IRS Tax Audits & Collections

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&
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Introduction

US Taxpayers who are under IRS Tax Audit, need to be aware of the following:

1. The audit does not mean taxes are due. Rather, the purpose of the audit is to ascertain how much in tax is due, if any.

2. Prior to the IRS imposing tax due under the audit, the Taxpayer/Taxpayer Representative may present legal authority and evidence to the IRS to confirm no tax is due. In the event of an adverse audit finding, they may request an audit reconsideration with the auditor, a meeting with the auditor's supervisor, and if necessary move up the IRS hierarchy to request a meeting with group/regional managers if the taxpayer does not believe they have been fairly treated or if their constitutional rights have been violated including the rights to due process and equal protection of the law (under the 14th amendment), and the right not to have excessive fines imposed (under the 8th amendment). If the taxpayer is accused of any criminal conduct, they may refuse to give any further evidence based on the 5th amendment right against self-incrimination.

3. Prior to the IRS assessing tax, penalty and interest the taxpayer has the right to seek an administrative IRS appeal, a post-Appeal mediation, and if the matter is not resolved the taxpayer who receives a Statutory Notice of Deficiency may go to US Tax Court prior to paying any tax due which is not assessed until after Tax Court trial. In the event the taxpayer files a Tax Court Petition the IRS will refer the matter back to Appeals for another settlement conference prior to tax court trial.

In summary, the taxpayer has many avenues to object to the tax proposed prior to assessment of the tax, the IRS filing of a tax lien (for the tax year(s) at issue) and the initiation of IRS tax collection for the tax due after audit.

Once the tax is assessed, prior to payment the taxpayer who cannot pay the tax in full may request an installment agreement for a monthly payment of the tax due based on their financial circumstances. In the alternative, the taxpayer may seek an offer in compromise to pay less than the amount of the tax due based on either doubt as to liability or doubt as to collectability. If the offer in compromise is accepted the taxpayer will have IRS collection "frozen" while the offer is being reviewed. If the offer is rejected the taxpayer may seek an appeal of the offer rejection under the IRS Collection Due Process Procedures (which were introduced as part of the Taxpayers Bill of Rights).

Two final caveats:

- Taxpayer's should never waive their 5th amendment right against self-incrimination and offer evidence, which may be used against them for criminal prosecution.
- Taxpayer's should hire tax counsel to represent them, be professional and timely in their IRS responses to avoid IRS jeopardy assessments i.e. either a pre-audit asset

seizure or an asset seizure prior to the IRS filing of a tax lien based on collection of the tax "being in jeopardy.”

Part 1 – IRS Audit Statistics

Chapter 1 – IRS Audit Statistics

On 2/24/15, the USA Today article, IRS Audit Rate for Individuals Drop by Kevin McCoy, confirmed that in 2014 the IRS Audit Rate dropped to .86% its lowest level since 2005.

Previously, IRS audits rose between 2005-2010 and have fallen 21.4% from 2011-2015.

In 2014 the IRS audited 1.1m taxpayers with income less than $200k (compared to 1.4m in 2010), and audited 34,000 taxpayers with income over $1m (compared to 41,000 in 2012).

Click link above for complete article.

IRS Audit Stats

According to the IRS Data Book (calendar year 2012, thru 9/30/12), in 2012, the IRS:

1. Processed 237.3 million federal tax returns

2. Collected $2.52 trillion in taxes

3. Issued tax refunds: $373.4 billion

4. Net tax collections: $2.15 trillion

Since US government spends $3.79 trillion there was $1.27 trillion "revenue shortfall".

Largest source of IRS tax receipts was 55% ($1.387 trillion) from individual estate and trust income taxes.

Calendar year 2011 (thru 9/30/11);

1. Estate tax returns: 12,582 estate tax returns filed, 3,762 audited (29.9% audit rate); estates b/n $5-10m had a 60% audit rate, estates over $10m had a 100% audit rate;

2. Gift tax returns: 223,090 filed, 3164 audited (1.42 % audit rate)

3. Income tax returns: 143,399,737 individual tax returns filed, 1,481,966 audited (1.03% audit rate)

In 2013 the audit rates were as follows:

1. Individual audits less than 1% (.96%) ie. 1 of every 104 tax returns

2. Income under $200k, audit rate is .88% (less than 1%)

3. Income b/n $200k-$1m audit rate is 2.7% (1 out of 37)

4. Income over $1m, audit rate is 10.85% (1 of 9)

5. For top income: b/n $5-10m 16% audit rate, over $10m (24% audit rate)

Chapter 2 - IRS Audits FY 2012

The IRS 2012 Fiscal Year Performance Results (10/1/11 – 9/30/12, updated 12/31/13) confirm the IRS increased audits by more than 12%.

1. Total IRS Audits (FY 2012): 18,654,923

2. Total Additional Tax Assessed from Audits in FY 2012: $38,699,308,000

Additionally, the IRS employed 97,941 employees (Budget $12.1billion), collected $2.5 trillion in taxes, and processed 237.3 million tax returns.

Detailed audit activities include the following:

1) Form 1040 - 143.4 million tax returns filed, audit rate 1.03%

2) Form 706 - 12,582 tax returns filed, 3,762 audited (29.9%). Estates between $5 million and $10 million audited nearly 60%, estates over $10 million 100% audit rate.

3) Form 709 - 223,090 tax returns filed, 3,164 audited, (1.42%)

4) Form 1065 - 3,524,808 tax returns filed, 16,691 audited (.47%)

5) Form 1120S - 4,469,329 tax returns filed, 21,658 audited (.48%)

6) Form 1120 - 1,999, 266 tax returns filed, 32,701 audited (1.64%)

7) Form 1041 - 3,036,900 tax returns filed, 5,070 audited (.17%)

IRS Audits 2012 Part II

According to the IRS Data Book (calendar year 2012 through 9/30/2012) in 2012, the IRS processed more than 237.3 million federal tax returns, and collected $2.52 trillion in taxes, issued refunds ($373.4 billion) net tax collections ($2.15 trillion). Since the U.S. government spent $3.79 trillion in expenditures, there was a "revenue shortfall in 2012 of: $1.27 trillion.

The largest source of IRS tax receipts is from individual, estate and trust income taxes allocating for nearly 55% of gross tax collections ($1,387,836,515)

IRS Audits

1. Corporate Tax: C-corporations (Form 1120) had 3.4 times the audit rate vs. S-corporations/Partnerships: C-Corp (1.64%), Partnerships (.47%), S-Corp (.48%)

2. Estate Tax: In calendar year 2011 (through 9/30/11): 12,582 Estate Tax Returns filed, 3,762 Audited (29.90%)

3. Gift Tax Returns: In calendar year 2011, 223,090 filed, 3,164 Audited (1.42%). Estate tax returns had 21 times the audit rate as gift tax returns. Estates $5 million - $10 million had a 60% audit rate. Estates over $10 million, 100% audit rate.

4. Individual Taxes: In calendar year 2011 (through 9/30/11) 143,399,737 individual returns filed, 1,481,966 audited (1.03%).

Less than 1% of all individual tax returns reporting taxable incomes of between $25,000 - $200,000 were examined.

If returns reported business income, up to 4 times more likely to be audited then returns without business income.

If returns reported income of $10 million or more, 12 times more likely to be audited than average individual tax returns.

Please see IRS Data Book C Pub 55B, issued March 2013.

Chapter 3 – Offshore Tax Evasion: IRS Tax Audit

For those US taxpayers committing offshore tax evasion i.e. not reporting foreign income, not disclosing offshore accounts, they face a myriad of IRS tax audit issues: Civil and Criminal Penalties, and a myriad of Statute of Limitations.

The IRS Civil and Criminal Penalty Issues include the following:

Civil Penalty Issues

1. Civil Tax Fraud (75% of tax due) (no statute of limitations).

2. Underpayment of Tax (25% of tax due).

3. For voluntary disclosures, under the IRS Offshore Voluntary Disclosure Program (2012), the values of foreign accounts and other foreign assets are aggregated for each year and the penalty is calculated during the period covered by the voluntary disclosure.

Under the 2012/IRS Voluntary Disclosure, total penalties of up to 90% of unpaid tax, and 27.5% of highest balance total foreign bank accounts/foreign assets as follows:

a. Failure to File a Tax Return (IRC Sec. 6651(a)(1), up to 25% tax due.

b. Failure to Pay Tax (IRC Sec. 6651(a)(2), up to 25% tax due.

c. Accuracy Related Penalty (IRC Sec. 6662), a 40% penalty for tax underpayment attributable to undisclosed foreign financial asset understatement.

d. Title 26 Penalty – 27.5% highest aggregate balance of foreign bank accounts, entities and assets.

Criminal Penalty Issues

U.S. taxpayers with undisclosed offshore bank accounts and unreported income face criminal charges for:

1. Tax Evasion (IRC 7201), five years in jail, $25,000 fine;

2. Filing False Tax Return (IRC Sec. 7206(1)), three years in jail, $250,000 fine;

3. Failure to File Tax Return (IRC Sec. 7203), one year in jail, $100,000 fine;

4. Willful failure to file FBAR or Filing False FBAR (31 USC Sec. 5322), ten years in jail, fines up to $500,000 with related civil penalty the greater of $100,000 or 50% of the total balance of the foreign account per violation (IRC Sec. 5321(a)(5).

In addition there are specialized tax, and other issues for offshore tax evasion:

1. The failure to file the Report of Foreign Bank and Financial Account ("FBAR", Fincen form 114, formerly TDF-90-22.1) can result in penalties that exceed the account balance e.g. the 50% yearly penalty imposed on the undisclosed account balance is imposed every year so if the FBAR report is not filed for 4 years the penalty is 200% of the account balance. So, if there was $5M on account, after 4 years of no FBAR filings the penalty would be $10M (which does not include the income tax on the unreported account earnings, additional penalties, see above, and interest);

2. An FBAR filing has a 6 year statute of limitations for imposition of the civil and related criminal penalty. These statutes do not begin to run until the FBAR is filed (this filing discloses all foreign bank and financial accounts over $10k).

In addition until the FBAR is filed, and the foreign bank accounts are disclosed, the Statute of Limitations on the related tax year Form 1040 filing does not commence.

3. Effective Tax Year 2011, Form 8938 is required to be attached to Taxpayer's Form 1040 to disclose the aggregate value of all foreign assets over $50k, which includes: Financial Accounts at foreign institutions, foreign stock, security, financial instrument or contract of interest in a foreign entity). Filing an FBAR does not eliminate the need to file Form 8938 to report foreign financial assets. For example, a US beneficiary of a foreign trust who is not within the scope of the FBAR reporting requirements because his interest in the trust is less than 50%, may still be required to disclosed the interest with his tax return if the $50k threshold is met. As with the FBAR filing, failure to file the Form 8938 suspends the statute of limitations for the related tax year Form 1040, which does not commence until the Form 8938(and any other information returns due are filed).

Statute of Limitations for IRS Audits

Civil and criminal tax proceedings have different statutes of limitation.

Civil Tax Fraud – For civil tax fraud (i.e. unreported income/undisclosed foreign bank accounts), there is no statute of limitations. The tax can be assessed at any time.

Criminal Tax Evasion – For criminal tax evasion (i.e. unreported income) the criminal statute of limitations is only on the prosecution of the crime of tax evasion, (not the assessment of the tax owed).

Offenses arising under the Internal Revenue laws generally have a 3-year period of limitation for prosecution (IRC Sec. 6531).

When the prosecution is for the offense of willfully attempting in any manner to evade or defeat any tax, the statute of limitations is 6-years (i.e. unreported Income).

IRC Sec. 6531(1): for offenses involving the defrauding or attempting to defraud the United States (whether by conspiracy or not, and in any manner);

IRC Sec. 6531(2): for the offense of willfully attempting in any manner to evade or defeat any tax;

IRC Sec. 6531(3): for the offense of willfully aiding or assisting in the preparation of a false or fraudulent tax return.

IRC Sec. 6531(4): for the offense of willfully failing to pay any tax or make any tax return.

IRC Sec. 6531(5): for offenses relating to false statements and fraudulent documents under IRC Sec. 7206(1) and Sec. 7207.

IRC Sec. 6531(8): for offenses arising under 18 U.S.C. 371, where the object of the conspiracy is to attempt in any manner to evade or defeat any tax.

Under IRC Sec. 6531, the 6-year statute of limitations shall be tolled, while the U.S. taxpayer who committed the offenses is outside the United States.

Generally, the IRS has 3 years from the date of the tax filing (Form 1040) to commence an audit. However, the 3 years are extended to 6 years if the Taxpayer:

1. Omitted more than 25% of gross income;

2. Omitted more than $5000 of foreign income;

3. Failed to file the FBAR and disclose the foreign account (which is required under Form 1040/Schedule B, Part III, question (7)(a), and if not disclosed is both perjury and a felony for filing a false tax return with up to 3 years in jail), which 6-year statute does not commence until the FBAR is filed (due June 30 each year, for the prior year, no extensions, in 2014 required to be filed electronically i.e. no paper filing, no “lost in the mail excuses”.)

As stated above, for the reasons specified the Statute of Limitations for the IRS to audit the Form 1040 may be extended from 3-6 years. Even if there is no understatement of income, if there is a failure to file information returns for offshore holdings/entities then the Form 1040 Statute of Limitations is suspended until the complete Form 1040 is filed with all information filings due.

The following information filings are due annually for offshore holdings/entities:

1. FBAR for accounts over $10k (due 6/30)

2. Form 8938 (“FATCA Filing” since 2011) for Foreign Financial Assets over $50k (due 4/15, unless extension (with Form 1040).

Under Form 8938 (Statement of Specified Foreign Financial Assets): a 3-year statute of limitations for failure to report a specified foreign financial asset or failure to file Form 8938;

A 6-year statute of limitations for U.S. taxpayer's failure to include in gross income an amount relating to specified foreign financial assets and the amount omitted is more than $5,000.

3. Form 3520-A to report annual foreign trust income; (with Form 1040)

4. Form 3520 to report transfers to the trust and distributions to trust beneficiaries; (with Form 1040)

5. Form 5471 for any US person who controls a foreign corporation. Control is defined as ownership of more than 50% of the outstanding stock or voting power for at least 30 consecutive days during that tax year. Control also includes: five or fewer US Persons who collectively own more than a 50% interest and individually own more than a 10% interest in the corporation.

A US person who becomes an Officer or Director of of a foreign corporation and owns at least 10% of the corporation stock by vote or value, must also file Form 5471 (with Form 1040).

6. Form 8865 Foreign Partnerships (same rules as Form 5471 re: control, filing dates);

7. Form 8858 for US persons who are owners of foreign disregarded entities (with Form 1040).

US Taxpayers with foreign income, entities should carefully review their annual tax filings due.

Chapter 4 - Criminal Tax Evasion: Burden of Proof

The U.S. taxpayer's exposure to civil penalty/criminal prosecution for unreported income and undisclosed foreign financial accounts is a "double-edged" sword with dual civil/criminal: Evidentiary Standards of Proof, Statute of Limitations, and Collateral Estoppel Issues.

If the IRS first institutes a civil tax audit, they may summons evidence, which may support both a civil penalty (e.g. fraud) and criminal culpability (e.g. tax evasion). The evidence from the civil tax audit may then be used for a subsequent criminal prosecution of the same U.S. taxpayer.

Civil and criminal tax deficiencies may differ; Criminal violations are charged only against the tax deficiency that results from fraud.

Civil tax deficiency includes all tax due on the tax returns (i.e. "evaded income and deductions adjustments).

Under a civil tax audit, the IRS may obtain evidence that may be illegal under criminal proceedings (e.g. Fifth Amendment defenses objecting to "tainted evidence") tax evidence obtained from the civil tax audit may enable the IRS (i.e. the U.S. Attorneys to initiate criminal proceedings against the taxpayer).

Criminal tax fraud requires a higher standard of proof than civil tax fraud. The government must prove "beyond a reasonable doubt" that the defendant is guilty of criminal tax fraud.

In civil tax fraud, the burden of proof required is a preponderance of the evidence (also termed "by clear and convincing evidence") which is a lower evidentiary standard).

A criminal tax decision of a court or jury will bind a civil tax decision, but a civil tax decision does not bind a criminal tax decision.

Chapter 5 - Criminal Tax Evasion: Collateral Estoppel

When criminal tax proceedings are followed by civil tax proceedings, the legal doctrine of collateral estoppel may apply. This doctrine provides that an issue necessarily decided in a previous proceeding (the first proceeding) will determine the issue in a subsequent proceeding (the second proceeding) but only as to matters in the second proceeding that were actually presented and determined in the first proceeding.

A conviction for criminal tax evasion collaterally estops the taxpayer from contesting the existence of tax fraud for purposes of the civil tax fraud penalty (i.e. 75% of the unpaid tax) because a finding of criminal tax fraud (beyond a reasonable doubt) establishes proof of civil tax fraud (by clear and convincing evidence).

Acquittal of criminal tax evasion does not collaterally estop the government from proving civil tax fraud (by clear and convincing evidence). The criminal acquittal may establish that proof of fraud did not exist beyond a reasonable doubt, but that does not mean that proof of fraud by clear and convincing evidence does not exist.

Chapter 6 - IRS Civil Tax Audits: Statute of Limitations

IRS civil tax audits generally have a 3-year statute of limitations which commences the later of:

1. Tax Return due date or,

2. Date of Tax Return Filing (evidenced by either electronic filing acceptance, or certified mail return receipt).

The 3 year statute of limitations is extended to 6 years if 25% or more of gross income received by the Taxpayer is omitted from the tax return. For this tax issue (i.e. omission of gross income), the Burden of Proof is on the IRS, but if their burden is satisfied all deductions are also subject to the IRS audit (not just the omitted income).

There is no Statute of Limitations if a tax return is not filed. There is no Statute of Limitations if Taxpayer commits tax fraud (however, the burden of proof is on the IRS).

The IRS often requests a statute extension if the statute will soon expire. If the statute is not extended the IRS will assess tax which can be a bad result (i.e. the tax is due) but have a good benefit (i.e. the audit is then terminated with no further tax disallowance issues to be raised by the auditor) with the taxpayer entitled to file a Notice of Protest and seek an IRS administrative appeal (to a separate division of the IRS/Appeals) without paying tax and no IRS tax lien filed or IRS collection instituted on the assessed tax (ie. no IRS levy).

The only exception would be a jeopardy assessment if the IRS considers tax collection to be “at risk” (i.e. the Taxpayer hides assets, flees the US et al.) the IRS may seize the Taxpayer assets under a levy, “freezing these assets” pending resolution of the audit assessment.

Taxpayers who elect to file amended tax returns face the following statute of limitations issues:

1. The amended tax return/claim for refund must filed within 3 years of the filing of the original tax returns

2. If the amended tax return increases tax and is filed within 60 days of the statute expiration date, the IRS gets an additional 60 days to assess from the date of the amended tax return filing;

3. For unfilled tax returns the Taxpayer has 2 years from the date the tax was paid to file a tax refund claim.

Caveat:

If the amended tax return does not increase the tax due, the Statute of Limitations is not extended. For Taxpayers who wish to file a tax refund claim, it may be advisable to file the claim within 60 days before the statute expiration which may preclude IRS review and audit before the expiration of the Statute of Limitations so the Taxpayer receives an uncontested tax refund.

Chapter 7 – GAO Report

United States Government Accountability Office (GAO) released a report in March 2013 entitled: Offshore Tax Evasion – IRS Has Collected Billions of Dollars, but May Be Missing Continued Evasion.

What the GAO Found was that as of December 2012, the Internal Revenue Service's (IRS) four offshore programs have resulted in more than 39,000 disclosures by taxpayers and over

$5.5 billion in revenues.

A supplement report was published in January 2014 listing Offshore Voluntary Disclosure Program participants by state and the location of foreign bank accounts reported by 2009 Offshore Voluntary Disclosure Program participants.

The top 7 states were:

California 2,524 24%

New York 1,884 18%

Florida 1,022 10%

New Jersey 631 6%

Texas 512 5%

Massachusetts 307 3%

Illinois 291 3%

The top 7 countries where the bank accounts were located:

Switzerland 5,427 42%

United Kingdom 1,058 8%

Canada 556 4%

France 528 4&

Israel 510 4%

Germany 484 4%

China 394 3%

In a recent study, Gabriel Zucman, Asst. Prof., London School of Economics (an international author who works with Thomas Piketty and Emanuel Saez) estimated:

1) Switzerland has $2.4 Trillion in global offshore funds, 1/3 of projected $7.6 Trillion total (which is 8% of projected global financial assets).

2) 60% of foreign owned deposits in Switzerland belong to British Virgin Islands, Jersey and Panama, the leading countries for domiciliation of shell companies.

3) Offshore funds in Swiss accounts have risen in recent years

4) Data from National Bank of Switzerland confirm only a small percentage of offshore funds in Switzerland have been disclosed to financial authorities

5) In 2017, Switzerland will automatically share banking information with OECD countries (Organization for Economic Co-operation and Development), under the multi-year OECD agreement it recently signed.

Switzerland is the Epicenter of International Tax Evasion & Money Laundering:

1) Under the 2013/2014 US Govt. GAO Report, the IRS Offshore Voluntary Disclosure Program listed the top 7 countries with undisclosed accounts. #1 was Switzerland with 42% of the accounts (UK was a distant second with 8% of the accounts). Switzerland holds more than 5x the bank accounts of "US tax cheats" than the 2d biggest jurisdiction (UK).

2) Major Swiss banks have admitted to tax evasion as their "business": In Feb 2009 UBS agreed to pay a $780m fine and entered into a deferred prosecution agreement with the US Dept. of Justice;

In Jan. 2013, Wegelin Bank, the oldest Swiss Bank (est. 1741) paid a $74m fine and entered a guilty plea to tax evasion charges and announced it would close its bank;

In November 2014, Credit Suisse entered a guilty plea to tax evasion and agreed to a $2.6B penalty.

As of December, 2014 more than a dozen Swiss Banks including major bank: HSBC & Julius Baer continue to be investigated for their roles in helping US taxpayers evade taxes. HSBC appears particularly egregious under investigation in numerous countries e.g. Belgium, Argentina et al. for aiding international tax evasion and money laundering.

The following press release was sent out by the U.S. Department of Justice on 11/21/2014:

Credit Suisse Sentenced for Conspiracy to Help U.S. Taxpayers Hide Offshore Accounts from Internal Revenue Service

Pays $1.8 Billion to Department of Justice and the Internal Revenue Service in a Fine and Restitution

Credit Suisse AG was sentenced today for conspiracy to aid and assist U.S. taxpayers in filing false income tax returns and other documents with the Internal Revenue Service (IRS). Credit Suisse pleaded guilty to conspiracy on May 19. The sentencing of the Swiss corporation is the result of a years-long investigation by U.S. law enforcement authorities that has also produced indictments of seven Credit Suisse employees and the owner of a trust company since 2011—two of those individuals have pleaded guilty so far—and of U.S. clients of Credit Suisse. The announcement was made by Deputy Attorney General James M. Cole, Acting Deputy Assistant Attorney General Larry J. Wszalek for the Justice Department's Tax Division, U.S. Attorney Dana J. Boente for the Eastern District of Virginia and IRS Commissioner John Koskinen.

