

# ***INTERNATIONAL TAXATION AND REPORTING ISSUES***

***“Practical Tax Savings, Tips, Traps,  
and Solutions”***

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**Kurt Kawafuchi, Esq.  
Hochman, Salkin, Rettig, Toscher & Perez, P.C.  
Office: (310) 281-3288  
Cell: (808) 258-3383  
Email: [kawafuchi@taxlitigator.com](mailto:kawafuchi@taxlitigator.com)  
Visit our website at [www.taxlitigator.com](http://www.taxlitigator.com)**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **WHAT TYPE OF CLIENTS MAY HAVE TO FILE INTERNATIONAL FORMS?**
  - **Immigrated to U.S. (currently-green card or citizen)**
  - **Dual residents or citizens**
  - **Foreign citizen or resident but U.S. asset(s), income or business**
  - **U.S. person who lived or worked abroad**
  - **Green card, sufficient physical presence in U.S., or intent with presence in U.S.**
  - **Foreign ties by family, friends, assets, income, entities including foreign trusts**
  - **Single-member LLC (Disregarded)- member is not U.S. person**
    - **Caveat: Nominee, agent, alter ego, and/or IRC §2036**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **U.S. Person (U.S. Income Taxation - General test)**
  - **Individuals: U.S. citizens and U.S. residents**
    - **Permanent Resident Alien (i.e., Green Card holder) or 183 physical present test (IRC§7710(b))**
  - **U.S. Partnerships**
  - **U.S. Corporations**
  - **Estate other than a foreign estate**
  - **Domestic Trusts**
- **U.S. Citizens & Resident for U.S. Estate, Gift, and GST purposes**
  - **U.S. Resident defined under Reg. §20.0-1(b) & §25.2501-1(b)**
  - **U.S. Domicile: Living or Residing in U.S. with Intent**
  - **Subject to worldwide transfers**
  - **Residing (living) with indefinite intent to reside in U.S.**
  - **Intent without physical move insufficient**
  - **Physical move without intent insufficient**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **U.S. PERSON FOR U.S. INCOME TAXATION**
  - **IRC §7701(b): 2 TESTS:**
- **(1) GREEN CARD TEST**
- **(2) SUBSTANTIAL PRESENCE TEST**
  - **Sum of Three Year Test:**
  - **100% of number of days in current year**
  - **1/3 of number of days in prior year**
  - **1/6 of number of days in second prior year**
  - **If sum is 183 or greater, U.S. resident for income taxation**
  - **Certain exceptions including medical conditions, certain teachers and professional athletes, and full-time students.**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **TAX TREATY EXCEPTION**
- **TREATIES VARY BUT GENERAL TIE BREAKER TESTS:**
  - Permanent Home
  - Center of Vital Interests (Closer Economic and Personal Ties)
  - Habitual Abode
  - Nationality (i.e., Citizenship)
  - Competent Authority
- **EVEN IF TREATY NON-RESIDENT,**
  - **IRS: MAY STILL HAVE U.S. TAX REPORTING OBLIGATIONS, e.g., Form 5471 of foreign corporations**
  - **Risk to U.S. Permanent Resident Alien (i.e., Green Card status) for U.S. Immigration status if claim to be a U.S. tax nonresident**

**IF U.S. RESIDENT: WORLDWIDE INCOME TAX & U.S. REPORTING REQUIREMENTS**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **DUAL CITIZENS**

- **Possibly taxed on worldwide taxation by >1 country—**
  - If so, generally credits from income source country
  - Possible treaty relief for dual citizen, i.e., tie-breaker rules
  - Generally, still subject to U.S. income tax and reporting

- **U.S. INCOME TAX - NONRESIDENT NONCITIZEN**

- **U.S. source income**
  - 30% withholding tax on gross income
- **Effectively connected income with a U.S. trade or business**
  - Pay regular U.S. tax on taxable income: (income – deductions) and credits
- **FIRPTA (10% of Amount realized  $\geq$  Sales Price)**
- **Many states like Calif. and Hawaii have state FIRPTA, e.g., HARPTA**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FOREIGN TAX CREDITS**
  - **Generally allowed by residency country for income earned from source country**
  - **Two limits:**
    - **General limit: lesser of actual tax or U.S. tax on income**
    - **Basket Limit: (1) Passive and (2) General/Other Basket**
  - **IRS may sometimes seek to limit credit if green card holder living abroad & entitled to lower tax treaty withholding rate and allow tax treaty rate rather than actual tax rate and residence income tax rate paid**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Nonresidents Non-Citizens**
- **U.S. Special Estate & Gift Tax Rules**
  - U.S. estate & gift tax “resident” different than income tax
  - Double check for treaty definition
  - No \$5.43 million estate, gift & GST exemption
  - \$0 for gift tax exemption unless treaty allows exemption
  - \$60,000 for estate tax unless treaty allows increased exemption
  - U.S. resident likely eligible for \$5.43 million even if illegal
  - No gift splitting (both spouses must be citizens or residents at time of gift and both consent)
  - No unlimited marital deduction if noncitizen spouse or treaty



# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Nonresidents Non-Citizens: Special Estate & Gift Tax Rules – Marital Deduction (Cont'd)**
  - Unlike exemption, citizenship or residency of *donor/decedent* does not determine eligibility for unlimited marital deduction
  - Determined by *recipient* spouse
  - Thus, unlimited marital deduction allowed if U.S. citizen recipient spouse, or treaty allows (IRC §§2056(d)(1) and 2523(i)).

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Nonresidents Non-Citizens: Special Estate & Gift Tax Rules – Marital Deduction (Cont'd)**
  - **Expanded gift tax annual exclusion for spouse (\$143,000 in 2013)**
  - **Unlimited marital if U.S. citizen surviving spouse**
    - **Query: Late return? Penalty?**
  - **Otherwise, QDOT.**
    - **Taxed on distributions of principal except hardship**
    - **Will pay estate tax**
    - **Not as beneficial as normal marital deduction trust**
  - **IRC §2056A. Can possibly seek court approved reformation of marital *after* death.**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Nonresidents Non-Citizens of U.S. Special Rules**
  - **Hawaii bulk sales law: HRS §237-43 (FormG8A)**
    - **Transfer of all or large part of assets**
    - **Personal liability for all Hawaii taxes including unknown**
    - **Personal liability amount is lesser of FMV of asset(s) or unpaid Hawaii taxes, known or unknown**
    - **Tax clearance, then bulk sales --- leave sufficient time**
  - **Hawaii conveyance tax: leases of  $\geq 5$  years**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **U.S. Departure Tax (i.e., Exit Tax)(after 6/16/08): Form 8854**
  - **Former 10 year tax avoidance rule, e.g., 877, 2107, etc.**
  - **Applies to U.S. citizens or long-term residents**
    - **8 taxable years; could be < 8 full years, e.g., 12/31/X1, X2-X7, 1/1X8**
  - **Certain income or asset thresholds**
    - **\$2 million net worth, average net income tax >\$151k in prior 5 years, or failure to certify on Form 8854 that complied with all U.S. tax obligations for prior 5 years**
  - **Now, deemed sale upon expatriation (mark to market rule)**
    - **2013: Excess gain over \$668,000**
  - **Certain exceptions, e.g., deferred compensation, dual residents, etc., and can elect to defer tax**
    - **For U.S. citizens, be careful of the interview to renounce U.S. citizenship--  
-may be permanently barred if tax avoidance (Reed Amendment).**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Retained Interests (IRC 2036)**
  - **100% includible at FMV death if retain any interest, income, benefits, use, possession, control, right to control. Gift at lifetime transfer but generally reversed under IRC 2036**
  - **Possibly very draconian—applies to everyone**
  - **Reverses prior taxable gift. Gift tax payable restored.**
  - **In certain cases, could present a tax benefit**
    - **If 2036 applies and little or no estate tax but possible step-up. Beware: possible step down**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Joint or Tenants by the Entirety (IRC 2040)**
  - **100% includible if surviving spouse not U.S. citizen or treaty treats like U.S. citizen**
    - **Contribution rule**
      - **In determining contribution, tracing rule applies except no tracing for income contributed**
    - **Contrib. rule applies to a spouse (not 50/50 rule) if surviv. spouse is not a U.S. citizen or entitled to treaty benefits**
    - **If surviving spouse is U.S. citizen or entitled to treaty benefits, only 50% included in decedent's estate regardless of contributions.**
    - **Pro-rata if gift or inheritance from third-party**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Estate and Gift Tax Collections**
  - Normal tax liens, levies, seizures, etc.
  - **6324 “Super” special unrecorded estate and gift tax lien, and personal liability against fiduciaries, beneficiaries and persons in control of property**
  - **31 U.S.C. Section 3713**
    - Personal liability
    - U.S. priority 31 U.S.C. Section 3713

