International Tax Compliance: Navigating Tax Implications of Cross-Border Activities
Reporting and Filing Requirements, Guidelines on IRS Issue-Based Examinations, Audits and Litigation

WEDNESDAY, SEPTEMBER 4, 2019
1pm Eastern    |    12pm Central   |   11am Mountain    |    10am Pacific

Today’s faculty features:

Alison N. Dougherty, J.D., LL.M., Director, Tax Services, Aronson, Rockville, Md.
Antoinette L. Ellison, J.D., LL.M., Counsel, Jones Day, Atlanta

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International Tax Compliance:
Navigating Implications of Cross-Border Activities

Alison N. Dougherty  September 4, 2019

https://aronsonllc.com/person/alison-dougherty/
http://blogs.aronsonllc.com/tax/u-s-tax-foreign-persons-gain-sale-u-s-partnership-interest/
http://blogs.aronsonllc.com/tax/reporting-foreign-accounts-offshore-assets/
http://blogs.aronsonllc.com/tax/what-should-i-do-if-i-did-not-report
Tax Reform Impact on Cross-Border Activities

- Income (Including Gains and Losses)
  - I.R.C. § 951A Global Intangible Low-Taxed Income (GILTI)
    - IRS Notice 2019-01
    - REG-104390-18, REG-101828-19
    - TD 9865, TD 9866
  - I.R.C. § 956 CFC Earnings Invested in U.S. Property
    - IR-2018-210
    - REG-114540-18
    - TD 9859
  - Limitations on Carried Interest
    - IR-2018-37
    - IRS Notice 2018-18
Tax Reform Impact on Cross-Border Activities

- Deductions and Depreciation
  - I.R.C. § 163(j) Business Interest Expense
    - IR-2018-82
    - IRS Notice 2018-28
    - REG-106089-18
  - I.R.C. § 245A 100% Dividends Received Deduction
    - REG-106282-18
  - I.R.C. § 250 Deduction for FDII and GILTI
    - IR-2019-27
    - REG-104464-18
  - I.R.C. § 267A Hybrid Arrangements
    - REG-104352-18
Tax Reform Impact on Cross-Border Activities

- **Taxes**
  - I.R.C. § 11
    - 21% U.S. federal corporate income tax rate
  - I.R.C. § 59A Base Erosion and Anti-Abuse Tax (BEAT)
    - IR-2018-250
    - REG-104259-18
  - I.R.C. § 965 Transition Tax on Foreign Corporation Earnings
    - Various IRS news releases and notices
    - REG-104226-18
    - T.D. 9846
    - IRS FAQs
    - IRS Publication 5292
  - I.R.C. §§ 864(c)(8) and 1446(f) U.S. Withholding Tax on a Foreign Partner’s Sale of a Partnership Interest
    - IR-2018-81
    - IRS Notice 2018-08, Notice 2018-29
    - REG-113604-18, REG-105476-18
Tax Reform Impact on Cross-Border Activities

- Foreign Tax Credits
  - I.R.C. §§ 861, 904, etc.
    - IR-2018-235
    - REG-105600-18
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 8991 base erosion and anti-abuse tax (BEAT)
  - Form 8992 global intangible low-taxed income (GILTI)
  - Form 8993 I.R.C. § 250 deduction for foreign derived intangible income (FDII) and GILTI
  - 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, 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 5472
    - $25,000 penalty for the failure to file on time
    - No limit on continuation penalty
  - 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
### Filing Requirements for Categories of Filers

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*See also Additional Filing Requirements on this page.
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</table>

*See also Additional Filing Requirements on this page.*
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
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.
OVERVIEW

- LB&I Examination Procedure
- LB&I Compliance Campaigns
- Acknowledgment of Facts IDR
- Proactive Approach to Audits
LB&I EXAMINATION PROCESS (LEP)
• Historical practice of IRS Large Business and International ("LB&I") Division:
  
  o Majority of resources devoted to examining the largest taxpayers.
  