At sentencing in the U.S. District Court for the Eastern District of Virginia, U.S. District Chief Judge Rebecca Beach Smith entered judgment and conviction and a restitution order requiring Credit Suisse to pay approximately $1.8 billion dollars to the United States by Nov. 28, per the plea agreement. Credit Suisse will pay the Justice Department's Crime Victims Fund, through the District Court Clerk's Office for the Eastern District of Virginia, a fine of approximately $1.136 billion and will pay the IRS $666.5 million in restitution. The parties agreed that Credit Suisse cannot challenge the restitution amount, which can also provide a basis for an IRS civil tax assessment.

"Today, with its criminal conviction and the payment of $2.6 billion in fines and restitution, Credit Suisse is held fully accountable for helping U.S. taxpayers engage in tax evasion," said Deputy Attorney General Cole.

(Click link above for complete article).

Part II – Collections

Chapter 8 - Collections

Internal Revenue Service Tax Liens/Levies (Transferee Liability)

1. Claim Against Transferee or Fiduciary: Collection from Transferee of Property.

The liability of a transferee of property is generally assessed and collected in the same manner as is any other deficiency imposed by the IRS (Reg. § 301.6901-1(a)). The term "transferee" includes an heir, legatee, devisee, distributee of an estate of a deceased person, the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a Code Sec. 368(a) reorganization, and all other classes of distributees. Such term also includes, with respect to the gift tax, a donee (without regard to the solvency of the donor) and, with respect to the estate tax, any person who, under Code Sec. 6324(a)(2), is personally liable for any part of such tax (Reg. § 301.6901-1 (b)).

2. Transferee Assessment and Collection Period. Unless a taxpayer has filed a false return with intent to evade tax, an assessment against a transferee or fiduciary must be made within the following periods:

a. in the case of an initial transferee, within one year after the expiration of the period of limitation for assessment against the taxpayer;

b. in the case of a transferee of a transferee, within one year after the expiration of the period of limitation for assessment against the preceding transferee or three years after the expiration of the period of limitation for assessment against the taxpayer, whichever of these two periods expires first;

c. if a timely court proceeding has been brought against the taxpayer or last preceding transferee, within one year after the return of execution in such proceeding; or

d. in the case of a fiduciary, within one year after the liability arises or within the limitations period for collection of the tax, whichever is the later (Code Sec. 6901; Reg. § 301.6901-1(c)).

3. Collection from Fiduciary. In order to receive advance notice from the IRS with respect to assessments, every fiduciary must give written notice to the IRS of his fiduciary capacity. If this notice (Form 56) is not filed, the IRS may proceed against the property in the hands of the fiduciary after mailing notice of the deficiency or other liability to the taxpayer's last known address, even if the taxpayer is then deceased or is under legal disability. The fiduciary may be relieved of any further liability by filing with the IRS written notice and evidence of the termination (Reg. § 301.6903-1).

4. Bankruptcy or Receivership of Taxpayer: Tax Collection Procedure. When a taxpayer's assets are taken over by a receiver appointed by the court, the IRS may

immediately assess the tax if it has not already been lawfully assessed. The IRS may also assess the tax on (1) the debtor's estate under U.S. Code Title 11 bankruptcy proceedings or (2) the debtor, if the tax liability has become *res judicata* pursuant to a Title 11 bankruptcy determination (Code Sec. 6871(a) and (b)). Tax claims may be presented to the court before which the receivership (or a Title 11 bankruptcy) is pending, despite the pendency of proceedings in the Tax Court. However, in the case of a receivership proceeding, no petition shall be filed with the Tax Court after the appointment of the receiver (Code Sec. 6871(c)). The trustee of the debtor's estate in a Title 11 bankruptcy proceeding may intervene on behalf of the debtor's estate in any Tax Court proceeding to which the debtor is a party (Code Sec. 7464).

5. Liens and Levies: Property Subject to Liens. If a taxpayer fails to pay an assessed tax for which payment has been demanded, the amount due (including interest and penalties) constitutes a lien in favor of the United States upon all the taxpayer's property (real, personal, tangible, and intangible), including after-acquired property and rights to property (Reg. § 301.6321-1). Whether the taxpayer owns or has an interest in property is determined under the appropriate state law. Once the taxpayer's rights in the property are established, federal law determines priorities among competing creditors (Code Sec. 6323) and controls whether specific property is exempt from levy. Once a tax lien arises, it continues until the tax liability is paid or the lien becomes unenforceable due to a lapse of time (Code Sec. 6322). Time has lapsed if 10 years have passed from the date of assessment (or longer, if the taxpayer waives restrictions on collection) during which the IRS has not attempted to collect the tax either by suitor distraint (Code Sec. 6502 (a)).

6. Property Subject to Levy. Although a tax lien attaches to all the debtor's property, some property is exempt from levy. The following are among the items that are exempt from levy to some extent:

1. wearing apparel and school books;

2. fuel, provisions, furniture, and personal effects: up to $8,230 for 2009 ($8,250 for 2010);

3. unemployment benefits;

4. books and tools of a trade, business, or profession: up to $4,120 for 2009 and 2010;

5. undelivered mail;

6. certain annuity and pension payments;

7. workers' compensation;

8. judgments for support of minor children;

9. certain AFDC, social security, state and local welfare payments and Job Training Partnership Act payments;

10. certain amounts of wages, salary, and other income; and

11. certain service-connected disability payments (Code Sec. 6334(a)).

Certain specified payments are not exempt from levy if the Secretary of the Treasury approves the levy. Among the items so covered are certain wage replacement payments as specified at Code Sec. 6334(f).

The IRS may not seize any real property used as a residence by the taxpayer or any real property of the taxpayer (other than rental property) that is used as a residence by another person in order to satisfy a liability of $5,000 or less (including tax, penalties and interest).

In the case of the taxpayer's principal residence, the IRS may not seize the residence without written approval of a federal district court judge or magistrate (Code Sec. 6334(a) (13) and (e)).

Unless collection of tax is in jeopardy, tangible personal property or real property (other than rented real property) used in the taxpayer's trade or business may not be seized without written approval of an IRS district or assistant director.

Such approval may not be given unless it is determined that the taxpayer's other assets subject to collection are not sufficient to pay the amount due and the expenses of the proceedings.

Where a levy is made on tangible personal property essential to the taxpayer's trade or business, the IRS must provide an accelerated appeals process to determine whether the property should be released from levy (Code Sec. 6343 (a) (2)).

Levies are prohibited if the estimated expenses of the levy and sale exceed the fair market value of the property (Code Sec. 6331(f)).

Unless the collection of tax is in jeopardy, a levy cannot be made on any day on which the taxpayer is required to respond to an IRS summons (Code Sec. 6331(g)).

Financial institutions are required to hold amounts garnished by the IRS for 21 days after receiving notice of the levy to provide the taxpayer time to notify the IRS of any errors (Code Sec. 6332 (c)).

7. Recording and Priority of Tax Liens. Until notice of a tax lien has been properly recorded, it is not valid against any bona fide purchaser for value, mechanic's lienor, judgment lien creditor or holder of a security interest (such as a mortgagee or pledgee, for example) (Code Sec. 6323 (a)). Also, even a properly recorded tax lien may not be valid against so-called superpriorities, which include purchases of securities and automobiles, retail purchases, casual sales of less than $1,380 for 2009 and 2010,

certain possessory liens securing payment for repairs to personal property, real property taxes and special assessment liens, mechanic's liens for repairs and improvements to certain residential property, attorneys' liens, certain insurance contracts and deposit secured loans (previously referred to as passbook loans) (Code Sec. 6323 (b)). In addition, security interests arising from commercial financing agreements may be accorded superpriority status (Code Sec. 6323(c)).

Notice of a federal tax lien must be filed in the one office designated by the state in which the property is situated (Code Sec. 6323(f). Generally, personal property is situated in the state where the taxpayer resides (rather than where domiciled); for real property, the sites is its physical location. If, in the case of either real or personal property, the state designates more than one office or does not designate an office where notice must be filed, notice of the lien must be filed with the Clerk of the U.S. District Court for the district in which the property is situated (Code Sec. 6323(f) (1) (B)). If state law provides that a notice of lien affecting personal property must be filed in the county clerk's office located in the taxpayer's county of residence and also adopts a federal law that requires a notice of lien to be filed in another location in order to attach to a specific type of property, the state is deemed to have designated only one office for the filing of the notice. Thus, to protect its lien, the IRS need only file its notice in the county clerk's office located in the taxpayer's home county (Reg. §301.6323(f)-1(a)(2)). Notice regard- ing property located in the District of Columbia is filed with the Recorder of Deeds of the District of Columbia. Special rules apply in a state that requires public indexing for priority liens against realty.

A forfeiture under local law of property seized by any law enforcement agency or other local governmental branch relates back to the time the property was first seized, unless, under local law, a claim holder would have priority over the interest of the government in the property (Code Sec. 6323 (i) (3)).

The IRS may not levy against property while a taxpayer has a pending offer in compromise or installment agreement (Code Sec. 6331(k)). If the offer in compromise or installment agreement is ultimately rejected, the levy prohibition remains in effect for 30 days after the rejection and during the pendency of any appeal of the rejection, providing the appeal is filed within 30 days of the rejection. No levy may be made while the installment agreement is in effect. If the installment agreement is terminated by the IRS, no levy may be made for 30 days after the termination and during the pendency of any appeal.

8. Notice and Opportunity for Hearing. The IRS must notify any person subject to a lien of the existence of the lien within five days of the lien being filed (Code Sec. 6320; Reg. § 301.6320-1). Among other requirements, the notice must address the person's right to request a hearing during the 30-day period beginning on the sixth day after the lien is filed. Similarly, at least 30 days prior to the IRS filing a notice of levy on any person's property or right to property, the IRS must provide notice of the right to a hearing (Code Sec. 6330; Reg. § 301.6320-1). Whether in connection with the notice of lien or notice of

intent to levy, the hearing is to be held by the IRS Office of Appeals. At the hearing, the taxpayer may raise any issue relevant to the appropriateness of the proposed collection activity if such issue was not raised at a previous hearing. The taxpayer has 30 days after the hearing determination to appeal the determination to the Tax Court, which has exclusive jurisdiction over appeals of hearing determinations.

A taxpayer subject to a levy for the collection of employment taxes cannot request a hearing if the taxpayer already requested a hearing regarding unpaid employment taxes arising in the two-year period before the beginning of the taxable period at issue (Code Sec. 6330(h).

9. Release of Tax Liens and Levies. Taxpayers may appeal the filing of a notice of lien in the public record and petition for release. If filed in error, the IRS must release the lien and state that the lien was erroneous (Code Sec. 6326(b)). The request for relief must be based on one of the following grounds: (1) the tax liability had been satisfied before the lien was filed; (2) the assessing of the tax liability violated either the notice of deficiency procedures or the Bankruptcy Code; or (3) the limitations period for collecting the liability had expired prior to the filing of the lien (Code Sec. 6326; Reg. § 301.6326-1).

Further, the IRS may withdraw a public notice of tax lien before payment in full if:

the filing of the notice was premature or not in accord with administrative procedures;

1. the taxpayer has entered into an installment agreement to satisfy the tax liability;

2. withdrawal of the notice would facilitate the collection of the tax liability;

3. the withdrawal of the notice would be in the best interest of the taxpayer and the government, as determined by the National Taxpayer Advocate (Code Sec. 6323(j)).

The withdrawal of a notice of tax lien does not affect the underlying tax lien; rather, the withdrawal simply relinquishes any lien priority the IRS had obtained when the notice was filed.

The IRS is required to release a levy if:

1. the underlying liability is satisfied or becomes unenforceable due to lapse of time;

2. the IRS determines that the release of the levy will facilitate the collection of tax;

3. an installment payment agreement has been executed by the taxpayer with respect to the liability;

4. the IRS determines that the levy is creating a financial hardship; or

5. the fair market value of the property exceeds the liability, and the partial release of the levy would not hinder the collection of tax (Code Sec. 6343(a)).

In addition, a taxpayer may request that the IRS sell the levied property (Code Sec. 6335(f); Reg. §301.6335-1(d)).

The IRS has been given authority to return property that has been levied upon if:

1. the levy was premature or not in accordance with administrative procedure;

2. the taxpayer has entered into an installment agreement to satisfy the tax liability, unless the agreement provides otherwise;

3. the return of the property will facilitate collection of the tax liability; or

4. with the consent of the taxpayer or the Taxpayer Advocate, the return of the property would be in the best interests of the taxpayer and the government (Code Sec. 6343(d)).

Property is returned in the same manner as if the property had been wrongfully levied upon, except that the taxpayer is not entitled to interest.

A taxpayer may bring a suit in federal district court if an IRS employee knowingly or negligently fails to release a tax lien on the taxpayer's property after receiving written notice from the taxpayer of the IRS's failure to release the lien (Code Sec. 7432). The taxpayer may recover actual economic damages plus the costs of the action. Injuries such as inconvenience, emotional distress, and loss of reputation are not compensable damages unless they result in actual economic harm. Costs of the action that may be recovered are limited generally to certain court costs and do not include administrative costs or attorney's fees, although attorney's fees may be recoverable under Code Sec. 7430 (Reg. § 301.7432-1(c)). A two-year statute of limitations, measured from the date on which the cause of action accrued, applies (Code Sec. 7432(d) (3)).

A third-party owner of property against which a federal tax lien has been filed may obtain a certificate of discharge with respect to the lien on such property (Code Sec. 6325(b) (4)). The certificate is issued if (1) the third-party owner deposits with the IRS an amount of money equal to the value of the government's interest in the property as determined by the IRS or (2) the third-party owner posts a bond covering the government's interest in the property in a form acceptable by the IRS.

A third-party owner who is a co-owner of property with the taxpayer against whom the underlying tax was assessed may no longer be automatically barred from obtaining a certificate of discharge with respect to a lien on the property. Third-party owners may request the discharge of a tax lien on property that they own with the person whose tax liability gave rise to the lien (Reg. § 301.6325-1(b) (4)).

If the IRS determines that (1) the liability to which the lien relates can be satisfied from other sources or (2) the value of the government's interest in the property is less than the IRS's prior determination of the government's interest in the property, then the IRS will refund (with interest) the amount deposited and release the bond applicable to such property (Code Sec. 6325(b) (4) (B)). Within 120 days after a certificate of discharge

is issued, the third-party owner may file a civil action against the United States in a federal district court for a determination of whether the government's interest in the property (if any) has less value than that determined by the IRS (Code Sec. 7426(a) (4) and (b) (5)).

10. Mitigation of Effect of Statute of Limitations. The Code provides rules in Code Sec. 1311—Code Sec. 1314 (Reg. §1.1311(a)-l—Reg. §1.1314(c)-i) for relief from some of the inequities caused by the statute of limitations and other provisions that would otherwise prevent equitable adjustment of various income tax hardships. Adjustments are permitted, even though the limitation period for assessment or refund for the year at issue may have otherwise expired, when a determination under the income tax laws:

1. requires the inclusion in gross income of an item that was erroneously included in the income of the taxpayer for another tax year or in the gross income of a "related taxpayer";

2. allows a deduction or credit that was erroneously allowed to the taxpayer for another tax year or to a "related taxpayer";

3. requires the exclusion from gross income of an item included in a return filed by the taxpayer or with respect to which tax was paid and which was erroneously excluded or omitted from the gross income of the taxpayer for another tax year or from the gross income of a "related taxpayer" for the same or another tax year,

4. requires the correction of income or deduction items of estates or trusts or beneficiaries of either as between such "related taxpayers";

5. establishes the basis of property by making adjustments to such basis for items that should have been added to, or deducted from, income of preceding years;

6. requires the allowance or disallowance of a deduction or credit to a corporation where a correlative deduction or credit should have been allowed (or disallowed) to a related taxpayer that is a member of an affiliated group of corporations (where there is an 80% common ownership);

7. requires the exclusion from gross income of an item not included in a return filed by the taxpayer and with respect to which the tax was not paid but which is includible in the gross income of the taxpayer for another tax year or in the gross income of a related taxpayer; or

8. disallows a deduction or credit that should have been allowed, but was not allowed, to the taxpayer for another tax year or to a related taxpayer for the same or another tax year.

11. Claim for Refund or Credit. A claim for refund for an overpayment of income taxes is generally made on the appropriate income tax return. However, once the return has been filed and the taxpayer believes the tax is incorrect, the claim for refund by an

individual who filed Form 1040, 1040A, or 1040EZ is made on Form 1040X The refund claim is made on Form 1120X by a corporation that filed Form 1120. A claim for refund or credit for an overpayment of income taxes for which a form other than Form 1040, 1040A, 1040EZ, 1120, or 990T was filed is made on the appropriate amended tax return (Reg. § 301.6402-3).

12. Amendment of Refund Claim. A timely claim for refund based upon one or more specific grounds may not be amended to include other and different grounds after the statute of limitations has expired (Reg. § 301.6402-2 (b)).

Internal Revenue Service (Tax Collection)

1. Assessment of Deficiency. A "deficiency" is the excess of the correct tax liability over the tax shown on the return (if any), plus amounts previously assessed (or collected without assessment) as a deficiency, and minus any rebates made to the taxpayer (Code Sec. 6211). For this purpose, the tax shown on the return is the amount of tax before credits for estimated tax paid, withheld tax, or amounts collected under a termination assessment (Code Sec. 6211(b)).

The IRS is authorized to assess taxes (Reg. § 301.6201-1). The collection process begins when a notice of deficiency is sent to the taxpayer's last known address by registered or certified mail (Code Sec. 6212). In each deficiency notice, the IRS must provide a description of the basis for the assessment, an identification of the amount of tax, interest and penalties assessed (Code Sec. 7522), and the date determined to be the last day on which the taxpayer may file a petition with the Tax Court (Code Sec. 6213(a)). However, the failure by the IRS to specify the last day on which to file a petition will not invalidate an otherwise valid deficiency notice if the taxpayer was not prejudiced by the omission.

Within 90 days after notice of the deficiency is mailed (or within 150 days after mailing if the notice is addressed to a person outside the U.S.), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency (Code Sec. 6213). Payment of the assessed amount after the deficiency notice is mailed does not deprive the Tax Court of jurisdiction over the deficiency (Reg. § 301.6213-1(b)(3)).

If the taxpayer does not file a Tax Court petition within the 90-day time period, the tax may be collected. A taxpayer's property may be seized to enforce collection if there is a failure to pay an assessed tax within 30 days after notice of levy (Code Sec. 6331(d)(2)). However, the notice and waiting period does not apply if the IRS finds that the collection of tax is in jeopardy. Notices of levy must provide a description of the levy process in simple and nontechnical terms (Code Sec. 6331).

2. Waiver of Deficiency Restrictions. The taxpayer has the right to waive the restrictions on assessment and collection of all or part of a deficiency at any time, whether or not a notice of deficiency has been issued (Code Sec. 6213(d)). This is done by executing Form 870. Execution of a waiver of the restrictions on assessment and collection of the entire

deficiency in advance of the statutory ("90-day") notice relieves the IRS of sending such a notice and precludes appeal to the Tax Court. However, an appeal to the Tax Court is not precluded if the waiver covers only part of the deficiency or is executed after receipt of the 90-day deficiency notice. Payment of an amount as tax before issuance of the statutory notice has the effect of a waiver, and, if the amount paid equals or exceeds the amount of a subsequently determined deficiency, it deprives the Tax Court of jurisdiction (Reg. §301.6213-1(b)(3)).

3. Jeopardy and Termination Assessments. The IRS can immediately assess a deficiency if the assessment and collection of tax would be jeopardized by delay or if the collection of tax would be otherwise jeopardized, as, for example, when a taxpayer is leaving the country or seeking to hide assets (Code Sec. 6851; Code Sec. 6861). If a jeopardy assessment is made prior to the mailing of the notice of deficiency, the notice must be mailed to the taxpayer within 60 days after the assessment (Code Sec. 6861(b)). If a termination assessment is made, the assessment ends the taxpayer's tax year only for purposes of computing the amount of tax that becomes immediately due and payable. It does not end the tax year for any other purpose. In the case of a termination assessment, the IRS must issue the taxpayer a notice of deficiency within 60 days of the later of (1) the due date (including extensions) of the taxpayer's return for the full tax year or (2) the day on which the taxpayer files the return (Code Sec. 6851(b)).

The IRS may presume that the collection of tax is in jeopardy if an individual in physical possession of more than $10,000 in cash or its equivalent does not claim either ownership of the cash or that it belongs to another person whose identity the IRS can readily ascertain and who acknowledges ownership of the cash. In this case, the IRS may treat the entire amount as gross income taxable at the highest rate specified in Code Sec. 1. The possessor of the cash is entitled to notice of, and the right to challenge, the assessment However, should the true owner appear, he will be substituted for the possessor and all rights will vest in him (Code Sec. 6867).

4. Injunction to Restrain Collection. The Code prohibits a suit to restrain the assessment or collection of any tax (Code Sec. 7421(a)) or to restrain the enforcement of liability against a transferee or fiduciary (Code Sec. 7421(b)). Nevertheless, injunctive relief may be available in rare cases if irreparable harm will be done to the taxpayer and the taxpayer shows, at the outset of the suit, that the government could not collect the tax under any circumstances. However, injunctive relief may be obtained for assessment or collection actions (other than jeopardy or termination assessments) if a notice of deficiency has not been mailed to the taxpayer, the period for filing a Tax Court petition has not expired, or a Tax Court proceeding with respect to the tax is pending (Code Sec. 6213(a)).

5. Closing Agreement. The IRS is authorized to enter into a written agreement with a taxpayer in order to determine conclusively the tax liability for a tax period that ended prior to the date of the agreement (Form 866) or to determine one or more separate items affecting the tax liability for any tax period (Form 906). A closing agreement may

also be entered for tax periods that end subsequent to the date of the agreement. Closing agreements may be entered into in order to finally resolve questions of tax liability (Code Sec. 7121; Reg. § 301.7121-1). For example, a fiduciary may desire a final determination before an estate is closed or trust assets distributed. Closing agreements are final, conclusive, and binding upon both parties. They cannot be reopened or modified except upon a showing of fraud or malfeasance or the misrepresentation of a material fact. Generally, the IRS is not precluded from later determining additions to tax absent terms in the agreement that specifically address the issue of additions to tax.

6. Compromise of Tax and Penalty. The IRS may compromise the tax liability in most civil or criminal cases before referral to the Department of Justice for prosecution or defense. The Attorney General or a delegate may compromise any case after the referral. However, the IRS may not compromise certain criminal liabilities arising under internal revenue laws relating to narcotics, opium, or marijuana. Interest and penalties, as well as tax, may be compromised (Code Sec. 7122; Reg. § 301.7122-1). Offers-in-compromise are submitted on Form 656 accompanied by a financial statement on Form 433-A for an individual or Form 433-B for businesses (if based on inability to pay) (Reg. § 601.203(b)). A taxpayer who faces severe or unusual economic hardship may also apply for an offer-in-compromise by submitting Form 656. If the IRS accepts an offer-in-compromise, the payment is allocated among tax, penalties, and interest as stated in the collateral agreement with the IRS. If no allocation is specified in the agreement and the amounts paid exceed the total tax and penalties owed, the payments will be applied to tax, penalties, and interest in that order, beginning with the earliest year. If the IRS agrees to an amount that does not exceed the combined tax and penalties, and there is no agreement regarding allocation of the payment, no amount will be allocated to interest.

