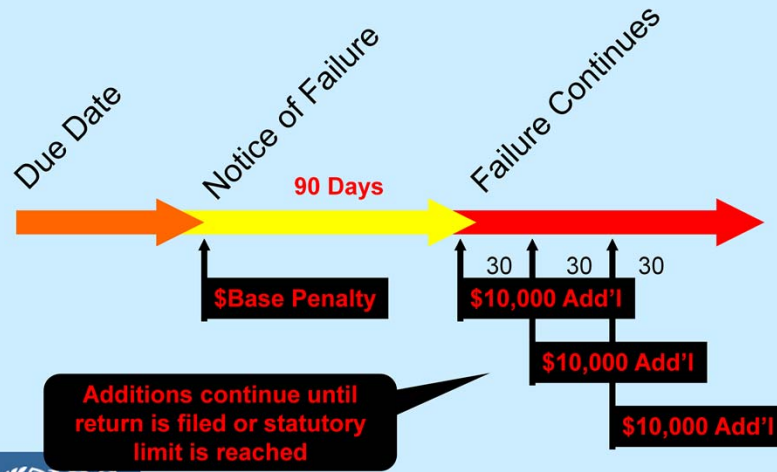
- No penalty for failure due to reasonable cause (and not willful neglect),

BUT

- The fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information is not reasonable cause.



“Tack-on” Penalty Structure



Foreign Corporations & Foreign Partnerships

- **In 1960 Congress enacted IRC § 6038 Related to Foreign Corporations and Foreign Partnerships.**
- **§ 6038(a) requires a U.S. person to file Form 5471 if they own or control a foreign corporation.**
- **§6038(a) also requires a U.S. person to file Form 8865 if they own or control a foreign partnership.**



Form 5471 Required Filers:

- **U.S. officer, director, or 10% shareholder of a foreign personal holding company**
- **U.S. person disposing of stock to below 10%**



Form 5471 Required Filers **(Cont'd)**

- **U.S. person who controlled foreign corporation for 30 day uninterrupted period during its year**
- **U.S. person who at year-end owns (directly, indirectly, or constructively) 10% or more of a foreign corporation that was a CFC for 30 days or more during the year**



IRC § 6038(b) Penalty Structure

- **§ 6038(b) imposes a \$10,000 penalty for each year that a required form 5471 or Form 8865 is not filed.**



Additionally, § 6038(c):

- Reduces the taxpayer allowed foreign tax credit by 10%.
- If the failure continues for over 90 days, the reduction of the foreign tax credit is increased by 5% for each successive 90 day period for which the required Form 5471 or Form 8865 is not filed.



Audit Suggestions

- **Forms 3520, 3520-A, 5471, and 8865 are required to be included in the taxpayer's 1040 tax return. If the amended return includes any of these forms, a potential penalty exists.**



Missing Forms?

If the forms are not present in the amended returns:

- **Ask the taxpayer whether they have any involvement with a foreign trust.**
- **Ask the taxpayer whether they receive gifts or bequest from a foreign person.**



Missing Forms (Cont'd)

- **Ask the taxpayer whether they are the 10% owner of any foreign corporations.**
- **Ask the taxpayer whether they are a partner in any foreign partnerships.**



Offshore Penalties – Procedures

Presenter: (b) (6)
(b) (6)



BACKGROUND

International information return penalties are civil penalties assessed on a U.S. person for failure to timely file complete and accurate international information returns required by specific Internal Revenue Code (IRC) sections.



BACKGROUND (cont'd)

Unless otherwise indicated, the term
"U.S. person" includes:

- citizens or residents of the United States
- domestic corporations
- domestic partnerships
- estates
- trusts



INVESTIGATE

Establish the person has a requirement to file the information return:

- Testimony of the taxpayer or other reliable third parties
- A late filed or incomplete international information return
- A filed return that indicates an information return filing requirement in other periods, or for related entities
- Reliable information that shows the taxpayer has control over, is receiving benefits from, is receiving distributions or income from an account in the name of a foreign entity
- Correspondence in the name of the foreign entity addressed to the taxpayer
- Reliable information received from a promoter investigation that shows the taxpayer has a filing requirement