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Tenants by the Entirety**
  - **Advantages**
    - **Super creditor protection against debts owed by 1 partner**
    - **May be available to same sex and civil unions (e.g., Hawaii)**
    - **Avoids probate**
  - **Disadvantages**
    - **Divorce – converts to tenants in common**
    - **Death – surviving spouse succeeds to decedent's interest**
    - **Possible new Hawaii law on transfers to trusts**



# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Permitted Transfers to Trust Act, i.e., Dynasty Trusts**
  - **Creditor protection**
  - **Possible tax savings from minimizing or avoiding transfer taxes, e.g., Dynasty or generation-skipping aspect**
  - **Expanded types of assets**
  - **Relaxed solvency requirements**

# ***REPRESENTING INTERNATIONAL CLIENTS***

**“If you are a US individual holding overseas assets, you must report and pay your taxes or we will be increasingly focused on finding you”**

Douglas H. Shulman,

Commissioner of Internal Revenue

Washington, D.C. , Oct. 26, 2009

# ***REPRESENTING INTERNATIONAL CLIENTS***

## ***Who Has Money Abroad?***

- **Historical reasons**
- **War and persecution**
- **Families with international presence**
- **Americans living overseas for a time**
- **American business interests**
- **Inheritance, gifts**
- **Diversification**
- **Tax Cheats...**

# **Common Foreign Information Returns**

**Form 5471 – Controlled Foreign Corporations**

**Form 8865 – Controlled Foreign Partnerships**

**Form 5472 – US Corp with 25% Foreign Ownership**

**Form 3520 – Foreign Trust Transactions**

**Form 3520A – Annual Foreign Trust Return**

**Form 926 – Transfers to a Foreign Corporation**

**Form 8854 – Expatriation Information**

**Form 8898 – Resident of U.S. Possession**

**Form 8938 – Statement of Specified Foreign  
Financial Accounts**

**FinCEN 114 – Foreign Bank Account Report**

# Summary of FBAR Penalties

<b>Violation</b>	<b>Civil Penalty</b>	<b>Criminal Penalty</b>	<b>Comments</b>
<b>Any Negligent Violation</b>	<b>Not more than \$500 for each negligent violation</b>	<b>N/A</b>	<b>31 U.S.C. § 5321(a)(6)(A), 31 C.F.R. 103.57(h). The penalty generally applies to businesses only.</b>
<b>Pattern of Negligent Activity</b>	<b>In addition to penalties under the Negligent Violation with respect to any such violation, not more than \$50,000</b>	<b>N/A</b>	<b>31 U.S.C. § 5321(a)(6)(B) The penalty generally applies to businesses only.</b>
<b>Non-Willful Violation</b>	<b>Up to \$10,000 for each negligent violation</b>	<b>N/A</b>	<b>31 U.S.C. § 5321(a)(5)(b)</b>

# Summary of FBAR Penalties

Violation	Civil Penalty	Criminal Penalty	Comments
<p><b>Willful - Failure to File TD F 90-22.1 or retain records of account.</b></p>	<p><b>Penalty: the greater of \$100,000 or 50% of the account balance at the time of the violation</b></p>	<p><b>Up to \$250,000 or 5 years or both</b></p>	<p><b>31 U.S.C. § 5321(a)(5)(c), for civil, and 31 U.S.C. § 5322(a) and 31 C.F.R. § 103.59(b) for criminal. The penalty applies to all U.S. persons.</b></p>
<p><b>Willful - Failure to File TD F 90-22.1 or retain records of account while violating certain other laws</b></p>	<p><b>Penalty: the greater of \$100,000 or 50% of the account balance at the time of the violation</b></p>	<p><b>Up to \$500,000 or 10 years or both</b></p>	<p><b>31 U.S.C. § 5322(b) and 31 C.F.R. § 103.59(c) for criminal. The penalty applies to all U.S. persons.</b></p>
<p><b>Knowingly and Willfully Filing False TD F 90-22.1</b></p>	<p><b>Penalty: the greater of \$100,000 or 50% of the account balance at the time of the violation</b></p>	<p><b>\$10,000 or 5 years or both</b></p>	<p><b>18 U.S.C. § 1001, 31 C.F.R. § 103.59(d) for criminal. The penalty applies to all U.S. persons.</b></p>