A $150 user fee is required for many offers-in-compromise (Reg. § 300.3). Taxpayers must normally pay the user fee at the time a request to compromise is submitted. No user fee is imposed with respect to offers (1) that are based solely on doubt as to liability or (2) that are made by low-income taxpayers (i.e., taxpayers whose total monthly income falls at or below income levels based on the U.S. Department of Health and Human Services poverty guidelines). If an offer is accepted to promote effective tax administration or is accepted based on doubt as to collectibility and a determination that collecting more than the amount offered would create economic hardship, the fee will be applied to the amount of the offer or, upon the taxpayer's request, refunded to the taxpayer. The fee will not be refunded if an offer is withdrawn, rejected or returned as nonprocessible. The IRS treats offers received by taxpayers in bankruptcy as non-processible, even though two district courts have held that the IRS must consider such offers (R.H. *Macher,* DC Va., 2004-1 USTC ¶50,114 (Nonacq.); *W.K. Holmes,* DC Ga., 2005-1 USTC ¶50,230). However, one district court and one bankruptcy court have held in favor of the IRS on this issue *(1900 M Restaurant Associates, Inc., DC D.C.,* 2005-1 USTC ¶50,116; *W. Uzialko,* BC-DC Pa., 2006-1 USTC ¶50,297).

Detailed IRS procedures for the submission and processing of offers-in-compromise are reflected in Rev. Proc. 2003-71.

Taxpayers are required to make nonrefundable partial payments with the submission of any offer-in-compromise (Code Sec. 7122(c)). Taxpayers who submit a lump-sum offer (any offer that will be paid in five or fewer installments) must include a payment of 20 percent of the amount offered. Taxpayers who submit a periodic payment offer must include payment of the first proposed installment with the offer and continue making payments under the terms proposed while the offer is being evaluated. Offers that are submitted to the IRS without the required partial payments will be returned to the taxpayer as nonprocessible. However, the IRS is authorized to issue regulations waiving the payment requirement for offers based solely on doubt as to liability or filed by low income taxpayers. Pending the issuance of regulations, the IRS has announced that it will waive the payment requirement for such offers (Notice 2006-68).

The required partial payments are applied to the taxpayer's unpaid liability and are not refundable. However, taxpayers may specify the liability to which they want their payments applied. Additionally, the user fee (see above) is applied to the taxpayer's outstanding tax liability. Any offer that is not rejected within 24 months of the date it is submitted is deemed to be accepted. However, any period during which the tax liability to be compromised is in dispute in any judicial proceeding is not taken into account in determining the expiration of the 24-month period (Code Sec. 7122 (f)).

7. General Three-Year Period. Generally, all income taxes must be assessed within three years after the original return is filed (the last day prescribed by law for filing if the return was filed before the last day). In the case of pass-through entities, the three-year rule begins to run at the time the pass-through entity's shareholder or other beneficial owner files an individual income tax return. A return filed prior to its due date is deemed to have been filed on the due date. A proceeding in court without assessment for collection of the tax must commence within the same period (Code Sec. 6501; Reg. §301.6501(a)-1). The period can be extended by a written agreement between the taxpayer and the IRS (Code Sec. 6501(c)(4); Reg. §301.6501(c)-1(d)). Interest on any tax may be assessed and collected at any time during the period within which the tax itself may be collected (but only up to the date on which payment of the taxis received) (Reg. §301.6601-1(f)).

If, within the 60-day period ending on the last day of the assessment period, the IRS receives an amended return or written document from the taxpayer showing that additional tax is due for the year in question, the period in which to assess such additional tax is extended for 60 days after the day on which the IRS receives the amended return or written document (Code Sec. 6501(c)(7)).

If unused foreign tax credits have been carried back, the statute of limitations on assessment and collection for the year to which the carryback is made will not close until one year after the expiration of the period within which a deficiency may be

assessed for the year from which the carryback was made (Code Sec. 6501(i); Reg. §301.6501(1)-1).

Deficiencies attributable to carryback of a net operating loss, a capital loss or the general business credit and research credit may be assessed within the period that applies to the loss or credit year. Deficiencies attributable to the carrying back of one of those credits as a result of the carryback of a net operating loss, capital loss or other credit may be assessed within the period that applies to the loss or other credit year (Code Sec. 6501(h) and (j)).

8. False Return or No Return. Tax may be assessed or a court proceeding to collect tax may be commenced at any time if:

a. the return is false or fraudulent,

b. there is a willful attempt to evade tax, or

c. no return is filed (Reg. §301.6501(c)-1).

In addition, in the case of a fraudulent return, the government may impose additional taxes at any time, without regard to statutes of limitations, although the burden of proof falls on the government to prove fraud by the taxpayer.

9. Listed Transactions. If a taxpayer fails to include any information required by Code Sec. 6011 on a tax return or statement relating to a listed transaction, the statute of limitations with respect to that transaction will not expire before one year after the earlier of: (1) the date on which the information is furnished to the IRS, or (2) the date that a material advisor satisfies the list maintenance requirements of Code Sec. 6112 with respect to the IRS's request relating to the taxpayer's transaction (Code Sec. 6501(c) (10)).

10. Omission of Over 25% of Income. If the taxpayer omits from gross income (total receipts, without reduction for cost) an amount in excess of 25% of the amount of gross income stated in the return, a six-year limitation period on assessment applies. An item will not be considered as omitted from gross income if information sufficient to apprise the IRS of the nature and amount of such item is disclosed in the return or in any schedule or statement attached to the return (Code Sec. 6501(e); Reg. §301.6501(e)-1(a)).

11. Collection After Assessment. After assessment of tax made within the statutory period of limitation, the tax may be collected by levy or a proceeding in court commenced within 10 years after the assessment or within any period for collection agreed upon in writing between the IRS and the taxpayer before the expiration of the 10-year period. The period agreed upon by the parties may be extended by later written agreements so long as they are made prior to the expiration of the period previously agreed upon. The IRS has to notify taxpayers of their right to refuse an extension each time one is requested (Code Sec. 6501(c)(4)). If a timely court proceeding has

commenced for the collection of the tax, then the period during which the tax may be collected is extended until the liability for tax (or a judgment against the taxpayer) is satisfied or becomes unenforceable.

Generally effective after 1999, the 10-year limitations period on collections may not be extended if there has not been a levy on any of the taxpayer's property. If the taxpayer entered into an installment agreement with the IRS, however, the 10-year limitations period may be extended for the period that the limitations period was extended under the original terms of the installment agreement plus 90 days. If, in any request made on or before December 31, 1999, a taxpayer agreed to extend the 10-year period of limitations on collections, the extension will expire on the latest of:

a. the last day of the original 10-year limitations period,

b. December 31, 2002, or

c. in the case of an extension in connection with an installment agreement, the 90th day after the extension.

Interest accrues on a deficiency from the date the tax was due (determined without regard to extensions) until the date payment is received at the rate specified (Reg. §301.6601-1(a)(1)). Interest may be assessed and collected during the period in which the related tax may be collected (Code Sec. 6601(g)).

12. Suspension of Assessment Period. When an income, estate or gift tax deficiency notice is mailed, the running of the period of limitations on assessment and collection of any deficiency is suspended for 90 days (150 days for a deficiency notice mailed to persons outside the United States) (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th or 150th day), plus an additional 60 days thereafter in either case (Code Sec. 6503(a)(1)). If a petition is filed with the Tax Court, the running of the period of limitations is suspended until the Tax Court's decision becomes final and for an additional 60 days thereafter (Code Sec. 6503(a)(1); Reg. §301.6503(a)-1).

The 10-year statute of limitations for collection after assessment is also suspended from the date the IRS wrongfully seizes or receives a third party's property to 30 days after the earlier of (1) the date the IRS returns the property or (2) the date on which a judgment secured in a wrongful levy action becomes final. Similarly, with respect to wrongful liens, the 10-year limitations period is suspended from the time the third party owner is entitled to a certificate of discharge of lien until 30 days after the earlier of (1) the date that the IRS no longer holds any amount as a deposit or bond that was used to satisfy the unpaid liability or that was refunded or released or (2) the date that the judgment in a civil action becomes final (Code Sec. 6503(f)).

For Chapter 11 bankruptcy cases, the running of the period of limitations is suspended during the period of the automatic stay on collection of taxes and for an additional period ending 60 days after the day the stay is lifted for assessments and for six months

thereafter for collection (Code Sec. 6503(h)). In receivership and other bankruptcy cases (such as Chapter 13) where a fiduciary is required to give written notice to the IRS of an appointment or authorization to act, the assessment period is suspended from the date the proceedings are instituted and ending 30 days after the day of notice to the IRS of such appointment. The extension period cannot exceed two years (Code Sec. 6872).

If the taxpayer and the IRS agree to the rescission of a deficiency notice, the statute of limitations again begins to run as of the date of the rescission and continues to run for the period of time that remains on the date the notice was issued (Code Sec. 6212(d)).

13. Suit for Recovery of Erroneous Refund. The government may sue to recover an erroneous refund (including, but not limited to, one made after the applicable refund period) within two years after such refund was paid (Code Sec. 6532(b)). However, a suit may be commenced within five years if any part of the refund was induced by fraud or misrepresentation of a material fact (Code Sec. 6532(b); Reg. §301.6532-2).

14. Criminal Prosecution. A criminal prosecution must generally be started within three years after the offense is committed (Code Sec. 6531). However, a six-year period applies in a case where there is:

a. fraud or an attempt to defraud the United States or an agency thereof, by conspiracy or otherwise;

b. a willful attempt to evade or defeat any tax or payment;

c. willful aiding or assisting in the preparation of a false return or other document;

d. willful failure to pay any tax or make any return (except certain information returns) at the time required by law;

e. a false statement verified under penalties of perjury or a false or fraudulent return, statement or other document;

f. intimidation of a U.S. officer or employee;

g. an offense committed by a U.S. officer or employee in connection with a revenue law; or

h. a conspiracy to defeat tax or payment (Code Sec. 6531).

15. Interest on Underpayment of Tax. Interest on underpayments of tax is imposed at the federal short-term rate plus three percentage points (Code Sec. 6621(a)(2)). The interest rates, which are adjusted quarterly, are determined during the first month of a calendar quarter and become effective for the following quarter.

Interest accrues from the date the payment was due (determined without regard to any extensions of time) until it is received by the IRS. Interest is to be compounded daily, except for additions to tax for underpayment of estimated tax by individuals and

corporations (Code Sec. 6601). For 2009, the interest rate on underpayments for the first quarter was 5 percent; and the interest rate for the second, third and fourth quarters was 4 percent.

If a carryback of a net operating loss, investment credit, work incentive program credit, jobs credit, or a net capital loss eliminates or reduces a deficiency otherwise due for such earlier year, the taxpayer remains liable for interest on unpaid income taxes (including deficiencies later assessed by the IRS) for the carryback year. The entire amount of the deficiency will be subject to interest from the last date prescribed for payment of the income tax of the carryback year up to the due date (excluding extensions) for filing the return for the tax year in which the loss or credit occurred (Code Sec. 6601(d); Reg. §301.6601-1(e)).

Interest on large underpayments of tax by corporations is imposed at the federal short-term rate plus five percentage points (Code Sec. 6621(c)(1); Reg. §301.6621-3). A large corporate underpayment is any tax underpayment by a C corporation that exceeds $100,000 for any tax period. For purposes of determining the $100,000 threshold, underpayments of different types of taxes (for example, income and employment taxes) as well as underpayments relating to different tax periods are not added together. The tax period is the tax year in the case of income tax or, in the case of any other tax, the period to which the underpayment relates (Code Sec. 6621(c)(3)).

The interest rate applies to time periods after the 30th day after the earlier of (1) the date the IRS sends the first letter of proposed deficiency that allows the taxpayer an opportunity for administrative review in the IRS Office of Appeals (a 30-day letter) or (2) the date the IRS sends a deficiency notice under Code Sec. 6212 (a 90-day letter). The 30-day period does not begin unless the underpayment shown in the letter or notice exceeds $100,000 (Code Sec. 6621(c)(2)(B)(iii)). An IRS notice that is later withdrawn because it was issued in error will not trigger the higher rate of interest on large corporate underpayments (Code Sec. 6621(c)(2)(A)). If the underpayment is not subject to deficiency payments, the 30-day period begins to run following the sending of any letter or notice by the IRS that notifies the taxpayer of the assessment or proposed assessment of the tax. A letter or notice is disregarded if the full amount shown as due is paid during the 30-day period (Code Sec. 6621(c)(2)(B)). For 2009, the interest rate on large corporate underpayments for the first quarter was 7 percent; and the interest rate for the second, third and fourth quarters was 6 percent.

The interest rates for overpayments and underpayments have been equalized (sometimes referred to as "global interest netting") for any period of mutual indebtedness between taxpayers and the IRS.

The IRS has the authority to abate interest in cases where the additional interest was caused by IRS errors or delays (Code Sec. 6404(e)). However, the IRS may act only if there was an error or delay in performing either a ministerial act or a managerial act (including loss of records by the IRS, transfers of IRS personnel, extended illness,

extended personnel training or extended leave) and only if the abatement relates to a tax of the type for which a notice of deficiency is required. Such taxes would be those relating to income, generation-skipping transfers, estate, gift and certain excise taxes, but not abatement of interest for employment taxes or other excise taxes.

Taxpayers requesting an abatement of interest generally must file a separate Form 843 for each tax period for each type of tax with the IRS Service Center where their tax return was filed or, if unknown, with the Service Center where their most recent tax return was filed.

In order to avoid the accrual of underpayment interest, a taxpayer may make a cash deposit with the IRS for future application against an underpayment of income, gift, estate, generation-skipping or certain excise taxes that have not been assessed at the time of the deposit (Code Sec. 6603). To the extent that a deposit is used by the IRS to pay a tax liability, the tax is treated as paid when the deposit is made and no interest underpayment is imposed. Furthermore, if the dispute is resolved in favor of the taxpayer or the taxpayer withdraws the deposited money before resolution of the dispute, interest is payable on the deposit at the federal short-term rate.

16. Interest on Additions and Penalties. Interest on penalties and additions to tax for failure to file, for failure to pay the stamp tax, and for the accuracy-related and fraud penalties will be imposed for the period beginning on the due date of the return (including extensions) and ending on the date of payment However, if payment is made within 21 calendar days after notice and demand is made (10 *business* days if the amount demanded is at least $100,000), then interest will stop running after the date of notice and demand (Code Sec. 6601(e) (3)). For all other penalties, interest will imposed only if the addition to tax or penalty is not paid within the 21- or 10-day period after notice and demand is made and then only for the period from the date of notice and demand to the date of payment (Code Sec. 6601(e) (2)).

Underpayments of Tax—Penalties

17. Accuracy-Related Penalty. The two penalties primarily applicable to underpayments of tax are the accuracy-related penalty (Code Sec. 6662) and the fraud penalty (Code Sec. 6663).

The accuracy-related penalty consolidates all of the penalties relating to the accuracy of tax returns. It is equal to 20% of the portion of the underpayment that is attributable to one or more of the following: (1) negligence or disregard of rules or regulations, (2) substantial understatement of income tax, (3) substantial valuation misstatement, and (4) substantial overstatements of pension liabilities (Code Sec. 6662(a) and (b)).

The accuracy-related penalty is entirely separate from the failure to file penalty and will be imposed if no return, other than a return prepared by the IRS when a person fails to make a required return, is filed (Code Sec. 6664 (b)). In addition, the accuracy-related penalty will not apply to any portion of a tax underpayment on which the fraud penalty

is imposed. Also, no penalty is imposed with respect to any portion of any underpayment if the taxpayer shows that there was reasonable cause for the underpayment and that the taxpayer acted in good faith (Code Sec. 6664(c)).

18. Negligence or Disregard of Rules and Regulations. If any part of an underpayment of tax is due to negligence or careless, reckless or intentional disregard of rules and regulations, the 20% accuracy-related penalty will imposed on that portion of the underpayment attributable to the negligence or intentional disregard of rules and regulations (Code Sec. 6662(a) and (c)). Negligence includes the failure to reasonably comply with tax laws, to exercise reasonable care in preparing a tax return, to keep adequate books and records, or to substantiate items properly (Reg. § 1.6662-3(b)(1)). Taxpayers may not avoid the negligence penalty merely by adequately disclosing a return position which is "not frivolous" on Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement (Conference Committee Report to P.L. 1103-66).

19. Substantial Understatement of Income Tax. The IRS may impose the 20% accuracy-related penalty when there is a substantial understatement of income tax. A substantial understatement exists when the understatement for the year exceeds the greater of (1) 10% of the tax required to be shown on the return (including self-employment tax) or (2) $5,000. In the case of corporations (other than S corporations or personal holding companies), a substantial understatement exists when the understatement exceeds the lesser of (1) 10% of the tax required to be shown on the return (or, if greater, $10,000) or (2) $10,000,000 (Code Sec. 6662(d)).

Taxpayers generally may avoid all or part of the penalty by showing:

a. that they acted in good faith and there was reasonable cause for the understatement,

b. that the understatement was based on substantial authority, or

c. if there was a reasonable basis for the tax treatment of an item, the relevant facts affecting the item's tax treatment were adequately disclosed on Form 8275 (Form 8275-R for return positions contrary to regulations) (Code Sec. 6662(d) (2) and Code Sec. 6664(c); Reg. §1.66624(d)—Reg. §1.66624(f)).

Substantial authority generally means that the likelihood that a taxpayer's position is correct is somewhere between 50% and the more lenient reasonable basis standard used in applying the negligence penalty. The disclosure exception does not apply to tax shelter items. Further, a corporation does not have a reasonable basis for its tax treatment of an item attributable to a multi-party financing transaction if the treatment does not clearly reflect the income of the corporation. Some items may be disclosed on the taxpayer's return, instead of on Form 8275 (Rev. Proc. 2008-14).

Only the following are authority for purposes of determining whether a position is supported by substantial authority:

a. The Internal Revenue Code and other statutory provisions,

b. proposed, temporary and final regulations construing the statutes,

c. revenue rulings and procedures,

d. tax treaties and the regulations thereunder, and Treasury Department and other official explanations of such treaties,

e. court cases,

f. congressional intent as reflected in committee reports, joint explanatory statements of managers included in conference committee reports, and floor statements made prior to enactment by one of a bill's managers,

g. General Explanations of tax legislation prepared by the Joint Committee on Taxation (the Blue Book),

h. private letter rulings and technical advice memoranda issued after October 31, 1976,

i. actions on decisions and general counsel memoranda issued after March 12, 1981 (as well as general counsel memoranda published in pre-1955 volumes of the Cumulative Bulletin),

j. Internal Revenue Service information and press releases, and

k. notices, announcements and other administrative pronouncements published by the IRS in the Internal Revenue Bulletin (Reg. §1.6662-4(d)(3)(iii)).

20. Substantial Valuation Misstatement. The 20% accuracy-related penalty is imposed on any portion of an underpayment resulting from any substantial income tax valuation misstatement There is a substantial valuation misstatement if (1) the value of any property, or adjusted basis of any property, claimed on a tax return is 150% or more of the amount determined to be the correct amount of the valuation or the adjusted basis, (2) the price for any property, or use of property, or services in connection with any transaction between persons described in Code Sec. 482 is 200% or more, or 50% or less, of the correct Code Sec. 482 valuation, or (3) the net Code Sec. 482 transfer price adjustment exceeds the lesser of $5 million or 10% of the taxpayer's gross receipts (Code Sec. 6662(e)).

The penalty is doubled to 40% in cases of “gross valuation misstatements” where claimed value or adjusted basis exceeds the correct value or adjusted basis by 200% or more (Code Sec. 6662(h)). A gross valuation misstatement with respect to a controlled taxpayer transaction (Code Sec. 482) occurs if the price claimed exceeds 400% or more, or 25% or less, of the amount determined to be the correct price or the net Code Sec. 482 transfer price adjustment for the year exceeds the .lesser of $20 million or 20% of the taxpayer's gross receipts.

No penalty is imposed unless the portion of the underpayment attributable to the substantial valuation misstatement exceeds $ 5,000, or $10,000 in the case of corporations other than S corporations or personal holding companies (Code Sec. 6662(e) (2)). The penalty will not be imposed if it is shown that there was reasonable cause for an underpayment and the taxpayer acted in good faith; however, the reasonable cause exception for underpayments due to gross valuation misstatements on charitable deduction property has been eliminated, although the exception still exists for substantial valuation misstatements on charitable deduction property and for gross valuation misstatements on property for which a charitable deduction is not being claimed (Code Sec. 6664(c)).

21. Fraud. The fraud penalty is imposed at the rate of 75% on the portion of any underpayment that is attributable to fraud (Code Sec. 6663). The fraud penalty will not apply, however, if no return is filed other than a return prepared by the IRS when a person fails to make a required return (Code Sec. 6664(b)). Although the failure to file penalty is entirely separate from the fraud penalty, in cases of a fraudulent failure to file, the failure to file penalty will be imposed at a higher rate. If any portion is attributable to fraud, it is presumed that the entire underpayment is attributable to fraud, unless the taxpayer establishes otherwise by a preponderance of the evidence with respect to any item. The accuracy-related penalty will not apply to any portion of an underpayment on which the fraud penalty is imposed. The IRS must meet its burden of proof in establishing fraud by clear and convincing evidence (Code Sec. 6663 (b)).

22. Tax Shelters. An accuracy-related penalty is provided for understatements resulting from listed and reportable transactions (Code Sec. 6662A). The penalty applies to understatements attributable to (1) any listed transaction and (2) any reportable transaction with a significant tax avoidance purpose. "Listed transaction" and "reportable transaction" are defined by reference to Code Sec. 6707A, which, in turn, defines those terms by reference to applicable regulations under Code Sec. 6011. A reasonable cause exception is provided under Code Sec. 6664(d).

Underpayments of Estimated Tax

23. Addition to Tax for Underpayment of Estimated Tax by Individuals. An underpayment of estimated tax by an individual and most trusts and estates will result in imposition of an addition to tax equal to the interest that would accrue on the underpayment for the period of the underpayment (Code Sec. 6654(a)). For the applicable rate of interest. In determining the addition to tax for an underpayment of individual estimated tax, the federal short-term rate that applies during the third month following the tax year of the underpayment will apply during the first 15 days of the fourth month following such tax year (Code Sec. 6621(b) (2) (B)). Changes in the interest rate apply to amounts of underpayments outstanding on the date of change or arising thereafter. An individual can avoid any penalty for underpayment of estimated tax by making payments.

24. Underpayment of Estimated Tax by Corporations. If estimated taxes are underpaid by a corporation (including an S corporation), a penalty is imposed in the amount of the interest that accrues on the underpayment for the period of the underpayment (Code Sec. 6655). The rate of interest is the rate charged on underpayment of taxes determined under Code Sec. 6621. The additions are calculated for quarterly periods ending with the installment due dates. Generally, additions to tax apply to the difference between payments made by the due date of the installment and the lesser of an installment based on (1) 100% of the tax shown on the current year's tax return or (2) 100% of the tax shown on the preceding year's return (prior-year safe harbor) (for a 12-month tax year). However, use of the prior-year safe harbor is not available to "large" corporations, i.e., corporations that have taxable income of $1 million or more for any of the three immediately preceding tax years. No additions to tax will be assessed if the corporation's tax liability is less than $500 for the tax year.

25. Confidentiality of Returns. Returns and tax return information are confidential and may not be disclosed to federal or state agencies or employees except as provided in Code Sec. 6103. A return is defined as any tax return, information return, declaration of estimated tax, or claim for refund filed under the Internal Revenue Code. Return information includes the taxpayer's identity, the nature, source or amount of income, payments, receipts, deductions, net worth, tax liability, deficiencies, closing (and similar) agreements, and information regarding the actual or possible investigation of a return. The prohibition on disclosure applies to all officers and employees of the United States, of any state, and of any local child support enforcement agency. It also applies to most other persons who have had access to returns or return information by virtue of permitted disclosures of such returns or information under Code Sec. 6103.

