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Overview of the latest IRS LB&I divisions compliance campaigns affecting cross-border activities

- Background
- First Wave Compliance Campaigns
- Second Wave Compliance Campaigns
- Observations
Background

• Historical practice of IRS Large Business and International ("LB&I"):  
  o Historically, LB&I devoted the majority of its resources to examining the largest corporations.
  
  o Large taxpayer examination activity typically took place within the Coordinated Industry Case (CIC) program.
    - The CIC program involves large taxpayers with complex issues.
    - Only about 900 taxpayers are under the CIC program.
  
  o LB&I historically had very limited visibility into corporate taxpayers not selected for full audits (usually referred to by the IRS as the "middle market").
Background

Since 2010, the IRS has experienced substantial budget cuts and increased responsibilities.

<table>
<thead>
<tr>
<th>Reduced Resources &amp; Coverage</th>
<th>Increased Responsibilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• IRS budget cut 18% from 2010 thru 2017</td>
<td>• 7% (9 million) more individual tax returns</td>
</tr>
<tr>
<td>• Lost around 13,000 employees</td>
<td>• Implementation of Affordable Care Act (ACA)</td>
</tr>
<tr>
<td>• Lowest individual and business audit coverage in a decade</td>
<td>• Implementation of Foreign Account Tax Compliance Act (FATCA)</td>
</tr>
<tr>
<td>• Individuals FY10 1.1%, FY16 0.7%</td>
<td>• Significant increase in identity theft cases</td>
</tr>
<tr>
<td>• Large corporate FY10 16.6%, FY16 9.5%</td>
<td></td>
</tr>
</tbody>
</table>
Background

• LB&I compliance campaigns were started as a return selection tool for the IRS to better allocate its resources and prioritize its workload:
  
  o LB&I changed its focus from a small number of large corporations to more precisely identified compliance risks throughout the entire LB&I population.
  
  o Compliance campaigns are viewed by the IRS as a return selection tool.
    
    ▪ A compliance campaign will not impact other existing IRS procedures, such as Fast Track Settlement, IRS Appeals, and the CIC program.
    
    ▪ The campaign merely provides the IRS an additional stream to identify audit targets.
  
  o The IRS expects that the majority of LB&I audit activity in the future will be campaign-driven.
The IRS has a variety of potential responses available for taxpayers identified through one or more compliance campaigns:

- **Soft letters**
  - Asking taxpayers to state their return position, or for more information.
  - Taxpayers are not required to reply to such soft letters.
  - But failure to reply could lead to a formal examination process.

- **Issued-based examinations**
  - Campaign examination does not by itself suggest non-compliance.
  - However, a higher level of scrutiny is usually imposed.

- **Development of Practice Units**

- **Stakeholder outreach**: e.g. talking on panels, holding webinars

- **Development of new forms that directly ask about these issues**
# First Wave Compliance Campaigns

- The IRS LB&I division announced the 13 initial campaigns in January 2017.
- The compliance campaigns related to cross-border issues are:

<table>
<thead>
<tr>
<th>Campaign</th>
<th>Description</th>
<th>Treatment</th>
<th>Executive Lead</th>
</tr>
</thead>
<tbody>
<tr>
<td>OVDP (Offshore Voluntary Disclosure Program) Declines-Withdrawals</td>
<td>Taxpayers are encouraged to consider entering one of the offshore programs if they have yet to resolve their non-compliance and meet the eligibility criteria</td>
<td>Variety, including issue based examinations</td>
<td>Pam Drenthe</td>
</tr>
<tr>
<td>Repatriation</td>
<td>Repatriation strategies resulting in tax free repatriation – mid-market</td>
<td>Improved issue selection, Issue based exams</td>
<td>John Hinding</td>
</tr>
<tr>
<td>Form 1120F Non-Filer</td>
<td>Use external data to identify 1120F non-filers</td>
<td>Soft letters, Issue based exams</td>
<td>John Hinding</td>
</tr>
<tr>
<td>Inbound Distributors</td>
<td>Inbound transfer pricing; focused on cost-plus or loss-based distributors</td>
<td>Issue based exams, Training program for revenue agents</td>
<td>Sharon Porter</td>
</tr>
</tbody>
</table>
Second Wave Compliance Campaigns

• Background
  o LB&I announced a second wave of campaigns in November 2017, before the Tax Cuts and Jobs Act (“TCJA”) was enacted.
  o Among the 11 additional campaigns, 7 focus on cross-border issues.

• Campaigns focusing on cross-border issues on next slides
<table>
<thead>
<tr>
<th>Campaign</th>
<th>Description</th>
<th>Treatment Stream</th>
<th>Lead Executive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form 1120F Chapter 3 and Chapter 4 Withholding Campaign</td>
<td>Verify withholding at source for IRS Forms 1120F claiming refunds</td>
<td>• Including, but not limited to, examinations</td>
<td>John Cardone</td>
</tr>
</tbody>
</table>
| Swiss Bank Program Campaign                        | Address noncompliance, involving taxpayers who are or may be beneficial owners of accounts under the Swiss Bank Program.  
  • The Swiss Bank Program was a path for Swiss banks to resolve U.S. criminal liabilities relating to undeclared accounts.                              | • Including, but not limited to, examinations                                      | John Cardone  |
| Foreign Earned Income Exclusion Campaign           | Addresses taxpayers who have claimed the benefits of the foreign earned income exclusion but do not meet the requirements  
  • U.S. citizens or resident aliens living abroad can exclude certain foreign-earned income from their U.S. tax base under some circumstances.              | • Including, but not limited to, examinations                                      | John Cardone  |
<table>
<thead>
<tr>
<th>Campaign</th>
<th>Description</th>
<th>Treatment Stream</th>
<th>Lead Executive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Verification of Form 1042-S Credit Claimed on Form 1040NR</td>
<td>Ensure the amount of withholding credits or refund/credit claimed on Forms 1040NR, U.S. Nonresident Alien Tax Return, is verified and whether the taxpayer has properly reported the income reflected on Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding.</td>
<td>Including, but not limited to, examinations</td>
<td>John Cardone</td>
</tr>
<tr>
<td>Corporate Direct (Section 901) Foreign Tax Credit (“FTC”)</td>
<td>Improve return/issue selection (through filters) and resource utilization for corporate returns that claim a direct FTC under IRC section 901. Focus on taxpayers who are in an excess limitation position. This is the first of several FTC campaigns. Future FTC campaigns may address indirect credits and IRC section 904(a) FTC limitation issues.</td>
<td>Issue based examinations</td>
<td>John Hinding</td>
</tr>
</tbody>
</table>
# Second Wave Compliance Campaigns