  o Large taxpayer examination activity typically took place within the Coordinated Industry Case (CIC) program:
    ▪ Approximately 900 taxpayers under the CIC program.
    ▪ Returns centrally scored and selected for continuous audit.
    ▪ Local IRS personnel determined the issues to be examined.
  
  o Limited visibility into taxpayers not selected for full audits (referred to as the “middle market”).
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>
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<tbody>
<tr>
<td>• IRS budget cut 18%</td>
<td>• 7% (10 million) more individual tax returns filed</td>
</tr>
<tr>
<td>• Lost around 13,000 employees (14% of workforce)</td>
<td>• Affordable Care Act (ACA) implemented</td>
</tr>
<tr>
<td>• Lowest individual and business audit coverage in a decade</td>
<td>• Foreign Account Tax Compliance Act (FATCA) implemented</td>
</tr>
<tr>
<td>• Individuals FY10 1.1%, FY16 0.7%</td>
<td>• Tax Cuts and Job Act enacted in 2017</td>
</tr>
<tr>
<td>• Large corporate FY10 16.6%, FY16 9.5%</td>
<td>• Significant increase in identity theft cases</td>
</tr>
</tbody>
</table>
BACKGROUND

• LB&I reorganized in February 2016
  o Eliminate divide between domestic and international compliance.
  o Realign resources:
    ▪ Five substantive “Practice Areas”
      ▪ Cross Border Activities;
      ▪ Enterprise Activities;
      ▪ Pass Through Entities;
      ▪ Treaty and Transfer Pricing Operations; and
      ▪ Withholding and International Individual Compliance.
    ▪ Four geographic “Compliance Practice Areas”
      ▪ Central, Eastern, Northeastern, and Western.
  o Shift from historic audit practice that focused on taxpayers to compliance campaign approach that focuses on issues.
• Publication 5125, LB&I Examination Process (LEP):
  o Effective for audits as of May 1, 2016.
  o Replaces Publication 4837, Quality Examination Process.
  o Incorporates:
    ▪ Information Document Request Directive; and
    ▪ Appeals Judicial Approach and Culture (AJAC).
  o Implements the issue-based approach for conducting examinations.
  o Identifies roles and responsibilities for LB&I exam teams and taxpayers or their representatives.
• Updates to IRM 4.46 published March 2016 and December 2018 to reflect LEP.
LB&I MOVEMENT TOWARD ISSUE-BASED EXAMINATIONS

• Issue-Driven Process
  o Part of 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.
Emphasis on 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 EXAMINATION PROCESS – ROLES AND RESPONSIBILITIES

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** – determine the scope of the audit:
  o Communication.
  o Issue Team Concept.
  o Examination Plan.

• **Execution** – determine the facts, apply the law to the facts, and understand the various tax implications of each issue:
  o Issue Development Process.
  o Written Acknowledgment of the Facts for Unagreed Issues.

• **Resolution** – reach agreement if possible on the tax treatment of each issue; if necessary, issue a Revenue Agent Report (RAR):
  o Issue Resolution.
  o Exit strategy.
LB&I COMPLIANCE CAMPAIGNS
OVERVIEW OF IRS LB&I COMPLIANCE CAMPAIGNS

- Return selection tool to better allocate resources and make the greatest use of limited resources.
- Centrally, not locally, identified issues.
- More precisely identified issues:
  - Data analysis; and
  - Integrated feedback loop.
- “Treatment streams” for compliance:
  - Soft letters;
  - Issued-based examinations;
  - Development of Practice Units;
  - Stakeholder outreach: e.g. panels, webinars.
- Majority of LB&I audit activity expected to be campaign-driven.
OVERVIEW OF IRS LB&I COMPLIANCE CAMPAIGNS

- 59 approved compliance-campaigns announced to date:
  - 01/31/2017 – 13 campaigns
    - OVDP Declines-Withdrawals, Repatriation
  - 11/30/2017 – 11 campaigns
    - Swiss Bank Program, Section 956 Avoidance
  - 03/13/2018 – 5 campaigns
  - 05/21/2018 – 6 campaigns
  - 07/02/2018 – 5 campaigns
    - Repatriation via Foreign Triangular Reorgs, Section 965 Tax
  - 09/10/2018 – 5 campaigns
  - 10/30/2018 – 5 campaigns
  - 04/16/2019 – 3 campaigns
    - Offshore Private Banking
  - 07/19/2019 – 6 campaigns
    - Post OVDP Compliance
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, cross-border activities).