Agreements and information received under a tax convention with a foreign government (including a U.S. possession) are confidential and generally cannot be disclosed (Code Sec. 6105).

26. Remedies for Unauthorized Disclosures. Taxpayers whose privacy has been invaded by an unlawful disclosure of returns or return information under Code Secs. 6103 or 6104 (pertaining to tax-exempt organizations) may bring a civil suit for damages. Upon a finding of liability, the taxpayer may recover the great of $1,000 for each unauthorized disclosure of the amount of the actual damages sustained as a result of the disclosure. Punitive damages, as well as litigations costs, may be recovered if the disclosure was willful or grossly negligent (Code Sec. 7431). Felony charges can also be brought against individuals who have made unauthorized and willful disclosures of any return information (Code Sec. 7213).

27. Disclosure of Return Information. A return preparer who uses return information for any purpose other than to prepare a return, or who make an unauthorized disclosure of return information, is subject to a $250 penalty for each disclosure, up to a maximum of $10,000. If the action is undertaken knowingly or recklessly, the preparer may be subject to criminal penalties or a fine of up to $1,000, or up to a year in jail, or

both, together with the cost of prosecution (Code Sec. 6713 and Code Sec. 7216). A taxpayer may bring a civil action for damages against the U.S. government if an IRS employee offers the taxpayer's representative favorable tax treatment in exchange for information about the taxpayer (Code Sec. 7435).

Unauthorized Return Inspections

28. Penalties for Unauthorized Inspections. A taxpayer may bring a civil action against the United States if a government employee knowingly or negligently inspects, without authorization, any return or return information under Code Secs. 6103 or 6104 (pertaining to tax-exempt organizations) of that taxpayer. The same action may also be taken against any other person who browses through returns or return information without proper authorization (Code Sec. 7431). Criminal penalties for willful unauthorized return inspection can also be imposed against any federal employee or IRS contractor. In addition, penalties may be imposed against any state employee or other person who acquires the return or return information under Code Secs. 6103 or 6104 (pertaining to tax-exempt organizations), which permits the use of federal return information for other government purposes, such as state tax and child support collection, law enforcement, social welfare program administration, and statistical use (Code Sec. 7213A).

29. Crimes. Criminal penalties may be incurred when the taxpayer (a) willfully fails to make a return, keep records, supply required information, or pay any tax or estimated tax, (b) willfully attempts in any manner to evade or defeat the tax, or (c) willfully fails to collect and pay over the tax. In addition to the felony charges listed in the preceding sentence, misdemeanor charges can be brought for (1) making fraudulent statements to employees, (2) filing a fraudulent withholding certificate, or (3) failing to obey a summons. The criminal penalties are in addition to the civil penalties (Code Sec. 7201—Code Sec. 7212). A good faith misunderstanding of the law or a good faith belief that one is not violating the law negates the willfulness element of a tax evasion charge.

Chapter 9 – The IRS and U.S. Taxpayer Emails

According to a 4/10/13 CNET article, the IRS thinks it doesn't need a warrant to read taxpayer emails in pursuit of tax collection. The files were released to the American Civil Liberties Union, under a Freedom of Information Act request, which demonstrates that the IRS broadly interprets their authority to "snoop through" U.S. taxpayer "inboxes".

The IRS has a "legal leg to stand on": The Electronic Communications Privacy Act allows the IRS to obtain emails older than 180 days without a warrant. An internal 2009 IRS document claimed that "the government may obtain the emails that have been in storage for more than 180 days without a warrant."

Another 2009 IRS file, the IRS Criminal Tax Division's "Search Warrant Handbook", showed "the 4th Amendment does not protect communications held in electronic storage, because 'internet users' do not have a reasonable expectation of privacy".

In December 2010, the 6th Circuit Court of Appeal ruled that just because your email is held in storage does not mean you lose that expectation of privacy, precluding federal and local law information from reviewing contents of U.S. taxpayer emails.

However, the 6th Circuit Court of Appeal was just the ruling of one appeals court, not the Supreme Court, and the IRS' stated position is "the IRS does not need a warrant for emails older than 180 days".

PART III – International Tax Evasion

Chapter 10 - International Tax Evasion: Money Laundering

International tax evasion has been the "Sport of Kings" for centuries. Cloaked in secrecy, done surreptitiously, no one could ever prove it. The "Super-rich" (i.e. the top 1%) get away with "tax cheating" and used their "tax cheating proceeds" to buy assets; e.g., real estate, boats, planes, cars, diamonds and art (all of which may constitute "money laundering").

The willful tax cheating by the super-rich may be "tax treason" defined: the betrayal of a trust, treachery; the offense of attempting by overt acts to overthrow the government of the state to which the offender owes allegiance.

So why do tax cheats get away with treason? Why do governments all over the world let the richest people cheat on their taxes and commit "tax treason"? What is the bottom line to tax treason? Is it that billions of people around the world suffer and live without adequate nutrition, housing, clothing, health care and education? Who is responsible for this tax mess?

With the proliferation of the Internet as an information database, after centuries of secrecy, the truth is coming out. Transparency is coming of age, and for the super-rich tax cheats, their days appear numbered.

Consider Recent Events in Spain and Africa

In Spain, there are 1,600 cases involving embezzlement, tax evasion, kickbacks and Swiss bank accounts, including: the former treasurer of Spain's ruling party, indicted, the former head of the country's Supreme Court resigned in disgrace. And now, Spain's Princess, Cristina, could land in jail and topple King Juan Carlos and the Spanish monarchy.

In April 2013, Princess Cristina was indicted on charges of complicity in fraud, tax evasion, money laundering and embezzlement, the first member of a European royal family to be charged in a serious crime in centuries.

The case revolves around her husband, Duke of Palma, Inaki Urdangarin, who is accused of fraud, tax evasion, forgery and the embezzlement of $7.8 million from regional governments through inflated contracts via their non-profit organization, Institute Noor.

Judge Jose Castro oversaw the Princess' indictment, saying she gave her consent to her husband's "shady deals". A specially appointed anti-corruption prosecutor requested the indictments be dropped. On May 7, 2013 an appeals court ruled to dismiss the case in a preliminary judgment. Judge Castro is likely to pursue another indictment.

In Africa on 5/10/13, a 120 page Africa Progress Report was issued stating $63 billion is lost annually in Africa through tax evasion, corruption, secret business deals, more than

all the money coming into Africa through aid and investment. Despite Africa's surging economic growth, fueled by a global resources boom, poverty and inequality have worsened.

Kofi Annan, the former U.N. Secretary General, who heads the panel that wrote the report, stated:

"It is unconscionable that some companies, often supported by dishonest officials, are using unethical tax avoidance, transfer pricing and anonymous company ownership to maximize their profits while millions of Africans go without adequate nutrition, health and education." The report stated:

"Revenues that could have been used to impact lives have instead been used to build personal fortunes, finance civil wars and support corrupt and unaccountable political elites. Revenue losses on this scale cause immense damage to public finance and to national efforts to reduce poverty. Some political elites continue to seize and squander the revenues generated by natural resources, purchasing mansions in Europe or the U.S. or building private wealth at public expense.

In the U.S., tax evasion is a felony (under Internal Revenue ("Code") Code section 7201) with a penalty of up to five years in prison. In addition, the crime of tax evasion includes other crimes for which a U.S. taxpayer may be prosecuted, including:

1. Obstruct Tax Collection. Under Code section 7212, a penalty of up to three years in prison;

2. Conspiracy to Impede Tax Collection. Under 18 U.S.C. §371, a "Klein Conspiracy" in which two or more persons agree to "impede" IRS tax collection, with a penalty of up to five years in prison;

3. Filing a False Tax Return. Under Code section 7206(1), up to three years in prison;

4. "FBAR" Violation. Willful violation re: disclose foreign aggregate accounts over $100,000 up to ten years in jail. 31 U.S.C. Sec. §5322(b),

If federal prosecutors throw the book at tax cheats, they may face over 25 years in prison.

Tax evasion by itself is punishable by over 25 years in prison. In addition, separate crimes may include: money laundering, wire fraud and mail fraud (each of which are separate felonies punishable by 20 years plus, in prison). So if a tax cheat commits tax evasion, money laundering, wire fraud and mail fraud, their maximum penalties may be over 85 years in prison (with an additional 10 years if the violation affects a financial institution).

For U.S. persons who are involved with international tax evasion (i.e. they collaborate with tax cheats from other countries helping those international tax cheats commit tax

evasion and launder money), they may be held liable for money laundering, a separate offense, since foreign tax evasion is a predicate offense, a Specified Unlawful Activity ("SUA"); i.e. a foreign crime, which subjects the U.S. person to penalties for money laundering.

In the Pasquantino case, (96 AFTR 2d 2005-5392 (2005), the U.S. Supreme Court determined that a foreign government (i.e. Canada) has a valuable "property right" in collecting taxes (in Pasquantino, "excise taxes"), The Supreme Court held that international tax evasion (i.e. taxes due to a foreign government) is a "Specified Unlawful Activity ("SUA"), which is both a predicate offense for money laundering (i.e. it is a "foreign crime"), and is a violation of the wire fraud statute (18 U.S.C. Sec. 1343) (i.e. the uncollected Canadian excises were "property" for purposes of the "fraud" element in the "wire fraud statute").

In Pasquantino, the U.S. Supreme Court held that the defendant's failure to pay taxes inflicted economic injury on Canada "no less than had they embezzled funds from the Canadian treasury. (Defendants) used interstate wires to execute a scheme to defraud a foreign sovereign of tax revenues. Their offense was complete the moment they executed the scheme inside the U.S., the wire fraud statute punishes the scheme, not its success.

International tax and estate planning may lead to tax evasion (and additional crimes: money laundering, mail fraud, wire fraud) if the U.S. taxpayer either fails to pay tax due to federal, state or foreign governments. The U.S. taxpayer may be culpable for violation of U.S. wire fraud laws, money laundering laws or mail fraud laws, which may lead to asset forfeiture.

Money laundering is the disguise of the nature or the origin of funds. It includes the transmutation of tax evasion proceeds into personal assets or 3rd party distributions (to family, friends, and others).

Income tax deficiencies (i.e. failure to pay tax due) which create "tax cheating" proceeds, when used to purchase assets or make investments may subject the taxpayer to separate felonies:

- Tax Evasion (failure to pay the tax due);
- Money Laundering. The use of proceeds from a specified unlawful activity, i.e. tax evasion, to purchase or make investments in assets which transmute the original illegal tax-cheating proceeds into another asset;
- Mail Fraud. The use of the postal system to effectuate a scheme to defraud. 18 U.S.C. Sec. 1341;
- Wire Fraud. The use of the telecommunications facilities to effectuate a scheme to defraud. 18 U.S.C. Sec. 1341.

Money Laundering

Money laundering may be linked to tax evasion. A violation of the money laundering statutes includes a financial transaction involving the proceeds of a specified unlawful activity ("SUA") with the intent to either:

1. Promote that activity;

2. Violate IRC Sec. 7201 (which criminalizes willful attempts to evade tax);

3. Violate IRC Sec. 7206 (which criminalizes false and fraudulent statements made to the IRS).

The tax involved in the transaction (and which is avoided) may be any tax: i.e. income, employment, estate, gift and excise taxes (See: U.S. Dept. of Justice, Criminal Tax Manual, Chapter 25, 25.03(2)(a).

Under the money laundering statutes, the IRS is authorized to assess a penalty in an amount equal to the greater of the financial proceeds received from the fraudulent activity, or $10,000 (under 18 U.S.C. Sec. 1956(b)), the authority is granted by statute to the U.S. not the IRS, and is enforced either by a civil penalty or a civil lawsuit.

Violations of statutes for mail fraud, wire fraud, and money laundering are punishable by monetary penalties, civil and criminal forfeiture. (See 18 U.S.C. section 981 (a)(1)(A) which permits property involved in a transaction that violates 18 U.S.C. sections 1956, 1957 and 1960 to be civilly forfeited).

Civil forfeiture statutes include:

1. 18 U.S.C. Sec. 1956, which outlaws the knowing and intentional transportation or transfer of monetary funds derived from specified criminal offenses. For Sec. 1956 violations, there must be an element of promotion, concealment or tax evasion;

2. 18 U.S.C. Sec. 1957, which penalizes spending transactions when the funds are contaminated by a criminal enterprise;

3. 18 U.S.C. Sec. 1960, which penalizes the unlicensed money transmitting business.

Under 18 U.S.C. Sec. 981(b)(2), seizures are made by warrant in the same manner as search warrants. Under 18 U.S.C. Sec. 981(b)(1), the burden of proof is by a preponderance of the evidence. The property may be seized under the authority of the Secretary of the Treasury when a tax crime is involved.

Under 18 U.S.C. Sec. 982(a)(1)(A), if the offense charged is a violation of the Money Laundering Control Act, and the underlying specified unlawful activity is mail or wire fraud, courts may order criminal forfeiture of funds involved in the activity on conviction.

The U.S. Dept. of Justice Tax Division policy requires U.S. attorneys to obtain Tax Division approval before bringing any and all criminal charges against a taxpayer involving a violation of the Internal Revenue Code. Absent specific approval, additional criminal charges for wire fraud, mail fraud and money laundering would not normally be included (U.S. Dept. of Justice Criminal Tax Manual, Chapter 25, 25.01). If the additional criminal charges are approved, the taxpayer risks having the trust assets seized or forfeited.

Regarding asset seizure, the U.S. government may seize assets pursuant to a violation of the money laundering laws. In addition, the IRS has authority for seizure and forfeiture under Title 26. Under IRC Sec. 7321, any property that is subject to forfeiture under any provision of Title 26 may be seized by the IRS.

Code section 7301 allows for the IRS to seize property that was removed in fraud of the Internal Revenue laws. Code section 7302 allows the IRS to seize property that was used in violation of the Internal Revenue laws.

In the case of transfer of funds to an offshore trust, it can trigger a violation of U.S. money laundering laws and lead to asset forfeiture. For example, tax counsel may recommend a tax planning strategy, and provide instructions by telephone, email or U.S. mail, which include client's transfer of funds pursuant to tax counsel's instructions. These combined actions may trigger a violation of U.S. money laundering laws and lead to asset forfeiture.

Tax Counsel, Tax Evasion (and Money Laundering) Offshore Trusts

A U.S. taxpayer's failure to comply with U.S. tax law may implicate tax counsel in tax evasion. The IRS or the U.S. Dept. of Justice may allege that tax counsel aided and abetted the client in evading U.S. tax, if tax counsel:

1. Aided and assisted the U.S. taxpayer in the submission of materially false information to the IRS; Code § 7206(2), or

2. Assisted the client in removing or concealing assets with intent to defraud. Code § 7206(4).

For a U.S. taxpayer's transfer of assets to an offshore trust, despite receiving U.S. tax counsel's tax compliance recommendations, the U.S. taxpayer fails to comply with U.S. tax law, and tax counsel fails to ensure ongoing tax compliance, tax counsel may be implicated in money laundering.

If the U.S. taxpayer's tax noncompliance includes: tax evasion and transfer of the "tax evasion proceeds" to the offshore trust by wire transfer or U.S. mail, the transfer of funds may be classified by the IRS/U.S. Dept. of Justice as wire fraud or mail fraud, both of which are "specified unlawful activities" under the Money Laundering Control Act (18 U.S.C. Sec. 1956 and 1957), the U.S. taxpayer and their tax counsel may be criminally prosecuted for violation of the money laundering statutes.

Specified Unlawful Activities are listed in 18 U.S.C. section 1956(c)(7). SUAs are the predicate offenses for money laundering and come in three categories:

1. State crimes,

2. Federal crimes, and

3. Foreign crimes.

If the U.S. client transfers funds to an offshore trust under a tax counsel's tax-planning strategy and the U.S. tax client is not in compliance with U.S. tax laws (despite tax counsel's recommendations) then tax counsel may be exposed to IRS penalties:

1. Code section 6694 imposes civil penalties on tax preparers;

2. Code section 7212 imposes criminal penalties for interfering with the administration of the Internal Revenue laws.

Chapter 11 - International Tax Evasion: Tax Evasion & Money Laundering (Additional Issues)

"Money Laundering" is the disguise of the nature or the origin of funds. The predicate offenses (known as Specified Unlawful Activities; i.e. "SUA"), under the Money Laundering Control Act (18 U.S.C. Sec. 1956 and 1957) include: state tax evasion, federal tax evasion and foreign tax evasion.

A U.S. Taxpayer (or Foreign Taxpayer) may be held liable for Tax Evasion if: - They willfully fail to pay a tax due.- They willfully fail to file a tax return due.- They willfully file a false or fraudulent tax return.

U.S. Taxpayers (and tax advisors) implicated in U.S. tax evasion face separate felonies for tax evasion and money laundering. Foreign Taxpayers, who commit Foreign Tax Evasion, may implicate U.S. tax advisors in money laundering felonies, for the foreign client transfer of funds, which involve the U.S. tax advisors.

For both U.S. and Foreign Taxpayers, undisclosed foreign accounts, may be the depository accounts used to commit tax evasion, including:

Taxpayer failure to pay tax, file tax returns, or file false (fraudulent) tax returns for the original funds (which are the source of the proceeds used to fund the foreign accounts). Taxpayer failure to pay tax, file tax returns, or file false (fraudulent) tax returns for the earnings, on the assets held in the undisclosed foreign accounts

Depending upon the counsel's role in taxpayer's non-compliance, counsel may be held liable for aiding and abetting the client in tax evasion. Counsel may be held liable for:

- Aiding and assisting in the submission of materially false information to the IRS (IRC Sec. 7206(2).

- Assisting the client in removing or concealing assets with intent to defraud (IRC Sec. 7206(4).

Under Pasquantino, 96 AFTR 2d 2005-5392 (2005), the U.S. Supreme Court held that a foreign government has a valuable property right in collecting taxes (in this case Canadian excise taxes), and that right may be enforced in a U.S. court of law. Counsel who advise on international tax issues could be viewed as interfering with a foreign government's right to collect taxes. In this case, taxpayer used interstate wiring to execute a scheme to "defraud a foreign sovereign of tax revenue" (both wire fraud and tax evasion, two separate predicate offenses for foreign money laundering).

Under Pasquantino, international tax evasion is deemed a "Specified Unlawful Activity," which is a predicate offense for money laundering.

"Klein Conspiracy Prosecution"

Under 18 U.S.C. Sec. 371 it is a crime for two or more persons to conspire to commit an offense against the U.S. Under Klein an agreement by two or more persons to impede the IRS with each participant knowingly, willfully and intentionally participating in the conspiracy.

International Estate Plan

Tax counsels who advise a client on an international estate plan, may subject themselves to liability. Once the estate plan is in place, a client's subsequent actions may lead to U.S. or foreign tax evasion; e.g., violation of U.S. money laundering, wire fraud or mail fraud laws.

If a Tax Attorney forms entities (e.g. Trust, Limited Liability Company, Corporation) sends instructions to a client via telephone, email, U.S. Mail, and a client transfers funds pursuant to counsel's instructions, it may lead to tax evasion, a predicate offense (an "SUA"), which can trigger a violation of U.S. money laundering laws.

After the entities are formed, and despite receiving tax compliance guidance from counsel, the client fails to comply with the tax law, and counsel fails to ensure ongoing full tax compliance, the client may be held liable for both tax evasion and money laundering. If so, tax counsel may be subject to civil and criminal penalties:- IRC Sec. 6694: civil penalties imposed on tax preparers.- IRC Sec. 7212 (criminal penalties imposed for interfering with the administration of the internal revenue law).

U.S. Financial Reports

U.S. financial institutions file Currency Transaction Reports (CTR) and Suspicious Activity Report (SAR) with the Detroit Computing Center (uploaded at the IRS Currency Banking and Retrieval System database at the IRS/DCC).

The combined CTR/SAR currency transaction reports provide a paper trail (i.e. a "road map") for the IRS Criminal Investigation Division ("CID") investigation of "financial crimes" (i.e. tax evasion and money laundering).

A Currency Transaction Report (CTR) is filed by financial institutions that engage in a currency transaction in excess of $10,000.

A Suspicious Activity Report (SAR) is filed on transactions involving at least $5,000 that the financial institution knows, suspects, or has reason to suspect the money was derived from illegal activities. The SAR is also filed when transactions are part of a plan to violate federal laws and financial reporting requirements.

IRS Audits

Under a civil tax audit, the IRS may obtain evidence that may be illegal under criminal proceedings (e.g., Fifth Amendment defenses, objections to "tainted evidence"). With

tax evidence obtained from the civil tax audit, the IRS (with the U.S. Attorney) may initiate criminal proceedings.

U.S. Taxpayers with unreported foreign bank accounts (and income) are subject to IRS civil tax audits with civil penalties (monetary penalty, only) and criminal tax prosecution (monetary penalty and jail).

The IRS, under a civil tax audit:

May summon evidence, which support culpability for a crime (e.g., tax evasion) and civil penalties (e.g., 75% fraud penalty).

May trigger investigation into money laundering (i.e., when U.S. Taxpayers attempt to repatriate funds from undisclosed foreign bank accounts, they may be liable for money laundering).

Use evidence obtained under a civil tax audit to support a subsequent criminal prosecution (including culpability for 3rd party co-conspirators for obstructing tax collection and conspiracy).

Tax Conspiracy

18 U.S.C.A. §371 is the Federal Statute for conspiracy which provides that: "If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $ 10,000 or imprisoned not more than five years, or both."

Tax Conspiracy offenses include: willfully aiding or assisting in, or procuring, counseling, or advising, the preparation or presentation under, or in connection with any matter arising under, the Internal Revenue laws, of a false or fraudulent return, affidavit, claim or document (whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim or document).

Tax Conspiracy offenses include: willfully failing to pay any tax or make any return (other than a return required under authority of Part III of Subchapter A of Chapter 61) at the time or times required by law or regulations; for offenses described in Sections 7206(1) and 7207 relating to false statements and fraudulent documents.

Offenses for tax conspiracy arise under Section 371 of Title 18 of the United States Code (Conspiracy), where the object of the conspiracy is to attempt in any manner to evade or defeat any tax or the payment thereof.

If an individual or individuals charged with committing any of the offenses articulated above, are outside the United States or are fugitives from justice, within the meaning of Section 3290 of Title 18 of the United States Code, the Statute of Limitations is tolled.

Money Laundering

When individuals attempt to repatriate into the United States, the funds contained in the undisclosed foreign bank accounts, they may be liable for money laundering. Individuals who maintain foreign bank accounts where disclosure of said bank accounts is not revealed pursuant to law, and who would be culpable under the various offenses recited above, may be liable for money laundering (specifically 18 U.S.C. 1956 and 1957, which is part of the Money Laundering Control Act of 1986).

18 U.S.C 1956 penalizes individuals who knowingly and intentionally transport or transfer monetary proceeds from specified unlawful activities. While the funds reposing in the foreign bank accounts may have been derived from lawful activities conducted within or without the United States by American citizens, the various violations of the Internal Revenue Code and the conspiracy statute, could well subject individuals to charges of money laundering.

If in fact the unreported bank accounts contained funds derived from unlawful activities, it may subject individuals to not only violations of Federal statutes but California statutes as well (e.g., California Penal Code §§ 182 and 186.10, which deal with conspiracy and money laundering).