<table>
<thead>
<tr>
<th>Campaign</th>
<th>Description</th>
<th>Treatment Stream</th>
<th>Lead Executive</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Section 956 Avoidance</strong></td>
<td>Focuses on situations where a CFC loans funds to a U.S. Parent (USP), but nevertheless does not include a Section 956 amount in income. Determine to what extent taxpayers are utilizing cash pooling arrangements and other strategies to improperly avoid the tax consequences of Section 956.</td>
<td>Issue based examinations</td>
<td>John Hinding</td>
</tr>
<tr>
<td><strong>Individual Foreign Tax Credit (Form 1116)</strong></td>
<td>Addresses taxpayer compliance with the computation of the foreign tax credit limitation on Form 1116. Appears to have arisen due to the difficulty of this calculation and potential for inadvertent error.</td>
<td>Including examinations</td>
<td>Paul Curtis</td>
</tr>
</tbody>
</table>
Observations

• Many campaigns are aimed at cross-border issues and likely derive from the restructuring of LB&I and the dedication of three of the five new subject-matter practice areas to international issues (treaty and transfer pricing, withholding and international individual compliance, and cross-border activities).

• Several identified campaigns are vague about the techniques or responses to employ.

• The second wave campaigns were announced before the enactment of the TCJA. As a result of the changes from the TCJA, many of these cross-border issues identified in these campaigns are less relevant (or completely irrelevant) for future tax years.

  o Expect the IRS to refocus its efforts once it starts focusing on auditing post-TCJA returns.

  o Future compliance campaigns may focus on GILTI, BEAT, section 245A, etc.
Thank You

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Navigating Tax Implications of Cross Border Activities

Implications of The Enactment of The Tax Cuts and Jobs Act (2017)

Prepared by
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Los Angeles, California
Tel.: (310) 473-8067
E-mail: ontaxla@yahoo.com
Selected Provisions of TCAJA

One Time Transactional Inclusion (§ 965)

Global Intangible Low-Taxed Income GILTI (§ 951A)

Deduction (50%) for GILTI Amount (§ 250(a))
ONE TIME TRANSITIONAL INCLUSION
§ 965

Generally Effective as of the last tax year of a deferred foreign income corporation for its last taxable year beginning before January 1, 2018
Transitional Inclusion

In last TY of a “deferred foreign income corporation” (DFIC) which begins before January 1, 2018,

Increase in Subpart F Income of DFIC = \( \geq \) Accumulated Post 1986 Deferred Foreign Income As of 11/2/17 or Accumulated Post 1986 Deferred Foreign Income As of 12/31/17

\( \text{§ 965(a)(1)} \)
Deferred Foreign Income Corporation (DFIC) is any “specified foreign corporation” (SFC) that has positive (>0) accumulated post 1986 deferred foreign income on either:

11/2/17

Or

12/31/17

§ 965(d)(1)
Specified Foreign Corporation (SPC) means:

(A) Any CFC, and

(B) Any foreign corporation in which one or more domestic corporation is a “U.S. shareholder”

Note: A foreign corporation described in (B) is treated as CFC solely for taking into account Subpart F income of the corporation for purposes of 965(a), 965(a) and 965(f).

§ 965(e)
“Accumulated Post 1986 Deferred Foreign Income” means “Post 1986 E & P” except for:

Earnings attributable to income of the SFC that is effectively connected with conduct of a T or B within the U.S. and subject to tax under Chapter 1 or in case of a CFC if distributed would be excluded from gross income of a U.S. shareholder under § 959.

§ 965(d)(2)
Transitional Inclusion (Cont.)

“Post 1986 E & P” means:
E & P of the SFC computed in accordance with §§964(b) and 986 only taking into account periods when the foreign corporation was a SFC and accumulated in TYs beginning after December 11, 1986 as of either 11/2/17 or 12/31/17 without reduction for any dividends paid in the last taxable year that began before 1/1/18.

§ 965(d)(3)
Transitional Inclusion (Cont.)

Reduction in subpart F inclusion of U.S. Shareholder wrt at least one DFIC and at least one “E & P Deficit Foreign Corporation” required by § 951(a) by reason of § 965(a) = Pro rata share of Subpart F inclusion of “U.S. Shareholder” of each DFIC under §951(a) by reason of § 965(a) Allocation of “Aggregate Foreign E & P Deficit” to the DFIC

The U.S. Shareholder’s “pro rata share” is determined under the principles of § 951(a)(2). § 965(f).

§ 965(b)(1)
Transitional Inclusion (Cont.)

Allocation of the “Aggregate Foreign E & P Deficit” to a DFIC

\[
\text{U.S. Shareholder’s pro rata share of “Accumulated Post 1986 Deferred Foreign Income” of the DFIC} \\
= \frac{\text{“Aggregate Foreign E & P Deficit”}}{\text{of the U.S. Shareholder from all “E & P Deficit Foreign Corporations”}} \times \text{Aggregate of U.S. Shareholder’s pro rata share of the “Accumulated Post 1986 Deferred Foreign Income” of all DFICs}
\]

§ 965(b)(2)
Transitional Inclusion (Cont.)

The “Aggregate Foreign E & P Deficit” allocated to a DFIC wrt a U.S. Shareholder is treated as “previously taxed income” under § 959 when distributed. § 965(b)(4)(A)

The amount of the “Specified E & P Deficit” of a foreign corporation used to reduce the Subpart F inclusion of a U.S. Shareholder by reason of § 965(a) increases the U.S. Shareholder’s pro rata share of E & P of the E & P Deficit Foreign Corporation.

§ 965(b)(4)(B)
Transitional Inclusion (Cont.)

Aggregate Foreign E & P Deficit of a U.S. Shareholder

\[
= \text{Aggregate of U.S. Shareholder’s pro rata share of “Specified E & P Deficits” of all “E & P Deficit Foreign Corps” of the U.S. Shareholder or Aggregate of U.S. Shareholder’s pro rata share of “Accumulated Post 1986 Deferred Foreign Income” of all DFICs of the U.S. Shareholder}
\]

§ 965(b)(3)(A)(i)
Transitional Inclusion (Cont.)

If the Aggregate of U.S. Shareholder’s pro rata share of “Accumulated Post 1986 Deferred Foreign Income” of All DFICs of the shareholder is less than Aggregate of shareholder’s pro rata share of “Specified E & P Deficits” of the “E & P Deficit Foreign Corp’s” then:

The U.S. Shareholder designates the “Specified E & P Deficit” for each E & P Deficit Corp”.

§ 965(b)(3)(A)(ii)
Transitional Inclusion (Cont.)

“Specified E & P Deficit” wrt any “E & P Deficit = E & P of the “E & P Deficit Foreign Corporation”

Deficit in Post 1986
E & P of the “E & P Deficit Foreign Corporation”

§ 965(b)(3)(C)
Transitional Inclusion (Cont.)