# OFFSHORE ASSETS

*McBride v. United States (D. UT 2012)*

- **Definition of Willfulness**
  - *Williams & McBride* opinions broaden the test
    - **What did the return preparer know?**
    - **Was the box checked “no”?**
    - **Badges of fraud – concealment, tax loss, etc.**

# Meet Carl R. Zwerner

## The Facts

- 86 years old gentleman living in Florida
- Foreign account disclosed on timely filed 2007 Form 1040 – FBAR and 1040X filed – 10/13/2008
- Tax counsel contacted IRS CI – 02/10/2009
  - Non-client specific contact re 2004-2007
- CI letter “no criminal referral” – 02/17/2009
- FBARs and Forms 1040X filed for 2004, 2005 & 2006 – 03/27/2009

**NO IRS EXAMINATION AS OF 03/27/2009**



# Meet Carl R. Zwerner

## IRS Audit Begins in 2010

- Audit re tax years 2004-2007 but agent referenced extending audit to 1992 !
- **GOV'T** – Zwerner admitted to “willful misconduct” in failing to file FBARs in letter dated 08/09/10
- **ZWERNER** – letter of 08/09/10 was dictated by the agent as “the only way he would be able to obtain a reduction of the penalties that might otherwise apply”
- *United States v. Williams* (4th Cir. 2012)
- *McBride v. United States* (D. UT 2012)

# Meet Carl R. Zwerner

## The Audit

- **Attempted to enter 2011 OVDI during audit**
  - **2009 OVDP**, 03/26/09 to 10/15/09 (20% Penalty)
  - **2011 OVDI**, 02/08/11 to 09/09/11 (25% Penalty)
  - **2012 OVDP**, 01/09/12 – present (27.5% Penalty)
- **Civil Fraud Penalty Assessed (75% of income tax)**
  - Conceded by IRS Appeals – 2004 and 2005
  - Abated by U.S. Tax Court – 2006
  - Not asserted – 2007

# U.S.A. vs. Carl R. Zwerner

Case # 1:13-cv-22082-CMA (SD Florida, June 11, 2013)

- **FBARS Filed – Due June 30**

- 2007 FBAR and 1040X filed 10/13/2008
- 2004, 2005 & 2006 FBARs and 1040X's filed 3/27/2009, (BEFORE the audit commenced)

- **50% FBAR Penalties Assessed - 31 U.S.C. § 5321**

- 2004 – \$723,762 (on June 21, 2011)
- 2005 – \$745,209 (on August 10, 2011)
- 2006 – \$772,838 (on August 10, 2011)
- 2007 – \$845,527 (on August 10, 2011)

# U.S.A. vs. Carl R. Zwerner

Case # 1:13-cv-22082-CMA (SD Florida, June 11, 2013)

- **FBAR Liability** – \$3,488,609.33 (as of June 6, 2013)
- **Highest Account Balance** – \$1,691,054 (at any time between 2004 – 2007)
- **Criminal FBAR Cases** – one-year, 50% FBAR penalty
- **Eighth Amendment to the U.S. Constitution** – a civil penalty is unconstitutional if the penalty is at least in part “punishment” and such punishment is *grossly disproportionate to the conduct which the penalty is designed to punish*

# THE DOJ PROGRAM FOR SWISS BANKS

- Department of Justice has 14 banks under investigation – other Swiss banks are eligible for a non-prosecution agreement or non-target letter
  - New tack on DOJ policy in prosecuting business entities
- Program requires substantial disclosures of US related account information (not names) dating back to Aug. 1, 2008, as well as potentially large penalties
  - US will then use treaty to get the names
- Account holders under more pressure to come forward – they avoid prosecution, and bank gets reduced penalty

# TAX ENFORCEMENT FOCUS ON UNDECLARED FOREIGN FINANCIAL ACCOUNTS

- If the initial contact is by the IRS, a purely civil tax resolution is no longer certain and significant civil penalties are likely
- If the initial contact is by the Department of Justice, a purely civil tax resolution is anything but certain and is perhaps unlikely.

## **DOJ Letter Re Investigation of undeclared Foreign Financial Accounts**

The Department of Justice is conducting an investigation of U.S. taxpayers who may have violated federal criminal laws by failing to report they had a financial interest in, or signature authority over, a financial account located in a foreign country. We have reason to believe that you had an interest in a financial account in India that was not reported to the IRS on either a tax return or FBAR, Department of Treasury Form TD F 90-22.1, report of Foreign Bank and Financial Account. You are advised that the destruction or alteration of any document that may relate to this investigation constitutes a serious violation of federal law, including but not limited to obstruction of justice . . . You are further advised that you are a subject of a criminal investigation being conducted by the Tax Division [of the Department of Justice].”