Undisclosed Offshore Accounts: Records Subpoenas

At the California Tax Bar November 2012 Conference, San Diego speaker Kevin M. Downing (Miller Chevalier, Washington, D.C.) former lead U.S. Attorney prosecuting UBS, advised of new subpoena rules for Foreign Accounts which are undisclosed by U.S. taxpayers.

Once a records subpoena is served, there is no 5th Amendment right not to produce records, no production immunity.

If U.S. taxpayer does not have records, they must get records from the Foreign Financial Institution (i.e., undisclosed offshore account).

A refusal to comply with the records subpoena can result in the U.S. taxpayer being put in jail, with the account subject to an annual 50% penalty (of the highest account balance) under the "FBAR" rules. The U.S. government will not tolerate U.S. taxpayer's "stonewalling" (the incarceration and penalty have been affirmed by the 5th Circuit, the 7th Circuit and the 9th Circuit Court of Appeals).

Civil and Criminal Tax Fraud: Burden of Proof (Evidentiary Standards)

The U.S. taxpayer's exposure to civil penalty/criminal prosecution for unreported income and undisclosed foreign financial accounts is a "double-edged" sword with dual civil/criminal:

- Evidentiary Standards of Proof; - Statute of Limitations;- Collateral Estoppel Issues

If the IRS first institutes a civil tax audit, they may summons evidence, which may support both a civil penalty (e.g. fraud) and criminal culpability (e.g. tax evasion). The evidence from the civil tax audit may then be used for a subsequent criminal prosecution of the same U.S. taxpayer.

Civil and criminal tax deficiencies may differ-

Criminal violations are charged only against the tax deficiency that results from fraud.

Civil tax deficiency includes all tax due on the tax returns (i.e. “evaded income and deductions adjustments).

Under a civil tax audit, the IRS may obtain evidence that may be illegal under criminal proceedings (e.g. Fifth Amendment defenses objecting to “tainted evidence”) tax evidence obtained from the civil tax audit may enable the IRS (i.e. the U.S. Attorneys to initiate criminal proceedings against the taxpayer).

Criminal tax fraud requires a higher standard of proof than civil tax fraud. The government must prove “beyond a reasonable doubt” that the defendant is guilty of criminal tax fraud.

In civil tax fraud, the burden of proof required is a preponderance of the evidence (also termed “by clear and convincing evidence”) which is a lower evidentiary standard).

A criminal tax decision of a court or jury will bind a civil tax decision, but a civil tax decision does not bind a criminal tax decision.

Collateral Estoppel

When criminal tax proceedings are followed by civil tax proceedings, the legal doctrine of collateral estoppel may apply. This doctrine provides that an issue necessarily decided in a previous proceeding (the first proceeding) will determine the issue in a subsequent proceeding (the second proceeding) but only as to matters in the second proceeding that were actually presented and determined in the first proceeding.

A conviction for criminal tax evasion collaterally estops the taxpayer from contesting the existence of tax fraud for purposes of the civil tax fraud penalty (i.e. 75% of the unpaid tax) because a finding of criminal tax fraud (beyond a reasonable doubt) establishes proof of civil tax fraud (by clear and convincing evidence).

Acquittal of criminal tax evasion does not collaterally estop the government from proving civil tax fraud (by clear and convincing evidence). The criminal acquittal may establish that proof of fraud did not exist beyond a reasonable doubt, but that does not mean that proof of fraud by clear and convincing evidence does not exist.

Unreported Income (Undisclosed Foreign Bank Accounts)

U.S. taxpayers with unreported income and disclosed foreign financial accounts are subject to IRS civil tax audits with civil tax penalties (monetary penalty only) and criminal tax prosecution (monetary penalty and jail).

The U.S. taxpayer's tax records may include evidence, which supports culpability for a crime (e.g. tax evasion) and civil tax penalties (e.g. 75% fraud penalty).

Statutes of Limitation

Civil and criminal tax proceedings have different statutes of limitation.

Civil Tax Fraud - For civil tax fraud (i.e. unreported income/undisclosed foreign bank accounts), there is no statute of limitations. The tax can be assessed at any time.

Criminal Tax Evasion - For criminal tax evasion (i.e. unreported income) the criminal statute of limitations is only on the prosecution of the crime of tax evasion, (not the assessment of the tax owed).

Offenses arising under the Internal Revenue laws generally have a 3-year period of limitation for prosecution (IRC Sec. 6531).

When the prosecution is for the offense of willfully attempting in any manner to evade or defeat any tax, the statute of limitations is 6-years (i.e. unreported Income).

IRC Sec. 6531(1): for offenses involving the defrauding or attempting to defraud the United States (whether by conspiracy or not, and in any manner);

IRC Sec. 6531(2): for the offense of willfully attempting in any manner to evade or defeat any tax;

IRC Sec. 6531(3): for the offense of willfully aiding or assisting in the preparation of a false or fraudulent tax return.

IRC Sec. 6531(4): for the offense of willfully failing to pay any tax or make any tax return.

IRC Sec. 6531(5): for offenses relating to false statements and fraudulent documents under IRC Sec. 7206(1) and Sec. 7207.

IRC Sec. 6531(8): for offenses arising under 18 U.S.C. 371, where the object of the conspiracy is to attempt in any manner to evade or defeat any tax.

Under IRC Sec. 6531, the 6-year statute of limitations shall be tolled, while the U.S. taxpayer who committed the offenses is outside the United States.

Form 8938

Under Form 8938 (Statement of Specified Foreign Financial Assets):

A 3-year statute of limitations for failure to report a specified foreign financial asset or failure to file Form 8938;

A 6-year statute of limitations for U.S. taxpayer's failure to include in gross income an amount relating to specified foreign financial assets and the amount omitted is more than $5,000.

Chapter 12 - International Tax Evasion: Civil/Criminal Penalties

Civil Penalty Issues

1. Civil Tax Fraud (75% of tax due) (no statute of limitations).

2. Underpayment of Tax (25% of tax due).

3. For voluntary disclosures, under the IRS Offshore Voluntary Disclosure Program (2012), the values of foreign accounts and other foreign assets are aggregated for each year and the penalty is calculated during the period covered by the voluntary disclosure. Under the 2012/IRS Voluntary Disclosure, total penalties of up to 85% of unpaid tax, and 27.5% of highest balance total foreign bank accounts/foreign assets as follows:

a. Failure to File a Tax Return (IRC Sec. 6651(a)(1), up to 25% tax due.

b. Failure to Pay Tax (IRC Sec. 6651(a)(2), up to 25% tax due.

c. Accuracy Related Penalty (IRC Sec. 6662), a 40% penalty for tax underpayment attributable to undisclosed foreign financial asset understatement.

d. Title 26 Penalty – 27.5% highest aggregate balance of foreign bank accounts, entities and assets.

IRS/Criminal Penalty Issues

U.S. taxpayers with undisclosed offshore bank accounts and unreported income face criminal charges for:

1. Tax Evasion (IRC 7201), five years in jail, $25,000 fine;

2. Filing False Tax Return (IRC Sec. 7206(1)), three years in jail, $250,000 fine;

3. Failure to File Tax Return (IRC Sec. 7203), one year in jail, $100,000 fine;

4. Willful failure to file FBAR or Filing False FBAR (31 USC Sec. 5322), ten years in jail, fines up to $500,000 with related civil penalty the greater of $100,000 or 50% of the total balance of the foreign account per violation (IRC Sec. 5321(a)(5).

Chapter 13 - International Tax Evasion: Willfulness Defense

U.S. taxpayers, who fail to file tax returns or pay taxes due, face a felony for willful evasion of tax (IRC Sec. 7201). U.S. taxpayers, particularly international investors who are classified as U.S. taxpayers, under either the "Substantial Presence Test" or "Green Card Test", often defend their tax non-compliance by stating that they were "unaware of the law".

Under U.S. tax law, "ignorance of the law is no excuse" (in Latin: ignorantia juris non excusat). The legal principal is that a person who is unaware of a law may not escape liability for violating that law because they were unaware of its content.

U.S. Model Penal Code Section 2.02(9) states that knowledge that an activity is unlawful is not an element of an offense unless the statute creating the offense specifically makes it one.

For federal tax evasion, willfulness is required. This legal position was enshrined in Cheek v. U.S., (1991) 498 U.S. 192, which stated that in a federal criminal tax case, a taxpayer's "good faith" belief that he was not required to file tax returns would negate the 'intent element' of the crime of tax evasion (however, the defendant Cheek was held to not have a "good faith belief" and was convicted by the jury; i.e., the final arbiter of the evidence) and served a year and a day in jail.

On the issue of intent, the jury may consider "willful blindness"; i.e. the defendant willfully, knowingly and intentionally concealed the truth from himself, so that the defendant "intentionally" committed a tax crime.

Chapter 14 - Form W-8 Tax Withholding

Under IRC §§1441 and 1442, a Tax Withholding Agent must withhold 30% of any payment of an amount subject to tax withholding made to a Payee that is a Foreign Person unless the Withholding Agent obtains valid documentation that the Payee is either a U.S. Payee or a Beneficial Owner.

A U.S. Payee is any person required to furnish Form W-9.

A Beneficial Owner is any person or entity that is required to furnish:

1. Form W-8 BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding, [i.e., the Beneficiary is exempt from tax under a treaty]);

2. Form W-8 ECI (Certificate of Foreign Persons Claiming that Income is Effectively Connected with the Conduct of the Trade of Business in the United States, [i.e., the effectively connected income will be declared in the United States by the Beneficiary filing a U.S. Income Tax Return]); or

3. Form W-8 EXP (Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding, [i.e., any Foreign Government, International Organization, Foreign Central Bank of Issue, Foreign Tax-Exempt Organization, Foreign Private Foundation or Government of a U.S Possession]).

Under Form W-8 EXP, the Payee claims an exemption for withholding under IRC §115(2), IRC §501(C), IRC §892, IRC §895, or claims a reduced rate of withholding under IRC §1443(b).

Tax Withholding Agents

Tax Withholding on Payments to Foreign Taxpayer

Non-Resident Aliens and Foreign Corporations are generally subject to a flat 30% tax on U.S. Source Income that is not effectively connected with the conduct of a U.S. trade or business. To insure collection and payment of the tax, a Tax Withholding Agent must withhold 30% of the gross amount paid to a Foreign Taxpayer which is subject to tax (IRC §§1441 and 1442).

A lower tax-withholding rate may apply to scholarship or fellowship grants, gross investment income, and dispositions of U.S. real property interests. In addition, a tax treaty may also reduce the rate of tax withholding.

Only income of a Foreign Taxpayer is subject to tax withholding rules. A Foreign Taxpayer includes any Non-Resident Alien, (including a bona fide Resident of Puerto Rico) or an Alien Resident of Guam, the Northern Mariana Islands, the U.S. Virgin Islands and American Samoa (Treas. Reg. 1.1441-1(c)).

A Non-Resident Alien who elects resident status for income tax purposes will still be considered a Foreign Taxpayer for withholding purposes. A Foreign Taxpayer includes Foreign Corporations, Partnerships, Estates, Trusts (and the Foreign Branch of U.S. Financial Institutions in certain circumstances).

Income Subject to Tax Withholding

Income is subject to tax withholding requirements if it is from sources within the United States and is:

1. Fixed or determinable annual or periodical income ("FDAP" Income, e.g., interest, dividends, rents, royalties and compensation). FDAP Income does not include most gains from the sale of property.

2. Certain gains for the disposal of timber, coal, or domestic iron ore.

3. Gains relating to the contingent payment received from the sale or exchange of patents, copyrights, and similar intangible property.

Income payable for personal services performed in the United States will be treated as from sources who are within the United States, regardless of where the location of the contract, place of payment or residence of Payor.

Effectively Connected Income ("ECI") with the conduct of a U.S. trade or business is not subject to the withholding requirement (including income received as wages). ECI is subject to the tax and withholding rules, as if the Foreign Taxpayer were a U.S. Citizen Resident, or Domestic Entity.

Under IRC §1446, special rules apply to the effectively connected income of a Partnership (Foreign or Domestic) that is allocable to its Foreign Partners.

Withholding Agent

A Withholding Agent is the Person or Entity required to deduct, withhold and pay any tax on income paid to a Foreign Taxpayer (Treas. Reg. 1.1441-7). This duty is imposed on all persons that have the control, receive, custody, disposal, or payment of any items of income which are subject to withholding.

The Withholding Agent may be an Individual, Corporation, Partnership, Trust, or other entity (including a Foreign Intermediary or Partnership). A Withholding Agent may designate an Authorized Agent on its behalf.

The Tax Withholding Agent is personally liable for any tax required to be withheld, except in the case of certain conduit financing arrangements (IRC §1461). This liability is independent of the tax liability of the Foreign Taxpayer for whom any income is paid. Even if the Foreign Taxpayer pays the tax, the Withholding Agent may still be liable for any interest, penalties, or additions for failure to withhold (IRC §1463).

No Withholding

A Withholding Agent will not be required to withhold any amount if it has received documentation that confirms:

1. The Payee is a U.S. Person.

2. The Payee is a Beneficial Owner (i.e., a Foreign Person entitled to a reduced rate of withholding or a withholding exemption. Treas. Reg. 1.1441-1).

The Withholding Agent must obtain valid documentation from the Payee that it is either a U.S. Payee or Beneficial Owner. A U.S. Payee is any person required to furnish Form W-9. The U.S. Payee who furnishes Form W-9 may be subject to Form 1099 tax reporting and tax withholding requirements.

A Beneficial Owner is any person or entity who is required to furnish Form W-8 BEN, Form W-8 ECI, or Form W-8 EXP.

Payments to an intermediary (whether qualified or not), flow-through entity, or U.S. branch of Foreign Entity, may be treated as a U.S. Payee if valid documentation is provided on the Form W-8 IMY.

Withholding Agent Annual Returns

Every Withholding Agent must file an annual information return on Form 1042-S to report income paid to a Foreign Taxpayer during the tax year that is subject to withholding unless an exception applies (Treas. Reg. 1.1461-1, 1.6302-2).

A separate Form 1042-S must be filed for each recipient, as well as for each type of income that is paid to the same recipient. Form 1042 is used by the Withholding Agent to report and pay the withholding taxes.

Form 1042, Form 1042-S, must be filed regardless of whether or not taxes were required to be withheld. Forms 1042 and 1042-S must be filed by March 15th of the year following the year in which the income was paid.

The amount of tax required to be withheld will determine whether the Withholding Agent must deposit the taxes prior to the due date for filing the returns and how frequently such amounts must be deposited. Penalties may be imposed for failure to file, to provide complete and correct information, as well as for failure to pay any taxes.

Chapter 15 - IRS Form W-9

IRS Form W-9 is used by a person who files information returns with the IRS to report transactions. A U.S. Person (including a resident alien) provides their current Taxpayer Identification Number to the person requesting it ("The Requestor").

Summary

The Requestor uses the U.S. Person's Taxpayer Identification Number ("TIN") to report:

1. Income Paid (to the U.S. Person)

2. Real Estate Transactions

3. Mortgage Paid (by the U.S. Person)

4. Debt Cancellation

5. Acquisition or Abandonment of Secured Property

6. IRA Contributions (by the U.S. Person)

Form W-9 is used by a U.S. Person to certify:

1. Their Taxpayer Identification Number

2. They are not subject to "Back-up withholding"

3. If applicable, their allocable share of U.S. partnership income (U.S. trade or business) not subject to withholding tax, on foreign partners' share of "effectively connected income".

Form W-9 is used to claim exemption from back-up withholding for a U.S. Exempt Payee (who is exempt from tax under a U.S. Tax Treaty).

For Federal Tax purposes, a U.S. Person is defined as:

1. An Individual who is a U.S. Citizen or U.S. Resident Alien;

2. A U.S. Partnership, Corporation, Company or Association;

3. A U.S. Estate;

4. A Domestic Trust (defined under Treas. Reg. Section 301.7701-7).

Back-up Withholding

Payors making payments to U.S. Payees, under certain conditions must withhold and pay 28% of such payments to the IRS, known as "back-up withholding".

Payments that may be subject to back-up withholding include:

1. Interest

2. Tax-exempt Interest

3. Dividends

4. Broker and Barter Exchange Transactions

5. Rents

6. Royalties

7. Non-employee Pay

8. Real Estate transactions are not subject to back-up withholding

A U.S. Person is not subject to back-up withholding on payments received if they:

1. Give the Requestor their correct TIN

2. Make the proper certifications

3. Report all taxable dividends and interest on their tax return

Payments received by a U.S. Payee will be subject to back-up withholding if:

1. They do not give their TIN to the Requestor

2. They do not certify the TIN

3. The IRS tells the Requestor the U.S. Payee furnished an incorrect TIN

4. The IRS tells the Requestor the U.S. Payee is subject to back-up withholding because they did not disclose all reportable interest and dividends on their tax return

5. The U.S. Payee did not certify to the Requestor they are not subject to back-up withholding (for reportable interest and dividends for accounts opened after 1983)

Foreign Person (Non-Resident Alien/Foreign Entities)

A Foreign Person gives the Requestor the appropriate Form W-8 (not Form W-9) to confirm they are not subject to back-up withholding.

Non-Resident Alien who becomes a Resident Alien

Generally, only a Non-Resident Alien may use a tax treaty to reduce or eliminate U.S. Tax on income. Most treaties contain a "savings clause" which may specify exceptions which permit an exemption from tax (for certain types of income), even after the payee has become a U.S. Resident Alien (for tax purposes).

A U.S. Resident Alien who claims an exemption from tax (under a Tax Treaty Savings Clause) must attach a Form W-9 statement which specifies:

1. The Treaty Country (under which the Non-Resident Alien claimed a tax exemption)

2. The Treaty Article addressing the income received

3. The Tax Treaty Article which contains the Savings Clause (and its exceptions)

4. The type and amount of income exempt from tax

5. Sufficient facts to justify the tax exemption under the Treaty

Special Rules for Partnerships

U.S. Partnerships (that conduct a U.S. trade or business) are generally required to pay a withholding tax on any foreign partners' share of U.S. partnership income. If a Form W-9 is not received the Partnership is required to presume that a Partner is a Foreign Person, and pay the withholding tax.

The following U.S. Persons are required to give the Form W-9 to the Partnership to establish their U.S. tax status (and avoid withholding on their allocable shares of partnership net income):

1. The U.S. Owner of a Disregarded Entity (not the Entity);

2. The U.S. Grantor of a Grantor Trust (not the Trust);

3. The U.S. Trust (other than a Grantor Trust) and not the Trust beneficiaries.

Penalties

1. Failure to Furnish Correct TIN to Requestor -$50 penalty for each such failure (unless the failure is due to reasonable cause and not willful neglect).

2. Civil Penalty for False Information with Respect to Withholding - $500 penalty (if no reasonable basis for false statement).

3. Criminal Penalty for Falsifying Information - Willful falsifying certifications subject to fines and/or imprisonment.

4. Misuse of TIN's - If the Requestor discloses or uses TIN's in violation of Federal law, the Requestor may be subject to civil and criminal penalties.

Chapter 16 – Summary of HIRE and Foreign Account Tax Compliance ACT

On March 18, 2010, President Obama signed the Hiring Incentives to Restore Employment ("HIRE") Act (P.L. 111-147) (The "Act"), which included the Foreign Account Tax Compliance Act containing new foreign account tax compliance rules.

Under the Act, new reporting and disclosure requirements for foreign assets will be phased in between 2010 – 2014:

1. Foreign Institutional Reporting: Foreign Institutions have new reporting and withholding obligations for accounts held by U.S. Persons (generally effective after 12/31/12, commencing 1/1/13).

2. Foreign Financial Assets ($50,000): Individuals with an interest in a "Foreign Financial Asset" have new disclosure requirements. If foreign financial assets are valued in excess of $50,000, the U.S. Taxpayer must attach certain information to their income tax returns for tax years beginning after March 18, 2010. (U.S. Taxpayers are not required to disclose interests that are held in a custodial account with a U.S. financial institution).

The penalty is substantial ($10,000, plus additional amounts for continued failures, up to a maximum of $50,000 for each applicable tax period). The penalty may be waived if the individual can establish that the failure was due to reasonable cause and not willful neglect.

3. 40% Penalty: A 40% accuracy-related penalty is imposed for underpayment of tax that is attributable to an undisclosed foreign financial asset understatement. Applicable assets are those subject to mandatory information reporting when the disclosure requirements were not met. The penalties are effective for tax years beginning after March 18, 2010.

4. 6-Year Statute of Limitations: Statute of limitations re: omission of income in connection with foreign assets: The statute of limitations for assessments of tax is extended to six (6) years if there is an omission of gross income in excess of $5,000 attributable to the foreign financial asset. The six-year statute of limitations is effective for tax returns filed after March 18, 2010, as well as for any other tax return for which the assessment period has not yet expired as of March 18, 2010.

5. Passive Foreign Investment Companies: The Act imposes an information disclosure requirement on U.S. Persons who are PFIC shareholders. A PFIC is any foreign corporation if:

a. 75% or more of the gross income of the corporation for the taxable year is passive income; or

b. The average percentage of assets held by such corporation during a taxable year which produce passive income or which are held for the production of passive income are at least 50%.

6. Foreign Trusts with U.S. Beneficiaries: The Act clarifies if a foreign trust is treated as having a U.S. Beneficiary, an amount accumulated is treated as accumulated for the U.S. Person's benefit even if that Person's trust interest is contingent.

The Act clarifies that the discretion to identify beneficiaries may cause the trust to be treated as having a U.S. Beneficiary. This provision is effective after March 18, 2010.

7. Rebuttable Presumption/Foreign Trust – U.S. Beneficiary: The Act creates a rebuttable presumption that a foreign trust has a U.S. Beneficiary if a U.S. Person directly or indirectly transfers property to a foreign trust (unless the transferor provides satisfactory information to the contrary to the IRS). This provision is effective for property transfers after March 18, 2010.

8. Uncompensated Use of the Foreign Trust Property: The Act provides that the uncompensated use of the foreign trust property by a U.S. Grantor, a U.S. Beneficiary (or a U.S. Person, related to either of them), is treated as a distribution by the trust. The use of the trust property is treated as a distribution to the extent of the fair market value of the property's use to the U.S. Grantor/U.S. Beneficiary, unless the fair market value of that use is paid to the trust.

The loan of cash or marketable securities by a foreign trust, or the use of any other property of the trust, to or by any U.S. Person is also treated as paid or accumulated for the benefit of the U.S. Person. This provision applies to loans made and uses of property after March 18, 2010.

9. Reporting Requirements, U.S. Owners of Foreign Trusts: This provision requires any U.S. Person treated as the owner of any portion of a foreign trust to submit IRS-required information and insure that the trust files a return on its activities and provides such information to its owners and distributees.

This new requirement imposed on U.S. Persons treated as owners is in addition to the current requirement that such U.S. Persons are responsible for insuring that the foreign trust complies with its own reporting obligations. This provision is effective for taxable years beginning after March 18, 2010.

10. Minimum Penalty re: Failure to Report Certain Foreign Trusts: This provision increases the minimum penalty for failure to provide timely and complete disclosure on foreign trusts to the greater of $10,000 or 35% of the amount that should have been reported.

In the case of failure to properly disclose by the U.S. Owner of a foreign trust of the year-end value, the minimum penalty would be the greater of $10,000 or 5% of the amount that should have been reported. This provision is effective for notices and returns required to be filed after December 31, 2009.