“E & P Deficit Foreign Corporation” is:
any “Specified Foreign Corporation” wrt which the TP is a “U.S. Shareholder” if as of 11/2/17:

(i) Corp had a “Deficit in Post 1986 E & P”,
(ii) Corp was a SFC, and
(iii) TP was a “U.S. Shareholder” of the corp.

§ 965(b)(3)(B)
Application of Participation Exemption:
In case of U.S. Shareholder of a DFIC (domestic corporation), a deduction is allowed in the amount included in gross income of U.S. Shareholder under § 951(a)(1) equal to sum of:

55.71% of excess of amount included over “aggregate foreign cash position” (8%)* plus
77.14% of amount of “aggregate foreign cash position” (15.5%)* not to exceed the inclusion under § 951(a)(1) by reason of § 965.

§ 965(c)

*For individuals, the tax rate percentages are 9.053% and 17.54%.
Transitional Inclusion (Cont.)

**Computation of Participation Exempt Amounts:**
Percent rate equivalent percentage = \( PREP = \frac{x(100)}{y} \)

Amount of transitional inclusion under § 951(a) by reason of § 965 = \( TI = y \)

**8% PREP for Domestic Corps:**
\[
\begin{align*}
(y - x) .35 & = .08y \\
.35y - .35x & = .08y \\
-.35x & = .08y - .35y \\
-.35x & = -.27y \\
x & = \frac{.27y}{.35} \\
x & = .7714y \\
8\% \text{ PREP} & = 77.14\% \\
\end{align*}
\]

**15.5% PREP for Domestic Corps:**
\[
\begin{align*}
(y - x) .35 & = .155y \\
.35y - .35x & = .155y \\
-.35x & = .155y - .35y \\
-.35x & = -.195y \\
x & = \frac{.195y}{.350} \\
x & = .5571y \\
15.5\% \text{ PREP} & = 55.71 \\
\end{align*}
\]

§ 965(c)(2)
Computation of Highest Effective Marginal Tax Rate for Individual WRT the Participation Exemptions for the Transitional Inclusions:

Highest Marginal Effective Rate for Individuals = ER = Z (100)

Amount of transitional inclusion under § 951(a) by reason of § 965(a) = TI = y

8 % REP = 77.14%:
(y - .7714y) .396 = zy
(.2286y) .396 = zy
.090526y = zy
.09053 = z

100z = 9.053% = ER

15.5% REP = 55.71%:
(y - .55714) .396 = zy
(.4429y) .396 = zy
.17539y = zy
.17539 = z

100z = 17.54% = ER

§ 965(c)(2)
Transitional Inclusion (Cont.)

Participation Exemption
(Deduction) for Inclusions by U.S. shareholders (corps.) wrt all DFICs

\[
\text{GI} = \text{gross income inclusion under } \S \, 951(a) \text{ by reason of } \S \, 965(a)
\]

AFCP = aggregate foreign cash position

\[
\text{GI} = \text{gross income inclusion under } \S \, 951(a) \text{ by reason of } \S \, 965(a)
\]

\[
\text{GI} = \text{gross income inclusion under } \S \, 951(a) \text{ by reason of } \S \, 965(a)
\]

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\]

\[
\text{GI} = \text{gross income inclusion under } \S \, 951(a) \text{ by reason of } \S \, 965(a)
\]
Transitional Inclusion (Cont.)

The rate equivalent deduction of an “Expatriated Entity” is recaptured wrt a “Surrogate Foreign Entity” that first becomes so during the 10 year period beginning on December 22, 2017.

§ 965(e)

Special rules are provided for REITs that are U.S. shareholders of DFICs.

§ 965(m)
Transitional Inclusion (Cont.)

“Aggregate Foreign Cash Position” (AFCP) of a Specified Foreign Corporation

\[ \text{Aggregate of U.S. Shareholder’s pro rata share of “Cash Position” of each Specified Foreign Corporation (SFC) of the shareholder as of close of last taxable year beginning before 1/1/18} \]

or \[ \frac{1}{2} \text{ “Cash Position” as of close of last tax year of SFC ending before 11/2/17} \]  

\[ \text{“Cash Position” as of the close of year which precedes the last taxable year ending before 11/2/17} \]

\( \text{§ 965(c)(3)(A)} \)
“Cash Position” of a Specified Foreign Corp.  

\[ \text{Cash Position} = \sum \text{cash} \]

- Net accounts receivable \((A/R - A/P)\),
- FMV of personal property of type actively traded for which an established financial market exists,
- FMV of commercial paper, CDs, Federal Govt’, state and foreign securities,
- FMV of foreign currency,
- FMV of obligations with term < 1 year,
- FMV of assets identified by Treasury as “economic equivalent”

Look through to cash positions of “non corporate entities” which would be a SFC if treated as a corporation.
Transitional Inclusion (Cont.)

Disallowed foreign income taxes attributable = “Applicable X Percentage”

Foreign income taxes attributable to deduction for (Participation Exemption) for Transitional Inclusion
Transitional Inclusion (Cont.)

Applicable
Percentage = .771 [ TI-AFCP/TI] + .557 [AFCP/TI]

TI = Transitional Inclusion

AFCP = Aggregate Foreign Cash Position

§ 965(g)
Transitional Inclusion (Cont.)

U.S. shareholder of a DFIC may elect to pay “Net Tax Liability” (NTL) attributed to Transitional Inclusion in 8 installments without interest as follows:

(A) 8% of NTL for first 5 installments
(B) 15% of NTL for 6th installment
(C) 20% of NTL for 7th installment
(D) 25% of NTL for 8th installment

§ 965(h)
Transitional Inclusion (Cont.)

Net Tax Liability of U.S. Shareholder of DFIC = Net income tax w. Transitional Inclusion
- net income tax w/o Transitional Inclusion and w/o regard to any income or deduction attributed to a dividend received by the U.S. Shareholder from any DFIC

§ 965(g)(6)
Transitional Inclusion (Cont.)

Each shareholder of an S corporation that is a U.S. Shareholder of a DFIC may elect to defer the payment of his/her “Net Tax Liability” until the taxable year of the shareholder in which a “Triggering Event” occurs.

§ 965(i)(1)

Election to pay the Net Tax Liability in installments may be made not later than the due date for the return for the taxable year in which the “Triggering Event” occurs.

§ 965(i)(4)
Transitional Inclusion (Cont.)