RESEARCH

Verify the taxpayer has not filed a timely and complete information return

- For information returns attached to income tax returns
 - secure the original or amended income tax return
- For delinquent Forms 3520 and 3520-A
 - Form 3520 - BMF MFT 68
 - Form 3520-A - BMF MFT 42
 - If the U.S. person is an individual
 - BMFOL, with taxpayer's SSN + "V"



RESEARCH (cont'd)

Determine if the taxpayer has any previously assessed penalties

- IDRS research:
 - IMFOL or BMFOL with definer “I” for the TIN of the person to be assessed the penalty
 - BMF - MFT 13
 - IMF - MFT 55
 - TC 240
 - Not duplicate assessment



REFERRAL

- SB/SE examiners should make a mandatory referral for international assistance using the Specialist Referral System
 - Special Referral System: <https://srs.web.irs.gov>
 - Accepted referral: international works the case
 - Declined referral: SB/SE examiner works the case
 - See IRM 4.10.2.6.5.2.1



CONTROLS

Establish penalty case on ERCS for each year where there is a violation and the taxpayer will be assessed a penalty

- Prepare Form 5345D
 - TIN of the U. S. Person (single individual or entity) responsible for filing the return
 - No joint penalty assessments (except for Form 8938)
 - MFT P9
 - Activity Code 506
 - Tracking code of related income tax case



POA

A separate authorization is needed for the penalty

- POA should state “Civil Penalties”
- A POA for the income tax return does NOT cover the penalty issue



NOTICE LETTERS

- Send the appropriate Penalty Notice Letter
 - Satisfies the requirement for assessment of additional penalties if returns are not received within 90 days.
 - A separate notice letter should be provided to each taxpayer for each type of form required to be filed (Form 3520, 3520-A, 5471, 5472, 8865, 926, etc.)
 - Multiple tax years may be shown on one notice letter.



NOTICE LETTERS (cont.)

- Informs taxpayer of penalties and gives an opportunity for reasonable cause consideration
Addressed to the US Person responsible for filing the information returns
- Sent by Certified Mail, or hand delivered to the taxpayer
- Serves as the date to start the 90 day period for the taxpayer to respond
- Refer to IRM *Penalty Handbook, International Penalties* at IRM 20.1.9



SECURED DELINQUENT RETURNS

- Determine if it provides all of the required information and is accurate
 - If incomplete or inaccurate, inform the taxpayer that the return is not considered filed until it is complete and accurate



SECURED DELINQUENT RETURNS **(cont'd)**

Complete and accurate returns:

- For Form 3520 or 3520-A
 - Date stamp each return and make a photocopy
 - Write in RED across the top of the return – "Process as Original"



SECURED DELINQUENT RETURNS **(cont'd)**

- Complete Form 13133, *Expedite Processing Cycle*, and check the delinquent return box as well as the appropriate BMF or IMF box for "Do NOT Assess Failure to File Penalty."
- Attach completed Form 13133 to the delinquent return.
- The original delinquent return must be sent to:

Internal Revenue Service

1973 North Rulon White Blvd.

Mail Stop 4091

Ogden, UT 84404



SECURED DELINQUENT RETURNS **(cont'd)**

- For “information returns” (Forms 5471, 5472, 8865, 926, etc.)
 - Date stamp and make a photocopy
 - Associate the original document with the related income tax return.
 - Place the photocopy in the penalty case file.



REASONABLE CAUSE

- Applies to most, but not all, of the penalties
- Should not be considered until in full compliance for all open years
- Requests written statement for reasonable cause defense



REASONABLE CAUSE

(cont'd)

- Taxpayers who conduct business or transactions offshore or in foreign countries have a responsibility to exercise ordinary business care and prudence in determining their filing obligations and other requirements.