Chapter 17 - Foreign Financial Assets

U.S. Taxpayers who hold any interests in specified foreign financial assets during the tax year must attach their tax returns for the year certain information with respect to each asset if the aggregate value of all assets exceeds $50,000. An individual who fails to furnish the required information is subject to a penalty of $10,000. An additional penalty may apply if the failure continues for more than 90 days after a notification by the IRS to a maximum of $50,000. The penalty may be avoided if the Taxpayer shows a reasonable cause for the failure to comply.

The Joint Committee on Taxation, Technical Explanation of the Hiring Incentives to Restore Employment Act (JCX-4-10) clarifies that although the nature of the information required to be disclosed is similar to the information disclosed on an FBAR, it is not identical.

For example, a beneficiary of a foreign trust who is not within the scope of the FBAR reporting requirements because his interest in the trust is less than 50%, may still be required to disclose the interest with his tax return if the $50,000 value threshold is met. In addition, this provision is not intended as a substitute for compliance with the FBAR reporting requirements, which remain unchanged.

For purposes of IRC Code §6038(D) as added by the HIRE Act, a specified foreign financial asset includes:

1. Any depository, custodial, or other financial account maintained by a foreign financial institution, and

2. Any of the following assets that are not held in an account maintained by a financial institution:

a. Any stock or security issued by a person other than a U.S. Person

b. Any financial instrument or contract held for investment that has an issuer or counterparty other than a U.S. Person, and

c. Any interest in a foreign entity (IRC §6038(D)(b) as added by the 2010 HIRE Act).

The information required to be disclosed with respect to any asset must include the maximum value of the asset during the tax year (IRC §6038(D)(c) as added by the 2010 HIRE Act).

For a financial account, the Taxpayer must disclose the name and address of the financial institution in which the account is maintained and the number of the account.

In the case of any stock or security, the disclosed information must include the name and address of the issuer and such other information as is necessary to identify the class or issue of which the stock or security is a part.

In the case of any instrument, contract, or interest, a Taxpayer must provide any information necessary to identify the instrument, contract, or interest along with the names and addresses of all issuers and counterparties with respect to the instrument, contract, or interest.

Under these rules, a U.S. Taxpayer is not required to disclose interests held in a custodial account with a U.S. financial institution. In addition, the U.S. Taxpayer is not required to identify separately any stock, security instrument, contract, or interest in a disclosed foreign financial account.

An individual who fails to furnish the required information with respect to any tax year at the prescribed time and in the prescribed manner is subject to a penalty of $10,000 (IRC §6038(D)(d) as added by the 2010 HIRE Act). If the failure to disclose the required information continues for more than 90 days after the day on which the notice was mailed (from the Secretary of Treasury), the individual is subject to an additional penalty of $10,000 for each 30-day period (or a fraction thereof) with the maximum penalty not to exceed $50,000.

In addition to the $10,000 penalty (up to $50,000) under IRC §6038(D) a 40% accuracy-related penalty is imposed on any understatement of tax attributable to a transaction involving an undisclosed foreign financial asset.

The statute of limitations for omission of gross income attributable to foreign financial assets (omission of gross income in excess of $5,000 attributable to a foreign financial asset), is extended to six years.

The IRC §6038(D) penalties are not imposed on any individual who can show that the failure is due to reasonable cause and not willful neglect. (IRC §6038D(g), as added by the 2010 HIRE Act.)

The information disclosure with respect to foreign financial assets supplements the FBAR reporting regime. The HIRE Act broadens reporting requirements and extends the rules to ownership of foreign assets such as foreign stocks, securities, interests in foreign companies not covered by the FBAR reporting. The threshold reporting requirement amount for FBARs ($10,000) is increased to $50,000. While the FBAR reporting covers those having signatory or other authority, the new reporting regime focuses on ownership.

Chapter 18 - U.S. Taxpayer FBAR Tax Compliance Issues

FBAR rules are not found in the Code. Rather, they are set forth in the Bank Secrecy Act, first enacted by Congress in 1970. Since 2003, however, the IRS bears responsibility for enforcing these rules.

The FBAR rules require that every U.S. Person report (i) any financial interest or authority over a (ii) financial account in a foreign country with (iii) an aggregate value over $ 10,000 at any time during the taxable year. The report must be filed on a Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (hence the acronym "FBAR"). U.S. Persons must also disclose the existence of the account on their Form 1040, Schedule B, Part III. This is commonly referred to as "checking the 'B' box."

Taxpayers who fail to disclose the account on their Form 1040 could be subject to criminal sanctions for filing a false tax return.

The FBAR report is due on June 30th. This due date is not subject to extensions. The FBAR report must be filed separately from the U.S. Person's tax return.

Financial Interest Or Authority

A U.S. Person has a financial interest in a foreign account if he or she is the legal or beneficial owner. Attribution rules apply in making this determination. A person serving as a shareholder, partner, and trustee may also be deemed to hold a financial interest if the owner of the account is (i) a person acting as an agent on behalf of the U.S. Person, (ii) a corporation where the U.S. Person owns, directly or indirectly, more than 50 percent of the outstanding stock, (iii) a partnership in which the U.S. Person owns more than 50 percent of the profits, or (iv) a trust in which a U.S. Person has either a present interest in more than 50 percent of the assets or from which the U.S. Person receives more than 50 percent of the income. If these thresholds are met, the U.S. Person has an FBAR reporting obligation, regardless of whether he or she has any authority over the account.

Non-owners with authority over a foreign account are also subject to the FBAR reporting rules. Authority means the U.S. Person has the ability to order a distribution or disbursement of funds or other property held in the account. This is not limited to signature authority, but includes the ability to order distributions by verbal commands or other communication. Authority does not include persons who have the right to invest, but not distribute, the foreign account funds.

There is no limitation for taxpayers who have authority over a foreign account, but only in an official capacity. (For example, the president of a corporation, the general partner of a partnership, or the manager of an LLC may be subject to these rules.)

Both the entity, as beneficial owner, and the representative, who has control over the account, may be required to file an FBAR report. Similarly, when more than one U.S.

Person has authority over an account, i.e., president and vice president, both persons may have an FBAR reporting obligation.

Even when the account is subject to joint control, and the signature of someone other than the taxpayer is required to cause a distribution, the taxpayer is still considered to have authority over the account for FBAR reporting purposes.

Financial Account In A Foreign Country

The term financial account is broadly defined as any asset account and encompasses simple bank accounts (checking or savings), as well as securities or custodial accounts. It also includes a life insurance policy or other type of policy with an investment value (i.e., surrender value).

Foreign country naturally refers to any country other than the United States. Puerto Rico, U.S. possessions and territories are included as part of the United States (as they should) for these purposes. Accounts held by U.S. Persons in these areas are not foreign accounts subject to FBAR reporting.

The IRS has indicated that a traditional credit card with a foreign bank is not a foreign account. However, use of a credit card as a debit or check card could trigger foreign account status and thus an FBAR reporting obligation.

$10,000 Threshold

To be reportable, the account must have assets the value of which during the year, exceeds $10,000.

The Instructions to the FBAR report state that if the aggregate value of all financial accounts exceeds $10,000 at any time during the year, the U.S. Person must file an FBAR report. A U.S. Person who possesses multiple foreign accounts, all of which have less than $10,000, but which collectively exceed $10,000, may have an FBAR reporting obligation.

Taxpayers may transfer an appreciating asset to a foreign account, such as stock or securities. As these assets increase in value, they may trigger an FBAR reporting requirement.

Whether the account generates any income is not relevant.

Penalties

In an attempt to improve compliance, Congress enhanced the FBAR penalties in 2004. Under pre-2004 law, civil penalties applied only to willful violations. In 2009, civil penalties up to $10,000 may be imposed on non-willful violations. This penalty may be avoided if there was reasonable cause and the U.S. Person reported the income earned on the account. 31 U.S. C. §5321(a)(5).

Although reasonable cause is not defined, the IRS will likely apply the reasonable cause standard for late-payment/late-filing penalties.

The penalty for willful violations is far more severe. It is equal to the greater of $100,000 or 50 per-cent of the balance of the account at the time of the FBAR violation. No reasonable cause exception exists for a willful violation. 31 U. S. C. §5321(a)(5)(c).

The IRS has six years to assess a civil penalty against a taxpayer that violates the FBAR reporting rules.

Chapter 19 - Amended Tax Returns (Voluntary Disclosure)

U.S. Taxpayers who fail to report offshore accounts by filing FBAR (TD F 90.22-1) face criminal and civil penalties:

1. Failure to Report Income

(3 Felonies and 1 Misdemeanor) up to 14 years in jail, plus 75% Civil Tax Fraud Penalty, 25% Failure to Pay Tax Penalty.

2. Failure to File FBAR's

(a maximum annual penalty of 50% of the account balance, up to 10 years in jail a $500,000 fine).

3. Perjury

Taxpayers Form 1040/Schedule B must declare whether Taxpayers have any authority over, or interest in foreign accounts with a total of more than $10,000.

In the IRS 6/24/09 FAQ update the IRS stated:

What is the distinction between filing amended returns to correct errors and filing a voluntary disclosure?

An amended return is the proper vehicle to correct an error on a filed return, whether a taxpayer receives a refund or owes additional tax. A voluntary disclosure is a truthful, timely and complete communication to the IRS in which a taxpayer shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining the taxpayer's correct tax liability and makes arrangements in good faith to fully pay that liability. Filing correct amended returns is normally a part of the process of making a voluntary disclosure under IRM 9.5.11.9. Taxpayers and practitioners trying to decide whether to simply file an amended return with a Service Center or to make a formal voluntary disclosure under the process described in IRM 9.5.11.9 and the March 23, 2009 memoranda should consider the nature of the error they are trying to correct.

Taxpayers with undisclosed foreign accounts or entities should consider making a voluntary disclosure because it enables them to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution. Making a voluntary disclosure also provides the opportunity to calculate, with a reasonable degree of certainty, the total cost of resolving all offshore tax issues. It is anticipated that the voluntary disclosure process is appropriate for most taxpayers who have underreported their income with respect to offshore accounts and assets. However, there will be some cases, such as where a taxpayer has reported all income but failed to file the FBAR (FAQ 9), or only failed to file information returns (FAQ 42), where it remains appropriate for the taxpayer to simply file amended returns with the applicable Service Center (with copies to the Philadelphia office listed in FAQ 9).

The IRS stated position is that a Taxpayer's voluntary disclosure entitles the Taxpayer to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution.

In reality, a taxpayer who makes a voluntary disclosure may:

1. Spotlight their "tax crimes"

2. If the voluntary disclosure is not accepted, jeopardize them and subject them to criminal prosecution

The IRS SBSE 3/23/09 memorandum, Subject: Routing of Voluntary Disclosure Cases, which addresses a change in the processing of voluntary disclosure requests containing offshore issues.

1. Such requests will continue to be initially screened by Criminal Investigation to determine eligibility for voluntary disclosure, and, if involving only domestic issues will be forwarded to Area Planning and Special Programs for Civil Processing;

2. Voluntary disclosure eligibility for offshore issues will be initially screened by Criminal Investigation and forwarded to the Philadelphia Offshore Identification Unit (POIU) for processing.

Voluntary Disclosure risks include:

1. Heightened risk of criminal prosecution (since initial screening is by the IRS Criminal Investigation Division);

2. A voluntary disclosure may be used as an evidentiary admission of Taxpayer's unreported income;

3. A voluntary disclosure may waive Taxpayer's 5th Amendment right against self-incrimination;

4. While a voluntary disclosure is pending the IRS may request more information, commence an audit or initiate criminal prosecution.

As an alternative strategy to a voluntary disclosure, the "quiet filing" (for the Tax Years at issue) of an amended tax return (or original tax return) may instead:

1. Pre-empt criminal charges for the failure to file FBAR returns, Form 1040 tax returns and failure to pay tax;

2. Pre-empt a 75% civil tax fraud penalty, for failure to file or pay tax and a 25% failure to pay tax penalty;

3. If the income is properly reported (i.e., no substantial understatements which are subject to a 6 year statute of limitations), the tax filing will commence the 3-year statute of limitations (for each year) for IRS audit.

Chapter 20 - Statute of Limitations (FBAR)

On 6/24/09, in FAQ #31, the IRS confirmed they would be able to assess taxes under a 6-year statute of limitations if the IRS can prove a substantial omission of gross income:

How can the IRS propose adjustments to tax for a six-year period without either an agreement from the taxpayer or a statutory exception to the normal three-year statute of limitations for making those adjustments?

Going back six years is part of the resolution offered by the IRS for resolving offshore voluntary disclosures. The taxpayer must agree to assessment of the liabilities for those years in order to get the benefit of the reduced penalty framework. If the taxpayer does not agree to the tax, interest and penalty proposed by the voluntary disclosure examiner, the case would be referred to the field for a complete examination. In that examination, normal statute of limitations rules will apply. If no exception to the normal three-year statute applies, the IRS will only be able to assess tax, penalty and interest for three years. However, if the period of limitations was open because, for example, the IRS can prove a substantial omission of gross income, six years of liability may be assessed. Similarly, if there was a failure to file certain information returns, such as Form 3520 or Form 5471, the statute of limitations will not have begun to run. If the IRS can prove fraud, there is no statute of limitations for assessing tax.

The FAQ #42 cites 31 USC 532(b)(1) confirming the 6-year statute of limitations for FBARs

Chapter 21 - Annual Filing Requirements and Reasonable Cause Exception (FBAR)

In April 2003, the Financial Crimes Enforcement Network delegated authority of the TD F 90-22.1 form (i.e., FBAR form) to the Internal Revenue Service (see IR 2003-48 (4/10/03); 31 CFR §103.5(6)(b)(8)). The IRS enforces all penalties associated with the FBAR with the same power it enforces tax reporting and payment compliance.

The IRS has been given the authority to enforce the filing rules and audit the reports as appropriate.

The FBAR filing is due by June 30th of the year following the year of the report with no provisions for extensions. The due date means the date it must be received by the US Treasury. Mailing it on the date it is due will result in a late filing. The FBAR form, filed separately from the income tax, must be mailed to US Department of Treasury, PO Box 32621, Detroit, Michigan 48232-0621.

If there is an emergency, the form can be hand-delivered to a local IRS office for forwarding to the Treasury Department in Detroit.

An amended FBAR may be filed by completing a revised FBAR with the correct information writing the words “Amended” at the top of the revised FBAR and stapling it to a copy of the original FBAR. For Taxpayers amending a late-filed FBAR, they should include a statement explaining their reasons for a late filing (i.e., request a reasonable cause exception from penalty).

A failure to file a FBAR has civil and criminal penalties (which are in addition to any income tax penalties if the income is not reported). The IRS must assess the civil penalties within 6 years of the FBAR violation (31 USC 5321(b)(1)).

For a willful failure to file, the civil penalty increases from $10,000 (non-willful failure to file) to the greater of $100,000 or 50% of the account balance in the foreign account for the tax year.

The civil penalties for non-willful failure to file may be waived by the IRS if the Taxpayer can show reasonable cause. If the Taxpayer has a reasonable cause exception, the FBAR should be filed with an explanation (i.e., the reasonable cause, with an express request for waiver of penalties).

The waiver of civil penalties for a reasonable cause exception may include among other factors:

1. All the income from the foreign account was included on the US Taxpayer’s return.

2. The Taxpayer was unaware of the requirement to file (for example, lack of understanding of what constitutes a financial interest).

3. Once the Taxpayer became aware of the filing requirements, he filed all delinquent reports (up to 6 years).

Chapter 22 - Civil and Criminal Penalties (FBAR)

Each U.S. Person who has a financial interest in, or signature or other authority over, one or more foreign financial accounts (value over $10,000, at any time during a calendar year) is required to report the account on Schedule B/Form 1040, and TD F 90-22.1 (Report of Foreign Bank and Financial Accounts (FBAR)), due by June 30 of the succeeding year (I.R.M. 5.21.6.1. (2/17/09)).

Failure to file the required report or maintain adequate records (for 5 years) is a violation of Title 31 with civil and criminal penalties (or both). For each violation a separate penalty may be asserted.

(I) Non-Willful Violation

Civil Penalty – Up to $10,000 for each violation. 31 U.S.C.§ 5321(a)(5)(A)

(II) Negligent Violation

Civil Penalty – Up to the greater of $100,000, or 35 percent of the greatest amount in the account. 31 U.S.C.

(III) Intentional Violations

1. Willful - Failure to File FBAR or retain records of account

Civil Penalty -Up to the greater of $100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty - Up to $250,000 or 5 years or both

31 U.S.C. §5321(a)(5)(C), 31 U.S.C. § 5322(a) and 31 C.F.R. §103.59(b) for criminal

2. Knowingly and Willfully Filing False FBAR

Civil Penalty – Up to the greater of $100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty – $10,000 or 5 years or both

18 U.S.C. § 1001, 31 C.F.R. § 103.59(d) for criminal

3. Willful - Failure to File FBAR or retain records of account while violating certain other laws

Civil Penalty - Up to the greater of $100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty - Up to $500,000 or 10 years or both

31 U.S.C. § 5322(b) and 31 C.F.R. §103.59(c) for criminal

Chapter 23 - Criminal Penalties: Willful Failure to File (Defenses) (FBAR)

Under IRS Form 1040, at the bottom of Schedule B, Part III, on Page 2, Question 7(a) states: "at any time during the previous year, did you have any interest in or signatory or other authority over a financial account in a foreign country, such as a bank account, a security account, or other financial account? The answer is either yes or no. If yes, Question 7(b) requires the name of the foreign country (with the account). Question 8 requires confirmation of receipt of distribution from the account, or if the Taxpayer was a grantor of, or transferor to a foreign trust (which requires filing Form 3520).

A willful failure to file a FBAR can lead to a felony of up to 10 years in jail and a $500,000 fine. The IRS must prove willfulness in order to assert the $500,000 monetary penalty and the imprisonment for up to 10 years (see 31 USC 5321(a)(5)(B); CCA 200603026; Eisenstein, 731 F.2d 1540 (CA – 11, 1984)).

Willfulness must be proven by the IRS under the standard of clear and convincing evidence. If the Taxpayer knew about the requirement to file, it would affect his defense. If the Taxpayer failed to report the foreign account interest or other income on his income tax return, it would affect his defense.

If a failure to file is deemed to be part of a criminal activity involving more than $100,000 in a 12-month period, the penalty limit increases to $500,000 with up to 10 years in jail. The issue of whether a failure to file is willful or non-willful is based on the facts of each case. Willfulness has been defined as the voluntary, intentional violation of a known legal duty, see Cheek 498 US 192, 67 AFTR 2d 91-344 (Supreme Court 1991).

A Taxpayer's good faith belief that he does not have to file (or even his negligent failure to file) can be a defense to the charge of willful failure to file (i.e., a defense to criminal charges).

A defense may include that the Taxpayer was advised by his advisor that no FBAR was required.

Failure to maintain adequate records of the foreign account for the years the FBAR filing is due may result in additional civil and criminal penalties.

Part IV – IRS/OVDP

Chapter 24 - IRS Voluntary Disclosure: History

A tax crime is complete on the day the false return was filed.

Between 1945 and 1952, the IRS had a "voluntary disclosure" policy under which a taxpayer who failed to file a return or declare his full income and pay the tax due could escape criminal prosecution through voluntary disclosure of the deficiency, (so long as the voluntary disclosure was made before an investigation was started).

If the IRS determined that a voluntary disclosure had been made, no recommendation for criminal prosecution would be made to the Department of Justice.

Under current IRS practice, the review includes whether there was a true "voluntary disclosure" along with other factors in determining whether or not to recommend prosecution to the Department of Justice. (IRM, Chief Counsel Directive Manual (31) 330 (Dec. 11, 1989) (Voluntary Disclosure).

IRM 9781, Special Agents Handbook § 342.14, MT 9781-125 (Apr. 10, 1990) (Voluntary Disclosure). (although prosecution after voluntary disclosure is not precluded, the "IRS will carefully consider and weigh the voluntary disclosure, along with all other facts and circumstances, in deciding whether or not to recommend prosecution"). See also IRM 9131(1), MT 9-329 (Mar. 24, 1989). (Prosecution Guidelines).

IRS administrative practice recognizes that a taxpayer may still avoid prosecution by voluntarily disclosing a tax violation, provided that there is a qualifying disclosure that is (1) timely and (2) voluntary. A disclosure within the meaning of the practice means a communication that is truthful and complete, and the taxpayer cooperates with IRS personnel in determining the correct tax liability. Cooperation also includes making good faith arrangements to pay the unpaid tax and penalties "to the extent of the taxpayer's actual ability to pay."

A disclosure is timely if it is received before the IRS has begun an inquiry that is (1) "likely to lead to the taxpayer" and (2) the taxpayer is reasonably thought to be aware" of that inquiry; or the disclosure is received before some triggering or prompting event has occurred (1) that is known by the taxpayer and (2) that triggering event is likely to cause an audit into the taxpayer's liabilities.

Voluntariness is tested by the following factors: (1) how far the IRS has gone in determining the tax investigation potential of the taxpayer; (2) the extent of the taxpayer's knowledge or awareness of the Service's interest; and (3) what part the triggering event played in prompting the disclosure (where the disclosure is prompted by fear of a triggering event, it is not truly a voluntary disclosure).

No voluntary disclosure can be made by a taxpayer if an investigation by the Service has already begun. Therefore, once a taxpayer has been contacted by any Service function (whether it be the Service center, office examiner, revenue agent, or a special agent), the taxpayer cannot make a qualifying voluntary disclosure under IRS practice.

A voluntary disclosure can be made even if the taxpayer does not know that the Service has selected the return for examination or investigation may be too restrictive. Consequently, if there is no indication that the Service has started an examination or investigation, Tax Counsel may send a letter to the Service stating that tax returns of the taxpayer have been found to be incorrect and that amended returns will be filed as soon as they can be accurately and correctly prepared. This approach has the advantage of putting the taxpayer on record as making a voluntary disclosure at a time when no known investigation is pending. However, neither the taxpayer nor the lawyer can be completely certain that the voluntary disclosure will prevent the recommendation of criminal prosecution.

Where no IRS examination or investigation is pending a taxpayer's alternative is the preparation and filing of delinquent or amended returns. The advantage of filing delinquent or amended returns without a communication drawing attention to them is that the returns may not even be examined after being received at the Service center. In such an event, the taxpayer not only will have made a voluntary disclosure but will have avoided an examination as well. The disadvantage is that during the time the returns are being prepared, the taxpayer may be contacted by the Service and a voluntary disclosure prevented.

If a taxpayer who cannot make a qualifying voluntary disclosure nevertheless files amended or delinquent tax returns, these returns (1) constitute an admission that the correct income and tax were not reported and (2) if incorrect, may serve as an independent attempt to evade or as a separate false statement.

No formula exists, and a taxpayer must endure the uncertainty of the risk that a voluntary disclosure will not be considered truly voluntary by the Service. If so, an investigation that has already started but has lagged may be pursued more overtly and aggressively as a result of the disclosure.

Chapter 25 - Offshore Voluntary Disclosure Program 2012

The following is from IRS.gov

IRS Offshore Programs Produce $4.4 Billion To Date for Nation's Taxpayers; Offshore Voluntary Disclosure Program Reopens

WASHINGTON - Jan. 9, 2012 (Updated October 28, 2013) The Internal Revenue Service today reopened the offshore voluntary disclosure program to help people hiding offshore accounts get current with their taxes and announced the collection of more than $4.4 billion so far from the two previous international programs.