“Triggering Event” is the first to occur of the following events:

(i) Corp. ceases to be an S corp
(ii) Liquidation or sale of “substantially all” of the assets of the S corp, cessation of business, ceases to exist or any “similar circumstances”
(iii) Transfer of shares of S corp., including by reason of death, except a partial transfer is a TE only WRT the net tax liability attributed to the transferred stock and if an agreement with the Treasury is entered into by the transferee
Transitional Inclusion (§ 965)  
Aggregated Foreign Cash Position (AFCP)

\[
AFCP = \mid > \mid \sum_{1}^{n} \text{Pro rata Share of cash position of SFC at close of inclusion year}
\]

or

\[
\frac{1}{2} \sum \text{Pro rata Share of cash position of SFC at close of last TY beg. before 1/12/17}
\]

\[
+ \text{Pro rata Share of cash position of SFC at close of last TY preceding the last TY beg. before 1/12/17}
\]

§ 965(c)(3)(A)
Transitional Inclusion (§ 965)
Aggregated Foreign Cash Position (AFCP)
Multiple Inclusion years – Example

<table>
<thead>
<tr>
<th>USP</th>
<th>Tax Year Calendar</th>
<th>Inclusion Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFC-1</td>
<td>12/31</td>
<td>12/31/17</td>
</tr>
<tr>
<td>CFC-2</td>
<td>11/30</td>
<td>11/30/18</td>
</tr>
</tbody>
</table>

**Cash Position Table**

<table>
<thead>
<tr>
<th>Measurement Dates:</th>
<th>1/30/15</th>
<th>12/31/15</th>
<th>11/30/16</th>
<th>12/31/16</th>
<th>11/2/17</th>
<th>11/30/17</th>
<th>12/31/17</th>
<th>11/30/18</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFC-1</td>
<td></td>
<td>100</td>
<td>100</td>
<td></td>
<td></td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CFC-2</td>
<td>200</td>
<td>200</td>
<td></td>
<td>200</td>
<td></td>
<td></td>
<td></td>
<td>?</td>
</tr>
</tbody>
</table>

Notice 2018-07
Transitional Inclusion (§ 965)  
Aggregated Foreign Cash Position (AFCP)  
Multiple Inclusion Years – Example

Analysis

\[
\text{AFCP} = |100 + 0| \quad \text{or} \quad \left[ \frac{1}{2} (100 + 200 + 100 + 200) \right] \\
\text{of} \quad \text{CFC-1} \\
= 300
\]

Note: Treasury intends to issue regulations to avoid double counting of cash positions in case of a U.S. Shareholder has Section 965(a) inclusion amounts in more than one taxable year.

Notice 2018-07
Treasury intends to issue regulations that would disregard any receivable or payable of SFC from or to a “related” SFC.

Notice 2018-07
Transitional Inclusion (§ 965)
Adjustments to Post-1986 Earnings and Profits
To Account For Amounts Paid or Incurred

Between Measurement Dates (November 2, 2017 and December 31, 2017)
Resulting In “Double Counting”

<table>
<thead>
<tr>
<th>Non Subpart F of CFC-1</th>
<th>USP</th>
<th>CFC-1</th>
<th>CFC-2</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deductible Payment 11/3/17</td>
<td>100</td>
<td>100</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Deductible by CFC-2</td>
<td>110</td>
<td>90</td>
<td>210</td>
<td></td>
</tr>
</tbody>
</table>

Treasury intends to issue regulation to eliminate “double counting” in circumstances of payments of accrual or distributions between measurement dates.

Notice 2018-07
Transitional Inclusion (§ 965)
Adjustments to Post-1986 Earnings and Profits
To Account For Amounts Paid, Incurred or Distributed
Between Measurement Dates Resulting In Double Non-Counting

If if the intercompany payment is disregarded, the accumulated Post-1986 Deferred Foreign Income is higher. Treasury intends to issue regulations to prevent “double non-counting” in such circumstances.

Notice 2018-07
Global Intangible Low-Taxed Income (GILTI) § 951A

Effective for Tax Years of a foreign corporation beginning after December 31, 2017 and the Tax Years of U.S. Shareholders in which or with which the Tax Year of the foreign corporation.
“U.S. Shareholder” of any CFC includes in its gross income the shareholder’s “Global Intangible Low Taxed Income” (GILTI) of the CFC, for the TY of U.S. Shareholder in which or with which TY of CFC ends.

§ 951A(a)
Foreign corp. is a “controlled foreign corporation” (CFC only if it was a CFC at any time during the TY.

§ 951A(a)(e)(3)
A U.S. person is a “U.S. Shareholder” if the person owns (w/in meaning of § 958(a)) stock in the foreign corp. on the last day in the taxable year of the foreign corp. on which it is a CFC.

§ 951A(a)(e)(2)
GILTI (Cont)

GILTI = “Net CFC - Tested Income” of the U.S. Shareholder

for any U.S. Shareholder for any TY

“Net Deemed Tangible Income Return” (NDTIR”) of the Shareholder

§ 951A(a)(b)(1)
“Net CFC Tested Income” of a U.S. Shareholder of a CFC for any TY
\[ nCFC = \sum \text{Aggregate of Prorata Share of} \]
\[ 1 \quad \text{“Tested Income” of all CFCs wrt the shareholder is a U.S. Shareholder for TY of the CFC that ends with or w/i the TY of the shareholder} \]

- \[ nCFC = \sum \text{Aggregate of Prorata Share of} \]
\[ 1 \quad \text{“Tested Loss” of all CFCs wrt the Shareholder is a U.S. Shareholder for TY of the CFC that ends with or w/i the TY of the shareholder} \]

\[ \text{§ 951A(c)(1)} \]
“Tested Loss” of a CFC for any TY = Deductions including taxes allocated to GI of CFC under rules similar to § 954(b)(5) - Gross Income of CFC computed w/o regard to items described in § 951A(c)(2) (I) through (M) < 0

§ 951A(c)(2)(B)
“Tested Income” of a CFC for any TY = 

\[
-\text{Gross Income of CFC}
-\text{ECI (952(b))}
-\text{Subpart F income (954)}
-\text{GI excluded from subpart F income of high tax (954(b)(4))}
-\text{Dividends from “related persons” (954(d)(3))}
\]

- Deductions including taxes allocable to GI of CFC under rules similar to § 954(b)(5)

< 0

§ 951A(c)(2)(A)
GILTI (Cont)

\[ \text{NDTIR of U.S. Shareholder} = 0.10 \sum_{i=1}^{n} \text{QBAI} \]

Interest expense allocable to “Net CFC Tested Income” to extent interest income is not taken into account

SH is a U.S. SH

§ 951A(b)(2)
GILTI (Cont)

QBAI of a CFC for TY = \frac{1}{4} \sum_{1}^{4} \text{aggregate adjusted tax basis as of the close of each quarter for TY} \text{ "specified tangible property" used in t or b of CFC of a type where deduction is allowable under § 167}

§ 951A(d)(1)
GILTI (Cont)

Specified tangible property (STP) is (except for “dual use property”) any tangible property used in the production of “tested income”