- Too many issues for a financially-strapped IRS?
- Consistency among 9 waves of campaigns?
- Campaigns triggering IRS exams?
ACKNOWLEDGMENT OF FACTS IDR
ACKNOWLEDGMENT OF FACTS (AOF) IDR

• Relatively recent process for cases heading to IRS Independent Office of Appeals (Appeals).

• Relates to the AJAC Project:
  - Appeals hearing officers are not investigators or examining officers;
  - Appeals will not raise new issues, or reopen issues;
  - Appeals will return cases to Exam when a taxpayer submits new information or evidence; and
  - Appeals will settle a case based on factual hazards when the case is not fully developed and the taxpayer has provided no new information or evidence.
• 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.”

• Will be used by LB&I issue teams on all potentially unagreed issues, unless an exception is met.

• Goal: only fully-developed issues proceed to Appeals.
The purpose of this [AOF IDR] is to ensure that all relevant facts necessary to arrive at an accurate tax determination have been identified and considered before the Form 5701, Notice of Proposed Adjustment, is issued. Responding to this IDR presents the taxpayer an opportunity to provide additional relevant facts and may lead to the resolution of the issue at the examination level.

Another potential benefit of a thorough response to this IDR is preventing a delay in your case should it be returned from Appeals. The presentation of new facts in Appeals generally will require that the case be returned to Examination. Therefore, it is beneficial to ensure that all relevant facts are provided to the LB&I issue team before the Form 5701 is issued. Taxpayers are not prevented from providing additional facts in their written protest or in Appeals, but the expectation is that all relevant facts will be presented during the audit so that LB&I can make an accurate tax determination. While the interpretation of the law or the amount of the proposed adjustment may be unagreed, all relevant facts should be included in the attached draft Form 886-A.

(IRM Exhibit 4.46.4-3)
Additional Information

*The issue manager has the responsibility to ensure that any additional or disputed facts are appropriately considered and will ensure the response is reviewed timely.* Any specific concerns raised will be discussed before a final Form 886-A, Explanation of Items, is prepared.

*This AOF IDR is not subject to the IDR enforcement process:* however, the response or lack of response to the IDR will be referenced as part of the final Form 886-A when the Form 5701, Notice of Proposed Adjustment, is issued. It is the taxpayer’s responsibility to ensure all relevant facts have been identified and presented to support the tax position taken on their return. For additional guidance see IRM 4.46.4.10 and IRM 8.6.1.6.5, Taxpayer Provides New Information.

(IRM Exhibit 4.46.4-3)
AOF IDR – RESPONSE

• Whether to respond?

• When to respond?
  o Careful review.
  o Clear description of legal position.

• How to respond?
  o Facts; not legal arguments.
  o Characterization of facts.
  o Missing relevant facts.
  o Good faith errors; further investigation; and changes in IRS theories of adjustment.
PROACTIVE APPROACH TO AUDITS
Like any adversarial process, corporate taxpayers must have a “Proactive Approach” to IRS audit.

The “Proactive Approach” includes three elements:

(i) “Coordination & Consistency”;
(ii) Organization; and
(iii) “Offensive Strategy”.
“Coordination & Consistency” ensures transactions and audit responses are coordinated and consistently applied among all interested parties.

Consider meeting with drafters of documents, tax department, and any potential third parties.

Consider audits at the state level & internationally and ensure consistent message.
• Arguably most important aspect of any intense audit—organization of all agreements, correspondence (including e-mails), audit defense files, written responses to IRS, and documents turned over.

• One central location & document manager who is familiar with case.

• Helps with Appeals & litigation—can show what was shared.

• Helps create timelines, highlight favorable and unfavorable documents, and tracks responses internally.