REASONABLE CAUSE (cont'd)

Reasonable cause should not be granted just because:

- Lack of knowledge of filing requirement
- Reliance on another person to file returns, but failed to provide all necessary information
- Fear of imposed penalties by a foreign country for disclosing the required information



REASONABLE CAUSE

(cont'd)

- Refusal by a foreign trustee to provide information for any other reason, including difficulty in producing the required information or provisions in the trust instrument that prevent the disclosure of required information



REASONABLE CAUSE (cont'd)

If reasonable cause defense accepted:

- Document your determination and close penalty case with NO penalty assessment
- Include original returns or copies of the returns in the income tax case file
- Notate the in the income tax case workpapers secured delinquent returns and accepted reasonable cause



REASONABLE CAUSE (cont'd)

If reasonable cause defense denied:

- Send a determination letter to the taxpayer, explaining the reasons why reasonable cause was denied



PENALTY COMPUTATION

- Compute the amount of the penalty and prepare the assessment documents
- Prepare Form 8278, *Assessment and Abatement of Miscellaneous Civil Penalties*, and
- Prepare Form 886-A, *Explanation of Items*
- Refer to IRM 20.1.9, *Penalty Handbook, International Penalties* for penalty amounts



PENALTY COMPUTATION (cont'd)

Penalty computation time frames:

- The date returns are filed, or
- The required information is received, or
- The maximum penalty amount is reached.

For penalties without notice letter provisions, or if no notice letter was issued:

- Assess penalties promptly after receipt of the required returns or return information, or
- If no return is received, assess penalties 90 days after the request for the return.



CONTINUATION PENALTIES

- Some (but not all) of the information returns may be subject to an additional penalty
- Starts to accrue if the taxpayer's failure to file continues beyond a specified number of days after receiving notice of their filing requirement
- Can be assessed at the same time as the initial penalty or at a later date
- Separate penalty case files for each subsequent continuation penalty
- Maximum limits to some continuation penalties while others have no limitation on the amount that can be assessed
- Refer to IRM 20.1.9, *Penalty Handbook, International Penalties*



ASSESSABLE PENALTIES

- Most International penalties are *assessable penalties* and are not covered by deficiency procedures of IRC 6211 through IRC 6215 (relating to deficiency procedures for income, estate, gift, and certain excise taxes).
 - No 30-day letter
 - No agreement form
 - No notice is required prior to assessment



ASSESSABLE PENALTIES (cont'd)

- Notification exception is for Forms 3520 and Forms 3520-A
 - **Letter 3943**—Closing acceptance letter to be utilized after a taxpayer responds and the examiner determines that no penalties will be asserted.
 - **Letter 3944**—Closing no response letter to be utilized when a taxpayer either fails to respond to notice letter (Letter 3804) or when a taxpayer does not provide a statement of reasonable cause for failing to file such returns.



ASSESSABLE PENALTIES (cont'd)

- **Letter 3946**—Closing reasonable cause rejected letter to be utilized after a taxpayer responds and the examiner determines that penalties will be asserted



APPEAL RIGHTS

Appeals currently provides for post-assessment, pre-payment appeal rights for all international penalties.



APPEAL RIGHTS (cont'd)

- If Appeal's conference is requested
 - Include the taxpayer's written protest, if provided
 - Provide instructions on the Form 3198, *Special Handling Notice for Examination Case Processing*, directing CCP to forward the case to Technical Services following assessment.



PREPARE THE PENALTY CASE FILE

Create a separate penalty case file for each year and for each information return

- Form 3198, *Special Handling Notice for Examination Case Processing* – attached to the outside of the penalty case file
- Form 8278, *Assessment and Abatement of Miscellaneous Civil Penalties*
 - Assessment document for EACH separate penalty
 - Provides the campus with a Penalty Reference Numbers (PRN)



PREPARE THE PENALTY CASE FILE **(cont'd)**

- 886-A, *Explanation of Items* (attach to the Form 8278)
 - Considered the penalty report
 - See the Guidebook for detailed information to be included on the Form 886-A
- IMFOL/BMFOL “I” and if necessary, “T” to verify no duplicate penalty assessments for any year
- Activity record
- Copy of the delinquent information return, if filed
- Form 3244-A, *Payment Posting Voucher*, if necessary
- Workpapers/Correspondence (including Notice Letters)



CLOSE THE PENALTY CASE FILE

Close the penalty case file to CCP for assessment following local procedures. The penalty case can be closed either before or after the related income tax case(s).