§ 951A(d)(1)
“Dual use property” is property used for production of both “tested income” and income which is not tested income

§ 951A(d)(2)(B)
GILTI (Cont)

Specific Tangible Property Allocable to CFC = Adjusted basis of tangible property used in t or b by CFC for which deduction is allowed under § 167 \[ \times \] Shareholder’s pro rata share of “tested income” of CFC

Total gross income of CFC produced by the tangible property being allocated

§ 951A(d)(2)(B)
GILTI (Cont)

Allocation of Adjusted basis of STP of a partnership to a CFC

\[
\text{Adjusted basis of CFC's distributive share of income of partnership as percentage} \times \text{Adjusted basis of items of STP held by partnership}
\]

§ 951A(d)(3)
Deduction for Foreign Derived Intangible Income (FCII) and Global Intangible Low-Taxed Income (GILTI)
GILTI (Cont)

GILTI allocated to a U.S. Shareholder of a CFC = GILTI from all CFCs wrtw shareholder is a U.S. Shareholder

U.S. Shareholder’s pro rata share of “tested income” of the CFC

Σ aggregate of “tested income” of all CFCs wrtw the shareholder is a U.S. Shareholder

§ 951A(f)(2)
GILTI (Cont)

Deemed paid credit  =  $\frac{\text{GILTI}}{\text{Aggregate Tested Income}} X \text{Aggregate Tested Foreign Income Tax}$

See 78 Gross Up  =  $\frac{\text{GILTI}}{\text{Aggregate Tested Income}} X \text{Aggregate Tested Foreign Income Tax}$
GILTI (excluding passive category income) is a separate basket for FTC purposes
GILTI (Cont)

Coordination of GILTI and Subpart F are generally treated the same for purposes of:

- 951(a)(1)(A)
- 168(h)(2)(B) – not exempt
- 535(b)(10) ded for AET
- 904(h)(1)
- 952(c)(1)(A)
- 959
- 961
- 962
- 993(a)(1)(E)

- 996(f)(1)
- 1248(b)(1)
- 1248(d)(1)
- 6501(e)(1)(C) – 6 year S of L
- 6654(d)(2)(D) – estimated tax
- 6655(e)(4) – estimated tax
Deduction of Foreign Derived Intangible Income (FDII) And Global Intangible Low-Taxed Income (GILTI) under Section 250

Effective for Tax years beginning after 12/31/17

PL 115-97, § 14202(c)
Domestic corporation is allowed a deduction of the sum of:

- 37.5% of FDII
- 50% of GILTI under Section 78 gross up

§ 250(a)(1)
Deduction for FDII and GILTI (Cont)

Section 250 deduction for a domestic corporation for any year =

\[ 0.375 \times (\text{FDII} - \text{Reduction}) + 0.50 \times (\text{GILTI} - \text{Reduction}) \]

§ 250(a)(2)
Reduction in § 250 deduction =

\((0.375 \text{FDII} + 0.50 \text{GILTI}) - (\text{Taxable Income of Domestic Corp.})\)  
\(> 0\)  
= Excess
Deduction for FDII and GILTI (Cont)

Excess = (.375 FDII + .50 GILTI) – (Taxable Income of Domestic Corp.)

§ 250(a)(2)(A)(i)
Deduction for FDII and GILTI (Cont)

Reduction for FDII = Excess \(\frac{.375 \text{ FDII}}{.375 \text{ FDII} + .50 \text{ GILTI}}\)

Reduction for GILTI = Excess – Reduction for FDII

§ 250(a)(2)(B)
IRS PROTOCOL FOR ISSUE-BASED EXAMINATIONS AND GUIDELINES FOR COUNSEL

Antoinette L. Ellison
LB&I Movement Toward Issue-based Examinations

• Issue-Driven Process
  o Part of IRS’s shift from CIC Program to Compliance Campaigns
    ▪ Case-based (continuous audit based on taxpayer size) → Issue-based (audit based on issues presenting greatest audit risk)
  o Increased focus on international tax issues

• Issue Team Concept
  o Separate issue team for each issue identified for audit
    ▪ Comprised of employees most knowledgeable about a given issue
    ▪ Work with the taxpayer to develop examination procedures tailored to each issue
    ▪ Establish facts; ensure each party’s position is fully understood
    ▪ Case manager; Issue manager
• Publication 5125, LB&I Examination Process ("LEP")
  o Released February 25, 2016
  o Effective May 1, 2016
  o Replaces Publication 4837, Quality Examination Process ("QEP")
  o Applies in all LB&I cases
  o Provides an “organizational approach for conducting professional examinations from the first contact with the taxpayer through the final stages of issue resolution”
  o Expectations and best practices for both examining agents and taxpayers
Emphasis on taxpayer transparency and cooperation:

- The LB&I examination process will be discussed at the initial engagement so that both the taxpayer and LB&I have a clear understanding of the process and expectations. The examination can be efficient if the examination team and the taxpayer work together in a *spirit of cooperation, responsiveness, and transparency*. There is a greater likelihood that the taxpayer and LB&I will benefit in terms of resource utilization and tax certainty when the parties have *open and meaningful discussions of the issues throughout the examination process.*
LB&I Exam Team

- Work transparently in a collaborative manner with the taxpayer to understand their business and share the issues that have been identified for examination.
- Engage the taxpayer in the development of the audit steps and potential timeline appropriate for the issues selected in the examination plan; provide a final copy to the taxpayer.
- Follow the IDR procedures by:
  1. Discussing the Information Document Request(s) (IDRs) with the taxpayer before issuing to ensure that requests identify the issue and are properly focused.
  2. Timely reviewing IDR responses and providing feedback to taxpayers regarding the adequacy of their response.
  3. Following the LB&I IDR enforcement process if complete responses are not received by the agreed date.
- Keep the taxpayer informed of the status of each issue on a regular basis.
- Provide written documentation of all relevant facts, seek taxpayer acknowledgement, and if the issue is unagreed, appropriately document all disputed facts.
- Apply the law to the facts in a fair and impartial manner.
- Prepare well-developed Notices of Proposed Adjustment, Forms 5701/Forms 886-A.
- Resolve issues at the earliest appropriate point using the appropriate issue resolution tool.