• Should be protected by attorney-client privilege.
## SAMPLE IDR RESPONSE CHART

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<td></td>
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<td>Description of business</td>
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<td></td>
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<td>Flow of goods and services</td>
<td>Hannah B.</td>
<td>Provided</td>
<td>No</td>
<td></td>
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<tr>
<td>2/22/2016</td>
<td>IDR-2</td>
<td>Transfer pricing methodologies</td>
<td>Colton U.</td>
<td>Hopping over a Fence</td>
<td>Yes. Redact names for privacy law concerns</td>
<td>Clemson</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Foreign financial statements</td>
<td>Demi</td>
<td>Provided</td>
<td>Yes. Redact any confidential notes (i.e. litigation)</td>
<td>FSU</td>
</tr>
<tr>
<td>2/22/2016</td>
<td>IDR-3</td>
<td>Foreign tax returns</td>
<td>Demi</td>
<td>In Process of Compiling</td>
<td>Yes. Redact names for privacy law concerns</td>
<td>Documents are in Portuguese</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Reconciliation of foreign financial statements to foreign tax returns</td>
<td>Hannah G.</td>
<td>In Process of Compiling</td>
<td>No</td>
<td>FSU</td>
</tr>
</tbody>
</table>
OFFENSIVE STRATEGY

• **Offensive Strategy includes:**
  
  o Never give something for nothing—i.e., statute extensions.
  
  o Walking through IDR.s—what does the IRS really want or need.
  
  o Elevating issues to managers and beyond.
  
  o Generally, do not agree to prepare new documents or returns.
1. Consider risk of audit at all transaction stages:
   – pre-transaction;
   – post-transaction; and
   – pre-return/financial statement preparation.
2. Consider the privileges at every stage.
4. Consider what transactional documents must be retained.
5. Address what IRS is really requesting.
6. The truth, the whole truth, and nothing but the truth.
STRATEGIES FOR HANDLING FBAR AUDITS, OPT-OUTS, APPEALS AND LITIGATION
OVERVIEW

• Report of Foreign Bank and Financial Accounts (FBAR) Requirements
• The concept of “willful” violations
• Severity of FBAR penalties
• Taxpayer strategies
  o Pre-Audit
  o Opt Out
  o Audit
  o Appeals
  o Litigation
Report of Foreign Bank and Financial Accounts (FBAR)

- **Who**
  - U.S. person;
  - Signature authority or financial interest in foreign financial account(s) with aggregate value exceeding $10,000.

- **When**
  - April 15th following the calendar year reported.
  - An automatic extension to October 15th.

- **Record keeping**
  - Name on the account;
  - Account number;
  - Name and address of the foreign bank;
  - Type of account; and
  - Maximum value during the year.
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 an FBAR violation as “a voluntary, intentional violation of a known legal duty.”

• The manual further defines willfulness to include the concept of “willful blindness”:
  o Attributed to a person who made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements.
## 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>• $1,118</td>
<td>• N/A</td>
<td>31 U.S.C. § 5321(a)(6)(A)</td>
</tr>
<tr>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td><strong>Non-Willful – Failure to File or Retain Records</strong></td>
<td>• $12,921&lt;br&gt;• Reasonable cause defense available</td>
<td>• N/A</td>
<td>31 U.S.C. § 5321(a)(5)(B)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>Willful – Filing False FBAR</strong></td>
<td>• greater of $129,210 or 50% of account balance at the time of the violation</td>
<td>• $10,000 or 5 years or both</td>
<td>31 U.S.C. § 5321(a)(5)(C); 31 C.F.R. § 103.59(d)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>Willful – Failure to File or Retain Records</strong></td>
<td>• greater of $129,210 or 50% of account balance at the time of the violation</td>
<td>• $250,000 or 5 years or both</td>
<td>31 U.S.C. § 5321(a)(5)(C); 31 C.F.R. § 103.59(b)</td>
</tr>
</tbody>
</table>
## Taxpayer Strategies – Pre-Audit