The IRS reopened the Offshore Voluntary Disclosure Program (OVDP) following continued strong interest from taxpayers and tax practitioners after the closure of the 2011 and 2009 programs. The third offshore program comes as the IRS continues working on a wide range of international tax issues and follows ongoing efforts with the Justice Department to pursue criminal prosecution of international tax evasion. This program will be open for an indefinite period until otherwise announced.

"Our focus on offshore tax evasion continues to produce strong, substantial results for the nation's taxpayers," said IRS Commissioner Doug Shulman. "We have billions of dollars in hand from our previous efforts, and we have more people wanting to come in and get right with the government. This new program makes good sense for taxpayers still hiding assets overseas and for the nation's tax system."

The program is similar to the 2011 program in many ways, but with a few key differences. Unlike last year, there is no set deadline for people to apply. However, the terms of the program could change at any time going forward. For example, the IRS may increase penalties in the program for all or some taxpayers or defined classes of taxpayers – or decide to end the program entirely at any point.

"As we've said all along, people need to come in and get right with us before we find you," Shulman said. "We are following more leads and the risk for people who do not come in continues to increase."

The third offshore effort comes as Shulman also announced today the IRS has collected $3.4 billion so far from people who participated in the 2009 offshore program, reflecting closures of about 95 percent of the cases from the 2009 program. On top of that, the IRS has collected an additional $1 billion from up front payments required under the 2011 program. That number will grow as the IRS processes the 2011 cases.

In all, the IRS has seen 33,000 voluntary disclosures from the 2009 and 2011 offshore initiatives. Since the 2011 program closed last September, hundreds of taxpayers have come forward to make voluntary disclosures. Those who have come in since the 2011 program closed last year will be able to be treated under the provisions of the new OVDP program.

The overall penalty structure for the new program is the same for 2011, except for taxpayers in the highest penalty category.

For the new program, the penalty framework requires individuals to pay a penalty of 27.5 percent of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the eight full tax years prior to the disclosure. That is up from 25 percent in the 2011 program. Some taxpayers will be eligible for 5 or 12.5 percent penalties; these remain the same in the new program as in 2011.

Participants must file all original and amended tax returns and include payment for back-taxes and interest for up to eight years as well as paying accuracy-related and/or delinquency penalties.

Participants face a 27.5 percent penalty, but taxpayers in limited situations can qualify for a 5 percent penalty. Smaller offshore accounts will face a 12.5 percent penalty. People whose offshore accounts or assets did not surpass $75,000 in any calendar year covered by the new OVDP will qualify for this lower rate. As under the prior programs, taxpayers who feel that the penalty is disproportionate may opt instead to be examined.

The IRS recognizes that its success in offshore enforcement and in the disclosure programs has raised awareness related to tax filing obligations. This includes awareness by dual citizens and others who may be delinquent in filing, but owe no U.S. tax. The IRS is currently developing procedures by which these taxpayers may come into compliance with U.S. tax law. The IRS is also committed to educating all taxpayers so that they understand their U.S. tax responsibilities.

More details will be available within the next month on IRS.gov. In addition, the IRS will be updating key Frequently Asked Questions and providing additional specifics on the offshore program.

Chapter 26 - IRS/OVDP 2012 Tax Compliance

The IRS/OVDI program requires:

1. Filing complete and accurate Form 1040(x) amended federal income tax returns for all tax returns covered by the voluntary disclosure, with applicable schedules detailing the type and amount of previously unreported income from the account or entity (Schedule B for interest and dividends, Schedule D for capital gains and losses, Schedule E for income from partnerships, S Corporations, estates or trusts and the years after 2010, Form 8938, Statement of Specified Foreign Financial Assets).

2. File Form TDF 90-22.1 (Report of Foreign Bank and Financial Accounts, "FBAR Filings") for all tax years covered by the voluntary disclosure.

3. Cooperate in the voluntary disclosure process, including providing information on offshore financial accounts, institutions and facilitators and signing agreements to extend the period of time for assessing Title 26 liabilities and FBAR penalties.

4. Payment in full of tax, interest and penalties due. Penalties include:

a. Failure to File a Tax Return (IRC Sec. 6651(a)(1), 5% of the tax due per month, up to 25% (tax due).

b. Failure to Pay Tax Due Shown on Tax Return (IRC Sec. 6651(a)(2), 5% of the tax due shown on return, per month, up to 25% (tax due).

c. Accuracy Related Penalty (IRC Sec. 6662) Taxpayer may be liable for a 20% or 40% penalty. Under the IRC Sec. 6662(b)(7) and (j), a 40% accuracy-related penalty is imposed for any underpayment of tax that is attributable to an undisclosed foreign financial asset understatement.

d. Title 26 Penalty 27.5% of highest aggregate balance in foreign bank accounting/entities, or value of foreign assets, during the period covered by the voluntary disclosure.

Total penalties up to 70% of unpaid tax plus 27.5% of value of assets (total): aggregated foreign accounts and foreign assets (for the highest year's aggregate value during the period covered by the voluntary disclosure).

5. Execute a closing agreement on final return income covering specific matters, Form 906.

6. Agree to cooperate with IRS offshore enforcement effected by providing information about offshore financial institutions, offshore service providers, and other facilitators.

Civil Fraud/Criminal Tax Evasion

Until such time as the U.S. taxpayer and the IRS execute a Form 906 closing agreement, the U.S. taxpayer may be still subject to both imposition of civil tax fraud penalties and prosecution for criminal tax evasion, if and when the IRS "disqualifies the U.S. Taxpayer" from the IRS/OVDI (2012) (as is the case with Israel's Bank Leumi's U.S. clients).

Civil Tax Fraud

Civil fraud penalties imposed under IRC Sec. 6651(f) or 6663, for either underpayment of tax, or a failure to file a tax return due to fraud, the taxpayer is liable for penalties of 75% of the unpaid tax.

Criminal Tax Evasion

U.S. taxpayers with undisclosed offshore bank accounts and unreported income face criminal charges for:

1. Tax Evasion (26 USC Sec. 7201) [5 years in jail; $250,000 fine];

2. Filing False Tax Return (26 USC Sec. 7206(1)) [3 years in jail, $250,000 fine];

3. Failure to File Tax Return (26 USC Sec. 7203); [1 year in jail, $100,000 fine];

4. Willful Failure to File FBAR or Filing False FBAR (31 USC Sec. 5322) [10 years in jail, fines up to $500,000].

In addition, the willful failure to file the FBAR has a civil penalty as high as the greater of $100,000 or 50% of the total balance of the foreign account per violation (31 USC Sec. 5321(a)(5).

Chapter 27- IRS Voluntary Disclosure 2013: An Update

Two recent cases demonstrate the great risk attendant to the IRS offshore Voluntary Disclosure Program (2012-forward) ("OVDP").

In the Bank Leumi case, dozens of U.S. taxpayers with accounts at Bank Leumi were in 2013 peremptorily disqualified from the IRS OVDP without explanation. The IRS has recently reversed this position and according to tax counsels have readmitted the disqualified U.S. taxpayers. Although the various tax counsels appear satisfied with the IRS reversal of position their "sighs of relief" fail to address the "dangers of the OVDP:

1) As of the 2012 OVDP a 27 1/2% penalty based on the value of the undisclosed offshore assets (in addition to the original income tax due plus interest plus penalties of up to 70% of the tax due.)

2) Waiver of Constitutional Protections against: self-incrimination (5th amendment), unreasonable search and seizure (4th amendment), excessive fines (8th amendment).

These "trifecta" of constitutional protections disappear once a U.S. taxpayer enters the IRS OVDP disclosing: their names, social security numbers, undisclosed income, undisclosed assets, names of the advisors/colleagues/3rd parties who facilitated their "offshore tax evasion."

It is a risky strategy to voluntarily contact the IRS to disclose multiple tax crimes (felonies which if prosecuted may lead to over 25 years in jail with additional 20 year sentences for each instance of money laundering, wire fraud, mail fraud, total jail time over 85 years, if the prosecutor "throws the book" at the taxpayer. If you commit federal crimes, is it advisable to go to the U.S. Attorney to confess your crimes and beg for leniency? If not, then why confess federal tax crimes to the IRS (who may refer the case to the U.S. Attorney since the taxpayer's voluntary disclosure has neither transactional or use immunity.

In the case of Ty Warner (Beanie Bag founder, a member of the Forbes 400 richest Americans, with $2.6 billion net worth) he entered the IRS OVDP only to be rejected (for unknown reasons).

The risk for Ty Warner is best exemplified by his recently disclosed IRS settlement $53million for 202 taxes (on unreported income from undisclosed UBS/Swiss Bank accounts). Ty Warner has agreed to pay $53million on an unreported $3.1million in income which tax would have been $885k (nearly 60x the amount of the original tax due). In addition, he faces charges of criminal tax evasion, with up to a 5 year jail sentence (he awaits arraignment).

The $53million in settlement was due to imposition of a 50% "FBAR" penalty on the $93million he held in his UBS Swiss Bank account. If you are Ty Warner, you have to ask yourself the following question, best expressed by Bob Dylan, "If you can't do the time, don't do the crime.

Chapter 28 - Ty Warner & the IRS Voluntary Disclosure Program

On 10/2/13, Ty Warner, billionaire creator of Beanie Baby Toys, pleaded guilty in U. S. District Court (Chicago) to a single count of tax evasion for failing to report $3.2 million in income on a secret UBS (Swiss) Bank Account (with $93.6million). He paid a $53.6 million civil tax penalty and is scheduled for sentencing on January 15, 2014 (for up to 5 years in jail for tax evasion).

In 2009, Ty Warner tried to avoid criminal prosecution by entering into the IRS Offshore Voluntary Disclosure Program but was denied and it appears the evidence he submitted to the IRS was used against him in the U.S. government criminal prosecution. Warner's plea is not binding on the IRS.

See article, "Beanie Baby Creator Pleads Guilty to Swiss Bank Tax Dodge."

Chapter 29- IRS Civil/Criminal Penalties-Reasonable Cause (Willfulness)

Under Mortensen v. Commr., 440 F.3d 375, 385 (6th Cir. 2006), it was held that reasonable minds can differ over tax reporting, and under tax audits the IRS may disallow certain transactions.

The U.S. Congress was concerned that taxpayers would participate in the "audit lottery" and take questionable positions on their tax returns in the expectation of not being audited (See: H.R. Rep. No. 101-247, 1388 (1989). H.R. Rep. No. 101-247, as reprinted in 1989 U.S.C.C.A.N. 1906, 2858.

IRC Sec. 6662(b) imposes a civil penalty for substantial understatements of income, or liability overstatements (in addition, other civil penalties may be imposed for negligence and substantial valuation misstatements).

Under IRC Sec. 6064(c), no penalty will be imposed with "respect to any portion of an underpayment if it is shown that there was reasonable cause and the taxpayer acted in good faith."

Under Treasury Regulation Section 1.6664-4(b)(1), "reasonable cause" and "good faith" require courts to review the following taxpayer issues:

Experience;

Knowledge;

Sophistication;

Education;

Taxpayer reliance on a tax professional; and

Taxpayer's effort to assess the taxpayer's proper tax liability.

Under Treas. Reg. Sec. 1.6664-4(c), the IRS minimum requirements for determining whether a taxpayer reasonably relied in good faith on advice including a tax advisor's professional opinion.

The minimum requirements include:

1. The advice must be based on all pertinent facts and circumstances and the law as it relates to those facts and circumstances;

2. The advice must not be based on unreasonable factual or legal assumptions;

3. The advice must not unreasonably rely on the representations, statements, findings or agreements of the taxpayer or any other person;

4. A taxpayer may not rely on an opinion or advice that a regulation is invalid to establish that the taxpayer acted with reasonable cause and good faith unless the taxpayer adequately disclosed that the regulation in question is invalid (Treas. Reg. Sec. 1.6662-3(c)(2).

Under Treasury Regulation Sec. 1-6664-4(b)(1), reasonable cause and good faith are not necessarily established by reliance on the advice of a professional tax advisor.

However, under Treas. Rg. Sec. 1.6664-4(b)(2), a taxpayer may satisfy the "reasonable cause" and "good faith" exception because the taxpayer believed that the tax professional had knowledge in the relevant aspects of federal tax law.

In United States v. Boyle, 469 U.S. 241, 251 (1985), the U.S. Supreme Court held:

1. Taxpayers may not be sophisticated in tax matters, and that it is unrealistic for taxpayers to recognize errors in the substantive advice of an accountant or attorney;

2. To require the taxpayer to challenge the attorney, to seek a second opinion, or to try to monitor counsel would nullify the purpose of seeking the advice of a presumed expert in the first place.

Under Sklar, Greenstein & Scheer, P.C. v. Commr., 113 T.C. 135, 144-145 (1999) citing Ellwest Stereo Theaters of Memphis, Inc. v. Commr., T.C.M. 1995-610, the Tax Court established a three-prong test to prove reasonable cause, where a taxpayer is asserting a defense against an IRC Sec. 6662 penalty:

1. The tax advisor was a competent professional who had sufficient expertise for justifying reliance;

2. The taxpayer provided necessary and accurate information to the advisor;

3. The taxpayer actually relied in good faith on the advisor's judgment.

Under Treas. Reg. Sec.1-6664-4(b)(1), reliance on a tax advisor may be considered reasonable when the taxpayer knew that the tax advisor possessed specialized knowledge in the relevant aspects of federal tax law.

In the case Neonatology Assoc., P.A. v. Commr., 115 T.C. 43, 99 (2000), aff'd 299 F.3d 211 (3d Cir. 2002) the court held:

1. Taxpayer reliance on an insurance agent was found to be unreasonable because the insurance agent was not a tax professional;

2. The taxpayers were sophisticated and should have known that the tax benefits discussed were "too good to be true';

3. The court rejected the evidence the taxpayers presented that they also relied on tax attorneys and accountants.

In Stanford v. Commr., 152 F3d 450 (5th Cir. 1998) the court held:

1. Taxpayer could rely on a CPA with extensive experience in international banking law for advice regarding the taxpayer's controlled foreign corporation.

2. It was not reasonable to expect the couple to monitor their CPA to make sure he conducted sufficient research to give knowledgeable advice.

3. Intelligent investors have independent educated experts to advise them, particularly with respect to arcane matters of the law.

4. The Court vacated the penalty since the CPA was diligent in reviewing the taxpayer's business and tax records, and studying the statute, legislative history and regulations.

In Larson v. Commr., TC Memo 2002-295, 84 T.C.M. 608 (2002), the Court held that to satisfy the "reasonable cause" and "good faith" exception, the taxpayer must provide necessary and accurate information to the tax advisor. In Larson, the taxpayer received an incorrect Form 1099 which due to a printing error, read $1,891 (not $21,891). Here, the "reasonable cause" and "good faith" exception did not apply since the taxpayer had reason to believe that the tax reported on the tax return was not accurate and the taxpayer should have made additional efforts to assess the proper amount of his tax liability.

In Woodson v. Commr., 136 T.C. 585 (2001), the court held that the taxpayer's reliance on a return preparer did not constitute reasonable cause, since to qualify for the "reasonable cause penalty exception" the taxpayer must rely in good faith on the tax advisor's judgment or advice.

In Woodson, the tax return failed to include a $3.4M tax item and substantially understated the tax liability, the result of a "clerical mistake". Here the court did not apply the reasonable cause exception because the tax professionals did not provide advice to the taxpayers.

Under Treas. Reg. Sec. 1-6664-4(c)(2), tax advice constitutes analysis on the conclusions of a professional tax advisor. Here, the taxpayers did not provide evidence to show that a professional tax advisor's analysis or conclusions led to the omission of the item on the tax return. The taxpayers were not able to satisfy the "reasonable cause" and "good faith" defense as the taxpayers did not review the proposed return to ensure that the income items were included.

In Thomas v. UBS, 7th Cir. (2013), the court held that the Swiss Bank, UBS, is not liable to U.S. account owners for fines and interest paid when confessing to the IRS about their foreign accounts. The U.S. accountholders sued UBS, claiming the bank didn't give them accurate tax advice and should have kept them from breaking the law. The court threw out their lawsuit, saying they were tax cheats who didn't merit a day in court.

In Canal Corp. v. Commr., 135 T.C. 199 (2010), the court held that taxpayers may defend against the "accuracy-related" penalty, when the taxpayers rely on a tax professional, under a "three-prong test":

1. The taxpayer provided necessary and accurate information to the advisor.

2. The taxpayer acted in good faith on the tax professional's advice.

3. The tax advisor had apparent expertise to justify reliance.

In Canal the test was not satisfied and the court imposed accuracy-related penalties despite the taxpayer's reliance on a sophisticated advisor.

Taxpayers must not rely on tax professionals that provide tax advice that they personally know is incorrect or that they believe might not be correct based on their previous experience or business knowledge. Additionally, taxpayers should review any Form 1099s or other informational returns they receive to ensure they are complete and accurate.

In the case of U.S. v. Williams (U.S. App. Lexis 15017), (4th Cir. Va., July 20, 2012) (unpublished)), the 4th Circuit reviewed a District Court judgment that for civil penalty purposes Williams did not willfully fail to report his interest in two foreign bank accounts under 31 U.S.C. 5314.

The court held that Williams' conduct constituted "willful blindness" since:

1. He chose not to report the income;

2. He knew he had an obligation to report the existence of the Swiss accounts;

3. He knew what he was doing was wrong and unlawful;

4. On his Form 1040 tax return, he "checked no" on Schedule B regarding having an interest in foreign accounts.

The 4th Circuit ruled that Williams willfully violated 31 U.S.C. Sec. 5314 (to report two foreign bank accounts).

Civil Penalties (Tax Advice)

A U.S. taxpayer who relies on the advice of a tax professional may relieve the U.S. taxpayer from civil penalties if there has been no willful neglect. Under the IRC Sec. 6664: "No penalty shall be imposed… with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and the taxpayer acted in good faith with respect to such portion". Under related Treasury Regulations: "Reliance on an information return, professional advice, or other facts constitutes reasonable cause and good faith if under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith."

Under IRS Circular No. 230, U.S. taxpayers may now rely on tax opinions for relief from penalties only, if:

1. The tax opinion is based on a full legal and factual review and covers all the issues;

2. The drafter of the tax opinion may not be involved directly or indirectly with the "tax-shelter" promoter; i.e., it must be an independent tax opinion.

In the case of Canal Corp. v. Commr.,135 T.C. 199 (2010), the court held that the taxpayer could not rely upon Price Waterhouse Cooper's (PWC) tax opinion (for which they paid $800,000) because of PWC's involvement with the "underlying structures"; i.e. the tax shelter.

A U.S. taxpayer may avoid civil penalties if the U.S. taxpayer;

Makes full disclosure;

To an independent tax professional;

Who is experienced in the area of law;

Receives, reviews and understands the advisor's tax opinion;

No "blind reliance" on the tax opinion; i.e. two tests: "You should know better", or "It's too good to be true".

The taxpayer must rely upon the opinion; and

The taxpayer must follow the plan and the opinion.

Criminal Penalties (Willfulness)

For a U.S. taxpayer to avoid criminal prosecution, the tax rules are different than those tax rules for imposition of civil penalties. Tax crimes require "intent"; i.e. the U.S. taxpayer deliberately and intentionally pursued a criminal course of conduct.

The U.S. taxpayer must demonstrate that he had "a good faith belief" that he did not owe tax. If so, the U.S. taxpayer may be able to prevent a criminal conviction but not necessarily prevent being criminally prosecuted. The U.S. taxpayer must demonstrate that their "tax theory" (however misguided) was in "good faith" in order to negate the "intent element" of the crime of tax evasion.

For example, in the case of Vernice Kuglin, she successfully convinced a jury that the IRS's failure to respond to her written inquiry regarding the need to file a tax return or pay tax on over $900,000 in U.S. taxable income was a "reasonable, good faith belief" and she was not convicted of tax evasion.

For example, in the 2007 case of Tom Cryer (an attorney in Louisiana) tax evasion charges were dropped and he was acquitted on charges of willfully failing to file a tax

return. Cryer's defense was that the IRS refused to respond to his repeated demand that the government explain why his "tax theories" were not viable, instead they refused to respond to Cryer, stating his tax positions were "frivolous".

At trial, Cryer convinced jurors that he genuinely believed he owed no tax for the years in question, and without proof of criminal intent, he was acquitted.

In the case of the actor Wesley Snipes, he provided the IRS with a 600-page explanation of why he was a "non-taxpayer" which the IRS ignored as a "tax protester" manifesto. He was not convicted of tax evasion (i.e. a felony) but was convicted for failure to file a tax return (misdemeanor) and was sentenced to three one-year consecutive prison terms.

For civil tax penalties, U.S. taxpayers must demonstrate the key element for a penalty defense; i.e. reasonable reliance on counsel. In criminal courts, reliance on counsel is essential but the courts give wide latitude with respect to a willfulness defense and the taxpayer's "good faith belief".

In criminal cases, the prosecutor must prove beyond a reasonable doubt willfulness, or specific criminal intent, which means that the defendant:

1. Knew and understood the law; and

2. Intentionally set out to violate it; i.e. had the purpose of evading assessment or collection of taxes.

Regarding willfulness, the defendant may present a good faith defense, including good faith belief and reliance when reliance includes all that the defendant read and heard. According to the U.S. Supreme Court, good faith is a defense, no matter what the belief. However, the defendant is not allowed willful blindness; i.e. the defendant intentionally concealed the truth from himself.

Criminal penalties may be imposed for intentionally violating federal tax laws (i.e. willful violation). "Ignorance of the law excuses no one" is a legal principle holding that a person who is unaware of a law may not escape liability for violating that law merely because he or she is or was unaware of its content.

Under U.S. Model Penal Code Sec. 2.02(9), knowledge that at an activity is unlawful is not an element of an offense unless the statute creating the offense specifically makes it one.

In Cheek v. U.S. (1991), 498 U.S. 192, willfulness is required for federal tax crimes. In Cheek, the U.S. Supreme court reversed his conviction for willful failure to file a tax return.

Cheek's "tax theory" was that wages did not constitute income and he therefore failed to file a tax return. The U.S. Supreme Court held that Cheek was entitled to a good faith

instruction to the jury; i.e. the jurors could acquit him if they found Cheek believed in good faith that he was not required to file. The prosecutor had to prove that Cheek did not rely in good faith on what he heard and read. Cheek was eventually convicted and served a year and a day.

In order to avoid criminal convictions, U.S. taxpayers must rely upon independent, competent counsel. In the case of U.S. v. Lindsey Springer, (Case No. 09 C.R. 043 JHP, Northern District of Oklahoma), the taxpayer and his attorney each received a 15 year sentence for conspiracy to defraud the U.S. and evasion of taxpayer's taxes by use of the attorney's trust account to funnel client funds and from which account client expenses were paid.

Although the good faith belief and reliance arguments may be usable as a defense in a criminal tax case, often these off-shore situations involve "money laundering" (i.e. disguising the nature or origin of the funds), in which the government may criminally prosecute under the principal of "intentional blindness" or "ignoring what is reasonable" as a basis for conviction.

The best defense is a specific tax opinion letter from an independent, competent tax professional.

Chapter 30 - Accuracy Related Penalty

The two penalties primarily applicable to underpayments of tax are the accuracy-related penalty (Code Sec. 6662) and the fraud penalty (Code Sec. 6663).