Taxpayer (or their Representatives)

- Work transparently with the exam team by providing a thorough overview of business activities, operational structure, accounting systems, and a global tax organizational chart.
- Identify personnel for each issue with sufficient knowledge who can provide input when establishing initial audit steps, timelines, and actively assist in the development of the issues selected by the exam team.
- Follow the IDR procedures by:
  1. Reviewing and discussing IDRs with the issue team before issuance to ensure that they are properly focused and identify the issue.
  2. Working with the issue team to reach a reasonable response date for each IDR.
- For issues identified for examination, provide work papers and supporting documents requested, including those the taxpayer relied on when preparing the return.
- Collaborate with the issue team to arrive at an acknowledgment of the facts for unagreed issues; provide support for any additional or disputed facts.
- To foster early resolution, respond timely to each Form 5701 by providing a written legal position for issues in dispute.
- Resolve issues at earliest appropriate point using an issue resolution tool.
LB&I Examination Process – Three Phases

• Planning Phase
  o Communication
  o Examination Plan
    ▪ Issue focused
    ▪ Issue(s) identified, audit steps, timeline(s), and communication agreements

• Execution Phase
  o Issue Development
  o Written Acknowledgment of the Facts for Unagreed Issues

• Resolution Phase
  o Issue Resolution
  o Exit Strategy
LB&I Examination Process – Examples of Audit Steps

• IRM 4.46.3.7.1.2.1
  o Issue IDRs following the IDR process to request data
  o Schedule a taxpayer presentation
  o Schedule site visits to the taxpayer's facilities to gain a better understanding of the taxpayer’s business activity or operations
  o Conduct interviews or meetings with taxpayer personnel who are most familiar with the issue
  o Establish issue-specific materiality thresholds
  o Focus the examination to specific accounts, divisions, etc.
  o Consult with Counsel and subject matter experts (SMEs)
  o Identify relevant IRS procedural guidance such as the Industry Issue Resolution (IIR), Revenue Procedures, etc. specific to the issue being examined
LB&I Examination Process – Three Common Issues

1. Responding to IDRss
   – No fishing expedition or kitchen sink IDRss

2. Responding to demands for taxpayer interviews
   – IRC 7521

3. Written Acknowledgment of the Facts
LB&I Examination Process – Acknowledgment of the Facts for Unagreed Issues

• Publication 5125 instructs LB&I issue team members to “document[ ] all the facts that they have secured”.

• For issues potentially in dispute: “issue team members are expected to seek the taxpayer’s acknowledgment on the facts, resolve any factual differences and/or document factual disputes.”

• New “Acknowledgment of Facts” (AOF) IDR process for cases heading to Appeals
  o Issues with respect to AOF IDR
    ▪ Timing of issuance of AOF IDR with issuance of NOPA or other explanation of Exam’s legal position
    ▪ Interaction with Appeals’ AJAC policies
    ▪ Range of acceptable taxpayer responses
Reporting Standards and Methods to Avoid Penalties, Additional Tax Liability, and Ensure Compliance

- Outbound U.S. international tax reporting requirements
  - Form 5471 ownership of a foreign corporation
  - Form 926 transfers of cash or property to a foreign corporation
  - Form 8865 ownership of a foreign partnership
  - Form 8858 ownership of a foreign disregarded entity
  - Form 8832 check the box entity classification election
  - Form 8975 country by country reporting
  - Form 8938 specified foreign financial assets
  - FinCEN Form 114 foreign bank account report (FBAR)
  - Form 8621 ownership of a PFIC
  - Form 5713 international boycott report
  - Forms 1116 and 1118 foreign tax credits
  - Form 3520 transactions with foreign trusts and foreign gifts
  - Form 3520-A return of a foreign trust with a U.S. owner
  - Form 2555 foreign earned income exclusion
Reporting Standards and Methods to Avoid Penalties, Additional Tax Liability, and Ensure Compliance

- Inbound U.S. international tax reporting requirements
  - Form 5472 reportable transactions with related parties
  - Forms 1042, 1042-T, and 1042-S U.S. nonresident withholding tax
  - Forms 8804, 8804-C, 8805, and 8813 foreign partner withholding
  - Form 1120-F foreign corporation engaged in a U.S. trade or business
  - Form 1040NR nonresident individual income tax return
  - Form 8854 expatriation statement
  - Form 8840 Closer connection exception statement
  - Form 8843 statement for exempt individuals and medical condition
  - Form 8833 treaty based tax return position disclosure
  - Forms 8288, 8288-A, and 8288-B FIRPTA withholding
  - Forms W-8BEN, W-8BEN-E, W-8ECI, W-8IMY
U.S. International Information Return Penalties

The following penalties could apply for the failure to file, the late filing, or a substantially incomplete filing of a U.S. international information return.

- Forms 5471, 5472, 8865, and 8858 –
  - $10,000 penalty for the failure to file on time
  - Additional $10,000 penalty up to $50,000 maximum for each month that delinquency continues after IRS sends notice
  - Statute of limitations stays open on entire U.S. Federal tax return until complete and accurate form is filed.
  - Possible reduction in foreign tax credits from a foreign company
  - Possible criminal penalties for willful failure to file, fraudulent and false returns or statements
- Form 926 – Penalty is 10% of FMV of property transferred to foreign corporation and some types of transfers may result in a taxable sale or exchange.
- FBAR –
  - $10,000 civil penalty for nonwillful failure to file on time
  - greater of $100,000 or 50% of the account balance for willful or intentional failure to file
  - Criminal prosecution with possible imprisonment for willful or intentional failure to file
- Form 5713 – Penalty is $25,000 or up to one year imprisonment for the willful failure to file.
- Forms 1042 and 1042-S – Penalties can be up to 50% of the tax liability plus interest for the failure to file and pay the U.S. nonresident tax on time.
Examples of when a U.S. international information return is not substantially complete

- All required schedules are not attached or completed
- Overstatements or understatements of amounts that are required to be reported
- Incorrect or inaccurate information stated on the form
- All required information is not reported
<table>
<thead>
<tr>
<th>Required Information*</th>
<th>Category of Filer</th>
</tr>
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<tbody>
<tr>
<td>The identifying information on page 1 of Form 5471 above Schedule A, see Specific Instructions</td>
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<td>Schedule A</td>
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<td>Schedule B</td>
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<td>Schedules C, E, and F</td>
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<td>Schedule G</td>
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<td>Schedule H</td>
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<td>Schedule I</td>
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<tr>
<td>Separate Schedule J</td>
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<tr>
<td>Separate Schedule M</td>
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<tr>
<td>Separate Schedule O, Part I</td>
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<tr>
<td>Separate Schedule O, Part II</td>
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*See also Additional Filing Requirements on page 3.
SCHEDULES REQUIRED TO BE ATTACHED TO FORM 8865 BASED ON APPLICABLE U.S. FILER CATEGORY