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Streamline Program</th>
<th>Delinquent Submission Procedures</th>
<th>Voluntary Disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>• U.S. individuals</strong>&lt;br&gt;<strong>• Certify failure was non-willful</strong>&lt;br&gt;<strong>• IRS has not initiated an audit for any tax year</strong>&lt;br&gt;<strong>• Pay previous penalties assessed relating to “quiet disclosures”</strong>&lt;br&gt;<strong>• File delinquent FBARs for 6 most recent years</strong>&lt;br&gt;<strong>• File or amend returns for 3 most recent years</strong>&lt;br&gt;<strong>• Pay tax due on returns</strong></td>
<td><strong>• Not under civil exam or criminal investigation by IRS</strong>&lt;br&gt;<strong>• Not already contacted by IRS about delinquent FBARs</strong>&lt;br&gt;<strong>• Include a statement explaining why FBARs are being filed late</strong>&lt;br&gt;<strong>• File all delinquent FBARs electronically</strong></td>
<td><strong>• Request preclearance from CI</strong>&lt;br&gt;<strong>• Submit to CI a narrative of facts and circumstances, assets, entities, related parties and any prof’l advisors involved</strong>&lt;br&gt;<strong>• Submit all required returns and reports for the disclosure period</strong>&lt;br&gt;<strong>• Examinations of the most recent six tax years</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Benefits</strong></td>
<td><strong>Taxpayer residing in US:</strong> 5% misc. offshore penalty of the highest aggregate acct balance for 6 year FBAR and 3 year return period&lt;br&gt;<strong>Taxpayer residing outside US:</strong> No penalty</td>
<td><strong>No penalty if taxpayer reported, and paid all tax on, income from accts reported on delinquent FBARs</strong>&lt;br&gt;<strong>FBARs will not be automatically subject to audit</strong>&lt;br&gt;</td>
<td><strong>Civil fraud penalty under I.R.C. §§ 6663 or 6651(f) for at least one tax year with highest liability</strong>&lt;br&gt;<strong>Willful FBAR penalties</strong>&lt;br&gt;<strong>Can request I.R.C. § 6662 accuracy-related penalties not on a willful basis</strong></td>
</tr>
</tbody>
</table>
Taxpayer Strategies – Opt-Outs

• For the 2014 OVDP, FAQ 51 provided “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” was an irrevocable election by a taxpayer to have his case handled under the standard audit process.

• IRS took OVDP opt-outs seriously.

• On November 20, 2018, the IRS published the “Updated Voluntary Disclosure Practice”.

• The Updated Voluntary Dispute Practice does not specifically address opt-outs.
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 Independent Office of Appeals has long had a mission to “resolve Federal tax controversies without litigation on a basis which is fair and impartial to both the Government and the taxpayer… .” I.R.C § 7803(e)(3).

• 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; and
  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:
    ▪ Interest, collection costs and penalties under the FDCA accrue, which can amount to more than 30% over the two-year period.
Taxpayer Strategies – Litigation

• Sue first – pay all or part of the penalties and sue for a refund.
  o Taxpayer must:
    ▪ Bring an action within two years of the 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.
Antoinette Ellison, an accomplished lawyer with more than 15 years of experience, represents taxpayers in all aspects of tax controversies and litigation involving the IRS and state and local tax authorities. She regularly resolves tax examinations by the IRS and state and local jurisdictions as well as successfully represents taxpayers in administrative appeals including before the IRS Office of Appeals. She handles civil tax litigation matters in trials in the U.S. Tax Court and U.S. District Court.

Antoinette represents a broad range of taxpayers including multinational corporations, financial institutions, closely held businesses, and high net worth individuals. She has experience representing clients involved in the IRS Collection Process in negotiating offers in compromise and installment agreements and requesting collection due process hearings to appeal IRS lien and levy actions.

She is an active member of the State Bar of Georgia Tax Section and is the current chair-elect. She is also a columnist for the Journal of Taxation, IRS Rulings column.

Antoinette strongly believes in civic engagement and is proud to serve on the Special Olympics Georgia board.