The accuracy-related penalty consolidates all of the penalties relating to the accuracy of tax returns. It is equal to 20% of the portion of the underpayment of tax (i.e. greater of $5,000 or 10% 0f the tax) that is attributable to one or more of the following: (1) negligence or disregard of rules or regulations, (2) substantial understatement of income tax, (3) substantial valuation misstatement, and (4) substantial overstatements of pension liabilities (Code Sec. 6662(a) and (b))., or 40% of the tax underpayment from an undisclosed foreign financial account understatement.

The accuracy-related penalty is entirely separate from the failure to file penalty and will be imposed if no return, other than a return prepared by the IRS when a person fails to make a required return, is filed (Code Sec. 6664 (b)). In addition, the accuracy-related penalty will not apply to any portion of a tax underpayment on which the fraud penalty is imposed.

Also, no penalty is imposed with respect to any portion of any underpayment if the taxpayer shows that there was reasonable cause for the underpayment and that the taxpayer acted in good faith (Code Sec. 6664(c)).

Chapter 31 - Omission of Over 25% of Income

If the taxpayer omits from gross income (total receipts, without reduction for cost) an amount in excess of 25% of the amount of gross income stated in the return, a six-year limitation period on assessment applies.

An item will not be considered as omitted from gross income if information sufficient to apprise the IRS of the nature and amount of such item is disclosed in the return or in any schedule or statement attached to the return (Code Sec. 6501(e); Reg. §301.6501(e)-1(a)).

Chapter 32 - FBAR Civil Penalties: Reasonable Cause Exception

A failure to file a FBAR has civil and criminal penalties (which are in addition to any income tax penalties if the income is not reported). The IRS must assess the civil penalties within 6 years of the FBAR violation (31 USC 5321(b)(1)).

For a willful failure to file, the civil penalty increases from $10,000 (non-willful failure to file) to the greater of $100,000 or 50% of the account balance in the foreign account for the tax year.

The civil penalties for non-willful failure to file may be waived by the IRS if the Taxpayer can show reasonable cause. If the Taxpayer has a reasonable cause exception, the FBAR should be filed with an explanation (i.e., the reasonable cause, with an express request for waiver of penalties).

The waiver of civil penalties for a reasonable cause exception may include among other factors:

All the income from the foreign account was included on the US Taxpayer's return.

The Taxpayer was unaware of the requirement to file (for example, lack of understanding of what constitutes a financial interest).

Once the Taxpayer became aware of the filing requirements, he filed all delinquent reports (up to 6 years).

Chapter 33 - Collection After Assessment

After assessment of tax made within the statutory period of limitation, the tax may be collected by levy or a proceeding in court commenced within 10 years after the assessment or within any period for collection agreed upon in writing between the IRS and the taxpayer before the expiration of the 10-year period. The period agreed upon by the parties may be extended by later written agreements so long as they are made prior to the expiration of the period previously agreed upon. The IRS has to notify taxpayers of their right to refuse an extension each time one is requested (Code Sec. 6501(c)(4)). If a timely court proceeding has commenced for the collection of the tax, then the period during which the tax may be collected is extended until the liability for tax (or a judgment against the taxpayer) is satisfied or becomes unenforceable.

Generally effective after 1999, the 10-year limitations period on collections may not be extended if there has not been a levy on any of the taxpayer's property. If the taxpayer entered into an installment agreement with the IRS, however, the 10-year limitations period may be extended for the period that the limitations period was extended under the original terms of the installment agreement plus 90 days. If, in any request made on or before December 31, 1999, a taxpayer agreed to extend the 10-year period of limitations on collections, the extension will expire on the latest of:

the last day of the original 10-year limitations period,

December 31, 2002, or

in the case of an extension in connection with an installment agreement, the 90th day after the extension.

Interest accrues on a deficiency from the date the tax was due (determined without regard to extensions) until the date payment is received at the rate specified (Reg. §301.6601-1(a)(1)). Interest may be assessed and collected during the period in which the related tax may be collected (Code Sec. 6601(g)).

Chapter 34 - IRS: Jeopardy Assessment

Under a jeopardy assessment, Taxpayers who have unreported income may be subject to immediate IRS seizure of assets. If the IRS determines that tax collection is at risk, the IRS may immediately seize taxpayer assets without prior notice.

The IRS must have made a determination that a deficiency existed and that tax collection would be jeopardized if the IRS were to follow normal assessment and collection procedures. (IRC § 6861(a)).

In the event of a jeopardy assessment, the IRS is permitted to send a notice and demand for payment immediately. (IRC § 6861(a)).

Normally, the IRS assertion of an income tax deficiency is made after the taxpayer's year closes and the tax return is filed. However, if the IRS determines that a Taxpayer (who received significant income) may prejudice tax collection (e.g., leave the country, place assets beyond IRS reach) the IRS may issue a jeopardy assessment (levy on Taxpayer's property without prior notice (IRC § 6861(a)).

IRS jeopardy assessment requirements:

1. The Taxpayer's year is completed;

2. The due date of the tax return (with extensions) has passed;

3. Either:

- Taxpayer did not file tax return or;

- Tax liability on the filed return is understated, and;

- Tax collection is jeopardized.

Treas. Reg. Sections 301.6861 – 1(a)

IRS general levy requirements (IRC § 6330, 6331) do not apply if the IRS finds that tax collection is in jeopardy.

Under IRC § 6330(f), the IRS is entitled to levy on taxpayer's property, without prior notice to Taxpayer.

To justify a jeopardy levy, the IRS must be able to show:

1. The Taxpayer is (or appears to be) designing to quickly depart from the U.S.;

2. The Taxpayer is (or appears to be) designing to quickly place their assets beyond the reach of the IRS by:

a. Removing assets from the U.S.;

b. Concealing assets;

c. Dissipating assets;

d. Transferring assets to third parties; or

3. The Taxpayer is in danger of becoming insolvent (bankruptcy or receivership, alone is not sufficient evidence to establish financial insolvency for jeopardy purposes).

The IRS procedures for a jeopardy levy, (as stated in the Internal Revenue Manual):

1. IRS chief counsel must personally give prior written approval to a jeopardy levy (IRC § 7429(a));

2. Thereafter, the IRS must provide Taxpayer with a written statement, within five days, of the information upon which the IRS relied in making its jeopardy levy (IRC § 7429(a)(1)(B));

3. IRM 5.11, Notice of Levy Handbook section 3.5(5) instructs the IRS to try to give Taxpayer notice in person, or certified mail (last known address);

IRS notice should include:

a. Reason for jeopardy levy;

b. Taxpayer's rights to administrative and judicial review (IRC § 7429);

c. Notice of Taxpayer's rights to administrative and judicial review within a reasonable period of time (under IRC § 6330).

The jeopardy assessment may be made either:

Before or after a notice of tax deficiency is issued, and;

Also, either before or after a Tax Court petition is filed (IRC § 6861(a), Treas. Reg. Section 301.6861 – 1(a).

IRS notice and demand for payment gives the Taxpayer ten days to pay the tax in full or post a bond to stay collection (Treas. Reg. Section 301.6861 – 1(d).

If tax collection is determined to be in jeopardy, the IRS may immediately levy on Taxpayer's assets (without 30 day notice of intent to levy) (IRC § 6331(d)(3)), subject to IRS chief counsel personally approving the levy in writing (IRC § 7429(a)(1)(A)).

The IRS must send a formal notice of deficiency within 60 days after making the jeopardy assessment (IRC § 6861(b)). Upon receipt of notice of deficiency, the Taxpayer may file a Tax Court petition for redetermination of the deficiency amount (IRC § 6213(a)).

Under IRC § 6213(a), the Tax Court petition stops additional IRS assessments until the Tax Court decision is finalized. However, upon receipt of the notice of deficiency, payment (of the tax assessed), or a bond is required, within ten days, to stay collection (IRC § 6863(a)).

Under a jeopardy assessment, any amount collected by the IRS, in excess of the amount determined by the Tax Court, (as the final assessment), is refunded (IRC § 6861(f)).

Chapter 35 - Offer in Compromise

The IRS may compromise the tax liability in most civil or criminal cases before referral to the Department of Justice for prosecution or defense. The Attorney General or a delegate may compromise any case after the referral. However, the IRS may not compromise certain criminal liabilities arising under internal revenue laws relating to narcotics, opium, or marijuana. Interest and penalties, as well as tax, may be compromised (Code Sec. 7122; Reg. § 301.7122-1).

Offers-incompromise are submitted on Form 656 accompanied by a financial statement on Form 433-A for an individual or Form 433-B for businesses (if based on inability to pay) (Reg. § 601.203(b)). A taxpayer who faces severe or unusual economic hardship may also apply for an offer-in-compromise by submitting Form 656. If the IRS accepts an offer-in-compromise, the payment is allocated among tax, penalties, and interest as stated in the collateral agreement with the IRS.

If no allocation is specified in the agreement and the amounts paid exceed the total tax and penalties owed, the payments will be applied to tax, penalties, and interest in that order, beginning with the earliest year. If the IRS agrees to an amount that does not exceed the combined tax and penalties, and there is no agreement regarding allocation of the payment, no amount will be allocated to interest.

A $150 user fee is required for many offers-in-compromise (Reg. § 300.3). Taxpayers must normally pay the user fee at the time a request to compromise is submitted. No user fee is imposed with respect to offers (1) that are based solely on doubt as to liability or (2) that are made by low-income taxpayers (i.e., taxpayers whose total monthly income falls at or below income levels based on the U.S. Department of Health and Human Services poverty guidelines). If an offer is accepted to promote effective tax administration or is accepted based on doubt as to collectibility and a determination that collecting more than the amount offered would create economic hardship, the fee will be applied to the amount of the offer or, upon the taxpayer's request, refunded to the taxpayer. The fee will not be refunded if an offer is withdrawn, rejected or returned as nonprocessible. The IRS treats offers received by taxpayers in bankruptcy as non-processible, even though two district courts have held that the IRS must consider such offers (R.H. Macher, DC Va., 2004-1 USTC ¶50,114 (Nonacq.); W.K. Holmes, DC Ga., 2005-1 USTC ¶50,230). However, one district court and one bankruptcy court have held in favor of the IRS on this issue (1900 M Restaurant Associates, Inc., DC D.C., 2005-1 USTC ¶50,116; W. Uzialko, BC-DC Pa., 2006-1 USTC ¶50,297).

Detailed IRS procedures for the submission and processing of offers-in-compromise are reflected in Rev. Proc. 2003-71.

Taxpayers are required to make nonrefundable partial payments with the submission of any offer-in-compromise (Code Sec. 7122(c)). Taxpayers who submit a lump-sum offer (any offer that will be paid in five or fewer installments) must include a payment of 20 percent of the amount offered. Taxpayers who submit a periodic payment offer must

include payment of the first proposed installment with the offer and continue making payments under the terms proposed while the offer is being evaluated. Offers that are submitted to the IRS without the required partial payments will be returned to the taxpayer as nonprocessible. However, the IRS is authorized to issue regulations waiving the payment requirement for offers based solely on doubt as to liability or filed by low-income taxpayers. Pending the issuance of regulations, the IRS has announced that it will waive the payment requirement for such offers (Notice 2006-68).

The required partial payments are applied to the taxpayer's unpaid liability and are not refundable. However, taxpayers may specify the liability to which they want their payments applied. Additionally, the user fee (see above) is applied to the taxpayer's outstanding tax liability. Any offer that is not rejected within 24 months of the date it is submitted is deemed to be accepted. However, any period during which the tax liability to be compromised is in dispute in any judicial proceeding is not taken into account in determining the expiration of the 24-month period (Code Sec. 7122 (f)).

The IRS may not levy against property while a taxpayer has a pending offer in compromise or installment agreement (Code Sec. 6331(k)). If the offer in compromise or installment agreement is ultimately rejected, the levy prohibition remains in effect for 30 days after the rejection and during the pendency of any appeal of the rejection, providing the appeal is filed within 30 days of the rejection. No levy may be made while the installment agreement is in effect. If the installment agreement is terminated by the IRS, no levy may be made for 30 days after the termination and during the pendency of any appeal.

Chapter 36 - Attorney-Client Privilege

For U.S. taxpayers (U.S. citizens, long-term residents, "green card holders", "Substantial Presence Test" residents) reliance upon legal advice of competent counsel may be a defense against criminal and civil tax penalties. In the attorney-client relationship, a privilege may be asserted to maintain as confidential, the advice received by the client (and the facts disclosed by the client to the attorney).

The attorney-client relationship, and the privilege, does not extend to the client's accountants, unless the accountant was retained by the attorney, (and not by the client).

If retained by an attorney, client accountants may receive the benefits of Attorney-Client privilege. In United States v. Kovel, 296 F.2d 918 (2d Cir. 1961), the Attorney-Client privilege was extended to accountants retained to assist the attorney in understanding taxpayer's financial records.

The IRS Restructuring & Reform Act of 1998 extended Attorney-Client privilege to communications with federally authorized practitioners with respect to tax advice. (IRC § 7525)

IRC § 7525 applies to:

1. Any non-criminal matter before the IRS, or in Federal Court brought by or against the U.S.

2. IRC § 7525(b) provides the privilege will not apply to representation of a corporation involved in the promotion or the direct or indirect participation of any such corporation in any tax shelter.

3. The IRC § 7525 privilege does not extend to criminal tax investigations.

A federally authorized tax practitioner is any individual who is authorized under federal law to practice before the IRS. This includes attorneys, CPAs, and enrolled agents. IRC § 7525(a).

Tax advice is advice given by an individual on a matter for which he is authorized to practice before the IRS. IRC § 7525(a). In general, the privilege, like the common-law privilege, applies to the content of the advice, not the identity of the person seeking the advice.

For communications made on or after October 22, 2004, the privilege does not apply to written communications concerning tax shelters. Thus, the privilege does not apply to any written communication between a tax practitioner and any person, director, officer, employee, agent, or representative of a person, or any other person holding a capital or profits interest in a person, in connection with the promotion of the direct or indirect participation of the person in any tax shelter. IRC § 7525(b).

A tax shelter is a partnership or other entity, an investment plan or arrangement, or any other plan or arrangement, if a significant purpose of the partnership, entity, plan, or arrangement is the avoidance or evasion of federal income tax. IRC § 6662(d)(2)(C). (This exception was limited to communications concerning corporate tax shelters, IRC § 7525(b), prior to amendment by Pub. L. 108-357, American Jobs Creation Act of 2004, Section 813.)

The IRS's position is that the Attorney-Client privilege also does not apply to tax accrual workpapers (tax accrual and other financial audit workpapers relating to the tax reserve for deferred tax liabilities and to footnotes disclosing contingent tax liabilities appearing on audited financial statements).

These workpapers are not generated in connection with seeking legal or tax advice, but are developed to evaluate a taxpayer's deferred or contingent tax liabilities in connection with a taxpayer's disclosure to third parties of the taxpayer's financial condition. IRS Announcement 2002-63, 2002-2 C.B. 72.

The crime-fraud exception may be asserted to defeat the claim of tax practitioner privilege for communications that were made for the purpose of getting advice for the commission of crime or fraud. This prevents a party from seeking advice to commit a crime or fraud and then claiming that the communication is privileged.

To assert the crime-fraud exception, (1) there must be a prima facie showing of a crime or fraud, and (2) the communications in question must be in furtherance of the misconduct. U.S. v. BDO Seidman, 368 F.Supp. 2d 858 (N.D. Ill. 2005).

If the IRS shows sufficient evidence that the communication was made in furtherance of a crime or fraud, then the taxpayer may respond by providing an explanation that would rebut the IRS's evidence. The crime-fraud exception will apply only if the court finds the taxpayer's explanation unsatisfactory. U.S. v. BDO Seidman, No. 02 C 4822 (N.D. Ill. May 17, 2005), aff'd on this issue and vacated and remanded on other grounds, No. 05-3260 & 05-3518 (7th Cir. July 2, 2007).

Chapter 37 - Medicare Tax on Investment Income

Medicare Tax on Investment Income

On March 25, 2010, Congress passed the Healthcare and Education Reconciliation Act of 2010 (H.R. 4872).

The Reconciliation Act amends various provisions of the Patient Protection and Affordable Care Act (P.L. 111-148) which was enacted March 23, 2010.

The Reconciliation Act adds provisions that were not included in the Patient Protection Act including a Medicare Tax Investment Income.

The Reconciliation Act added a new IRC Section 1411 that imposes a new 3.8% Medicare tax on investment income. The new tax on individuals is equal to 3.8% of the lesser of:

1. The individual's net investment income for the year, or

2. The amount the individual's modified adjusted gross income exceeds the threshold amount ($200,000 individual).

For estates and trusts, the tax equals 3.8% of the lesser of:

1. Undistributed net investment income, or

2. Adjusted gross income (over $11,200, the dollar amount of the highest trust and estate tax bracket).

For married couples, the threshold amount is $250,000 for a joint return and $125,000 for married, filing separately. For all other individuals the threshold amount is $200,000 (i.e., if the individual's modified adjusted gross income exceeds $200,000, a 3.8% tax is imposed on the lesser of the individual's net investment income (for the tax year) or the adjusted gross income amount, i.e., $200,000).

Net investment income (defined): income from interest, dividends, capital gains, annuities, royalties and passive rental income (other than such income derived in the ordinary course of a trade or business), but does not include: municipal bond interest, 401(k), IRA, and pension payments

The definition of net income includes:

1. Income from passive activities, or

2. From a trade or business of trading in financial instruments or commodities.

This tax provision takes effect for tax years beginning after December 31, 2012 (i.e., commences January 1, 2013, first tax year, 2013).

The net investment tax is determined using Form 8960. The tax is an addition to the regular income tax liability, it is taken into account for purposes of calculating estimated tax payments and underpayment penalties. (IRC Sec. 6654(a)(f).

Conclusion

For those taxpayers who have been audited remember you cannot win an audit. Even if the audit is a "no change" your time, money, fees and "misery" means you will have already lost once you are audited. So the end game is to minimize costs, be time efficient and highly professional so as not to antagonize the auditor who may both audit other tax years and open up audits on related entities.

If you lose the audit, take advantage of the myriad settlement opportunities afforded by the IRS prior to having the tax assessed and IRS collection activity prompted. The Taxpayers Bill of Rights (I, II, III) remedied many past IRS abuses and gives taxpayers many protections so they are treated fairly and not bulldozed by the IRS with its nearly 100,000 employees and $10B+ annual budget.

The IRS collects over $2.5 trillion per year in taxes, processing several hundred million tax returns annually, and like a chain is only as strong as "its weakest link". The IRS personnel are often inundated with cases, overwhelmed with work and do physically have the time to fight "every battle".

Remember that time is on the taxpayer side, if they have fortitude and staying power, since the IRS has an 85% settlement goal and hopes to reach resolution on nearly 9 of 10 cases without litigation. If litigation is required, use the US Tax Court since it is the only forum (unlike the Federal District Court) where no tax is paid until after the case concludes. In other words, while the case is pending, no tax liens are filed, no tax is due.

Most importantly, whether you are in the audit stage, audit appeals or being pursued for active collection do not "be your own doctor". Just like you cannot operate on yourself successfully (as those who have tried may attest), it is not a good idea to represent yourself before the IRS which is an intricate, highly specialized tax field whose parameters include: audit skills, collection expertise, knowledge of tax compliance, tax planning, and navigation between the IRS and their appeals procedures and the various courts who ultimately hear the trial for contested tax matters.

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Gary S. Wolfe received his Juris Doctorate from Loyola Law School in 1982, where he was President of the Tax Law Society.

From 1982 through the present, Gary has been in private practice in Beverly Hills and Los Angeles.

Gary is an international tax attorney representing clients for IRS audits, international tax planning, and asset protection.

Previously, Gary was the managing partner of a tax and business law firm, which represented Fortune 500 companies (IBM, ITT) and financial institutions (Sterling Bank, First Charter Bank.) Gary now provides case management for international litigation.

In 1997, Gary completed the Team Beverly Hills civic leadership training.

From 1997-1999 Gary was Vice-President and Member of the Board of Trustees of The Greystone Foundation, Beverly Hills, California.

From 1995-2001, Gary was the Chief Financial Officer and a Member of the Board of Directors of the Le Faubourg Honore Homeowners Association, Beverly Hills, California.

Since 2004, Gary has been conducting private seminars throughout California on the IRS, International Tax and Asset Protection.

Since 2004, Gary has been researching the IRS and International Tax (and other issues).

As of December 2014, Gary has written 13 articles and 13 books, and has been interviewed in 4 articles:

Articles by Gary S. Wolfe

EB-5 Investor Green Cards By Mark Ivener and Gary Wolfe

Offshore Investment (December 2014/January 2015 Edition)

EB-5 Investors & the Perils of U.S. Estate and Gift Taxes with Mark Ivener

EB-5 Investors Magazine (Winter/2014 Edition)

Self-Study Article: A Primer on Passive Foreign Investment Companies and Comparison to Controlled Foreign Corporations with Allen Walburn

California Tax Lawyer (Fall 2013)

EB-5 Investor Visa And U.S. Tax Issues with Mark Ivener

ABA/The Practical Tax Lawyer (Fall 2013)

U.S. Based Hedge Funds and Offshore Reinsurance with Allen Walburn

ABA/The Practical Tax Lawyer

International Tax Evasion and Money Laundering

ABA/The Practical Tax Lawyer (Summer 2013)

International Tax Planning for U.S. Exports (IC-DISC) with Ryan L Losi

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Why Tax Evasion is a Bad Idea: UBS & Wegelin Bank

ABA/The Practical Tax Lawyer (Spring 2013)

U.S. Tax Planning for Passive Investments with David E. Richardson

ABA/The Practical Tax Lawyer (Winter 2013)

FBARs and Offshore Hedge Funds

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Penalty Regime for Foreign Bank Account Filing (FBAR)

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California Tax Lawyer (Summer 2009)

IRS Issues Guidance on Ponzi Schemes

California Tax Lawyer (Summer 2009)

Articles (Interviewed)

1. Learning From Gandolfini's Estate Plan 'Disaster' by Anthony Greco

Private Wealth Magazine (July 2013)

2. IRS Closes In On Secret Caribbean Accounts by Eric Reiner

Financial Advisor Magazine (June 2013)

3. Karate Enables Lawyers to Focus on 'the Task at Hand' by Eron Ben-Yehuda

Daily Journal (May 2005)

4. The Best Tax Haven Getaways by Christina Valhouli

Forbes.com (April 2004)

Books by Gary S. Wolfe

Asset Protection 2015: IRS Tax Audits and Lawsuits (2015)

Tax Planning for U.S. California Wine Exports (2015)

The IRS and Defrauded Investors: Theft Tax Loss (2015)

Offshore Tax Evasion: The IRS and Swiss Banks (2015)

Expatriation: The IRS & U.S. Taxes (2014)

EB-5 Visas: International Investors & U.S. Taxes (2014)with Ryan Losi, CPA and Mark Ivener, Esq.

U.S. Pre-Immigration Tax Planning (2014)

Tax Planning for U.S. and State Exports: IC-DISC (2013) with Ryan Losi, CPA and Allen Walburn, Esq.

Offshore Tax Evasion: IRS Offshore Voluntary Disclosure Program (2013)

Asset Protection 2013: The Gathering Storm (2013)

Offshore Tax Evasion: IRS Tax Compliance FATCA/FBAR (2013)

International Tax Evasion & Money Laundering (2013)

Offshore Tax Evasion: U.S. Tax & Foreign Entities (2013) with Allen B. Walburn, Esq.

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