<table>
<thead>
<tr>
<th>Filing Requirements</th>
<th>Category of Filers</th>
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<td>Schedule A-2—Affiliation Schedule</td>
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<td>Schedule B—Income Statement—Trade or Business Income</td>
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<td>Schedule K—Partners' Distributive Share Items</td>
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<td>Schedule L—Balance Sheets per Books</td>
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<td>Schedule M—Balance Sheets for Interest Allocation</td>
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<td>Schedule M-1—Reconciliation of Income (Loss) per Books With Income (Loss) per Return</td>
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<td>Schedule M-2—Analysis of Partners' Capital Accounts</td>
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<td>Schedule N—Transactions Between Controlled Foreign Partnership and Partners or Other Related Entities</td>
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<td>Schedule D—Schedule D (Form 1065), Capital Gains and Losses</td>
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<td>Schedule K-1—Partner's Share of Income, Deductions, Credits, etc. (direct partners only)</td>
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<tr>
<td>Schedule O—Transfer of Property to a Foreign Partnership</td>
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<tr>
<td>Schedule P—Acquisitions, Dispositions, and Changes of Interests in a Foreign Partnership</td>
<td></td>
</tr>
</tbody>
</table>
Form 5471 Examples from the IRS International Practice Unit Guidance

- **Example 1:** FSA 33381431 – The taxpayer did not substantially comply with the Form 5471 reporting requirements.
  - Significant understatements of purchases from and sales to some CFCs and related third parties reported on Schedule M
  - Significant inconsistencies in the earnings and profits of some CFCs
  - Other information reported on Form 5471 was accurate

- **Example 2:** CCA 200645023 – The taxpayer did not substantially comply with the Form 5471 reporting requirements.
  - Schedule C income statement and Schedule F balance sheet not reported in accordance with U.S. GAAP
  - Schedule O was not attached
  - Forms 5471 not filed for certain inactive or dormant foreign corporations
Form 5472 Example from the IRS International Practice Unit Guidance

Example 3: CCA 200429007 – The taxpayer did not substantially comply with the Form 5472 reporting requirement.
- Some transactions were reported erroneously
- Magnitude of each erroneously reported transaction was substantial in relation to all other reportable transactions, substantial in relation to the volume of business and overall financial situation

Specific Errors:
- Taxpayer over-reported amounts in Part IV purchases of stock in trade as $1,000X when the actual amount was $500x
- Taxpayer incorrectly reported intercompany A/R not required and later corrected Form 5472 to remove them
- Ending balance of related party loans did not match the beginning balance on the next year’s Form 5472 and the opening loan balance was incorrectly reported
- Taxpayer over-reported one amount and under-reported another amount. There was a relatively small aggregate difference between the correct total and what was reported.
Seven factors to consider in determining whether taxpayer has substantially complied.

1. The magnitude of the underreporting, or of the over-reporting, of the erroneous reported transactions in relation to the actual total amount of that reported type of transaction.
2. Whether the reporting corporation has reportable transactions other than the erroneous reported transactions with the same related party and correctly reported such other transactions.
3. The magnitude of the erroneous reported transactions in relation to all of the other reportable transactions as correctly reported.
4. The magnitude of the erroneous reported transactions in relation to the reporting corporation’s volume of business and overall financial situation.
5. The significance of the erroneous reported transactions to the reporting corporation’s business in a broad functional sense.
6. Whether the erroneous reported transactions occur in the context of a significant ongoing transactional relationship with the related party.
7. Whether the erroneous reported transactions are reflected in the determination and computation of the reporting corporation’s taxable income.
ALISON N. DOUGHERTY
DIRECTOR, TAX SERVICES
ARONSON LLC

Alison N. Dougherty provides tax services as a Director at Aronson LLC. Alison specializes in international tax reporting, compliance, consulting, planning, and structuring as a subject matter leader of Aronson’s international tax practice. She has extensive experience assisting clients with U.S. tax reporting and compliance for offshore assets and foreign accounts. She provides outbound U.S. international tax guidance to U.S. individuals and businesses with activities in other countries. She also provides inbound U.S. international tax guidance to nonresident individuals and businesses with activities in the United States. She has worked extensively in the area of U.S. international tax reporting and compliance with the preparation of the U.S. Federal Forms 5471, 926, 8865, 8858, 5472, 1042, 1042-S, 8621, 8804, 8805, 8813, 8288, 8288-A, 8288-B, 1116, 1118, 1120-F, 1040-NR, 3520, 3520-A, 2555, 5713, 8832, 8833, 8840, 8843, 8854, 8938, and FBAR. She has counseled U.S. taxpayers regarding the outbound formation, capitalization, acquisition, operation, reorganization, and liquidation of foreign companies. She has significant experience with U.S. Federal nonresident tax withholding, foreign partner tax withholding, and FIRPTA withholding. She works closely with nonresident individuals and businesses regarding inbound U.S. real property investment. She often assists U.S. taxpayers with IRS amnesty program disclosures of offshore assets and foreign accounts.

Alison completed the LL.M. (Master of Laws) in Securities and Financial Regulation in 2004 with academic distinction at Georgetown University Law Center. She completed the LL.M. (Master of Laws) in Taxation in 2000 and the Juris Doctor in 1999 at the University of Denver College of Law. She completed a Bachelor of Arts degree in Foreign Language in 1995 at Virginia Commonwealth University.
STRATEGIES FOR HANDLING FBAR AUDITS, OPT-OUTS, APPEALS AND LITIGATION
Overview

• Introduction: FBAR, Streamlined Filing Procedures, 2014 OVDP
• Severity of FBAR penalties
• The concept of “willful” violations
• Taxpayer strategies
  o Pre-Audit
  o Opt-outs
  o Audit
  o Appeals
  o Litigation
Introduction: FBAR, Streamlined Filing Procedures, OVDP

• **Reports of Foreign Bank and Financial Accounts (“FBAR”):** The Bank Secrecy Act requires a U.S. person with a financial interest in or signature authority over foreign financial account(s) with an aggregate value greater than $10,000 at any time in a CY to report the account(s) on FinCEN Form 114, Report of Foreign Bank and Financial Accounts.

• **Streamlined Filing Procedures:** These procedures provide a streamlined process for filing amended or delinquent returns for U.S. individual taxpayers (including estates) who certify their failure to report foreign financial assets and pay all tax due in respect of those assets did not result from willful conduct on their part.

• **2014 Offshore Voluntary Disclosure Program (OVDP):** A voluntary disclosure program that offers U.S. taxpayers with undisclosed income from offshore financial accounts or other foreign assets an opportunity to fulfill their tax and information reporting obligations, including FBARs.
# Severity of FBAR Penalties

<table>
<thead>
<tr>
<th></th>
<th>Civil</th>
<th>Criminal</th>
<th>Authority</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Negligent</strong></td>
<td>• $\leq 1,078</td>
<td>• N/A</td>
<td>31 U.S.C. § 5321(a)(6)(A)</td>
</tr>
<tr>
<td><strong>Non-Willful – Failure to File or Retain Records</strong></td>
<td>• $\leq 12,459</td>
<td>• N/A</td>
<td>31 U.S.C. § 5321(a)(5)(B)</td>
</tr>
<tr>
<td></td>
<td>• Reasonable cause defense available</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Willful – Filing False FBAR</strong></td>
<td>• $\leq \text{greater of } 100,000 or 50% of account balance at the time of the violation</td>
<td>• $10,000 or 5 years or both</td>
<td>18 U.S.C. § 1001; 31 C.F.R. § 103.59(d)</td>
</tr>
<tr>
<td><strong>Willful – Failure to File or Retain Records</strong></td>
<td>• $\leq \text{greater of } 124,588 or 50% of account balance at the time of the violation</td>
<td>• $\leq 250,000 or 5 years or both</td>
<td>31 U.S.C. § 5321(a)(5)(C); 31 U.S.C. § 5322(a); 31 C.F.R. § 103.59(b)</td>
</tr>
</tbody>
</table>
The Concept of “Willful” Violations

• “Willful” is an important term in the FBAR context; it determines whether a taxpayer:
  o can claim a reasonable cause defense;
  o can elect into Streamlined Filing Procedures; and
  o may be subject to criminal prosecution.

• IRM 4.26.16.6.5.1 defines willfulness for purposes of a willful FBAR violation as “a voluntary, intentional violation of a known legal duty.”
  o Willfulness includes where individuals purposefully choose not to be aware of their reporting responsibilities (“willful blindness”).
## Taxpayer Strategies – Pre-Audit

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Quiet Disclosure</th>
<th>Streamlined</th>
<th>2014 OVDP</th>
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</thead>
<tbody>
<tr>
<td><strong>Criteria</strong></td>
<td>• File delinquent FBARs and amended or delinquent returns</td>
<td>• U.S. individual</td>
<td>• Pass IRS CID review</td>
</tr>
<tr>
<td></td>
<td>• Pay tax due on returns</td>
<td>• Certify failure to report was non-willful</td>
<td>• IRS has not initiated an audit or received info of noncompliance</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• IRS has not initiated an audit for any tax year</td>
<td>• Waive the SOL</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• File delinquent FBARs for 6 most recent years</td>
<td>• File delinquent FBARs for 8 most recent years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• File or amend returns for 3 most recent years</td>
<td>• File or amend returns for 8 most recent years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Pay tax due on returns</td>
<td>• Pay tax due on returns</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Pay 20% accuracy-related penalty</td>
</tr>
<tr>
<td><strong>Benefits</strong></td>
<td>• Taxpayer residing in US: 5% misc. offshore penalty of the highest aggregate account balance for 6 year FBAR and 3 year return period</td>
<td>• 27.5% misc. offshore penalty of the highest aggregate balance of assets in any year in the disclosure period</td>
<td>• Criminal prosecution is precluded</td>
</tr>
<tr>
<td></td>
<td>• Taxpayer residing outside US: No penalty</td>
<td></td>
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</tr>
</tbody>
</table>

Taxpayer Strategies – Opt-Outs

- **IRM 4.63.3.21**: “2014 OVDP FAQ 51 provides a procedure for a taxpayer participating in OVDP to opt-out of the program …. Once a taxpayer opts out of OVDP …, full scope income tax, penalty, and FBAR examinations *will commence*.”

- An “opt out” is an election by a taxpayer to have his case handled under the standard audit process.

- Once made, the election is irrevocable.

- IRS takes OVDP opt-outs seriously:
  - Opt-outs increase the chance of being prosecuted criminally.
Taxpayer Strategies – Audits

• In general, filing an FBAR does not increase the chance of audit.
  o The IRS normally does not use FBARs as a primary factor in determining whether to initiate an audit.
  o The IRS usually looks to see if a taxpayer already under audit has an FBAR requirement and if that requirement has been fulfilled.

• Two key goals:
  o First, convince the FBAR auditor the violation was non-willful.
    ▪ The IRS has the authority to punish a willful violation with up to 5 years in prison.
    ▪ The real threat of a willful violation is the civil and criminal penalties.
  o Second, establish as many mitigating factors as possible to reduce the applicable penalties.
Taxpayer Strategies – Appeals

• The IRS Office of Appeals has long had a mission to “resolve tax controversies, without litigation, on a basis that is fair and impartial to both the Government and the taxpayer….” IRM 8.1.1.1(1).

• A taxpayer may protest and try to reach a compromise with Appeals either pre-assessment or post-assessment.

• The factors weighing in favor of appealing pre-assessment include:
  o Interest
  o ADR rights
  o DOJ approval required post-assessment for FBAR penalties in excess of $100,000.

• Involvement of IRS Counsel for willful FBAR penalties.
Taxpayer Strategies – Litigation

• Two choices: wait to be sued vs. sue first
• Wait to be sued
  o Benefits of waiting:
    ▪ IRS has no collection authority over assessed FBAR penalties.
    ▪ If not paid, the DOJ must initiate legal action to reduce the assessed penalty to judgment and collect on it.
    ▪ DOJ does not bring every FBAR case to court.
    ▪ Once the two-year SOL passes, enforcement is limited under the Federal Debt Collection Act (“FDCA”) to administrative offset, tax refund offset, federal salary offset, non-federal wage garnishment, referral to a private collection contractor, referral to a federal agency operating a debt collection center, reporting delinquencies to a credit rating bureau.
  o Costs of waiting:
    ▪ There is a substantial accrual of interest, collection costs and penalties under the FDCA that can amount to more than 30% over the two-year period.
• Sue first – pay all or part of the penalties and sue for a refund
  o Taxpayer must
    ▪ bring an action within the two years of assessment date;
    ▪ establish subject-matter jurisdiction in the District Court or Court of Claims and establish a waiver of sovereign immunity; and
      – Little Tucker Act (28 U.S.C. §1346(a)(2)) grants subject-matter jurisdiction in the District Court or Court of Claims and waiver if the taxpayer is seeking recovery of less than $10,000 per FBAR penalty assessment.
    ▪ establish a substantive cause of action (e.g., illegal exaction).
  o Taxpayer does not have to pay full amount of deficiency to be able to sue (Flora v. United States, 362 U.S. 145 (1960) does not apply)
New development: potential Administrative Procedure Act (“APA”) challenge for FBAR penalty assessments:

- FBAR assessments may be subjected to abuse of discretion review under the APA.
  - *See Moore v. United States, 2015 WL 1510007 (W.D. Wash. Apr. 1, 2015)* (allowing an APA challenge to the imposition of an FBAR penalty)
  - *But see Kentera v. United States, 2017 WL 401228 (E.D. Wis. Jan. 30, 2017)* (dismissing plaintiffs’ complaint against the US alleging violations of the APA on the basis that they had an adequate remedy at law).

- However, the strength of such challenge is not clear.
  - The court in *Moore* allowed the government to supplement information to support its assessment result.
Thank you

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