# NEW OFFSHORE COMPLIANCE OPTIONS

- Offshore Voluntary Disclosure Program
- **New 50% Penalty (effective 8/4/14)**
  - If publicly-known that financial institution or person is under investigation, e.g., a John Doe summons. Cannot rely upon IRS list.
- Streamlined Filing Compliance Procedures
  - US Persons Living Outside the United States
  - US Persons Living Inside the United States
    - Possible 5.0% penalty of certain foreign financial assets
    - Certification of Non-willfulness
    - If IRS disagrees, risk full audit and one or more 50% penalties
- Delinquent FBAR Procedure
- Delinquent International Information Return Procedure
- Traditional voluntary disclosures: Still viable?

# OFFSHORE COMPLIANCE

## *Now What?*

- The vast majority of 38,000+ taxpayers participating in the 2009, 2011 and 2012+ IRS Offshore Voluntary Disclosure programs previously filed returns prepared by preparers – preparers the IRS might believe were complicit in the non-compliance or possibly less than diligent in preparing the original returns
- Practitioners must exercise due diligence re preparation of returns and documents and in determining the correctness of representations to the client and to the IRS – CIR 230 §10.22
  - Practitioners are presumed to have exercised reasonable care and due diligence when relying upon work product.

-- Were you intentionally ignorant?



# OFFSHORE COMPLIANCE

- **Retrospective Cleanup v. Prospective Compliance**
  - No obligation to go back
  - BUT . . . Preparer must advise regarding potential penalty exposure (Cir. 230 § 10.33) and to comply going forward
  - Other vehicle for IRS to learn that account was held in prior years
    - Will a first time FBAR ping the system?
    - \$ threshold for IRS enforcement efforts?

# IRS VOLUNTARY DISCLOSURE PRACTICE

IRM 9.5.11.9 (12-02-2009)

- Informal – an issue to be considered in decision re criminal prosecution referral by IRS to the Department of Justice
- No substantive or procedural rights for taxpayers
- Cannot rely on the fact that other similarly situated taxpayers may not have been recommended for criminal prosecution
- Requires truthful, timely and complete disclosure

# Practitioner Standards

## CIR 230 §10.34

- Must advise client of opportunities to avoid penalties through disclosure and the requirements for an adequate disclosure
- May rely in good faith, without verification, upon information furnished by the client
- Must make reasonable inquiries if information received or assumptions appear incorrect or incomplete
- Must advise client of potential penalties re:
  - Positions on returns you prepared or positions where you rendered advice
  - Any documents submitted to the IRS

# IRS VOLUNTARY DISCLOSURE PRACTICE

IRM 9.5.11.9 (12-02-2009)

- IRS practice since 1952 - encourage voluntary compliance
  - Legal source income
    - Timely – disclosure before IRS has initiated an examination or otherwise has information re taxpayer (Informant?)
  - Truthful and complete
- Taxpayer must
  - Fully cooperate with IRS
  - Make good faith arrangements to pay any tax, interest, and penalties determined by the IRS to be due
  - Disclose every aspect of noncompliance

# IRS VOLUNTARY DISCLOSURE PRACTICE

IRM 9.5.11.9 (12-02-2009)

- Will not automatically guarantee immunity from prosecution – however, a voluntary disclosure may result in prosecution not being recommended by IRS (no “referral” the Department of Justice for prosecution)
- IRS representatives to refrain from offering opinions or discussing hypothetical investigations with anonymous taxpayers or his/her representatives – may inquire as to reasons why they are making the voluntary disclosure

# VOLUNTARY DISCLOSURE COMMUNICATIONS

IRM 9.5.11.9.6 (11-01-2011)

- **No specified format required** – information may be provided either verbally or in writing – must identify taxpayer and provide a brief description of all omitted income, the tax scheme used by the taxpayer, and a dollar estimate of the total taxes owed
- **Statement must be made by the taxpayer** (either verbally or in writing) that they are willing to cooperate with the IRS in determining the correct tax liability and make good faith arrangements to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable in full. This is critical
- **TP may submit amended returns** with their voluntary disclosure communication or wait to submit amended returns until after Criminal Investigation evaluates the communication and makes a recommendation to SB/SE Planning and Special Programs Unit (PSP) or LB&I Offshore Identification Unit (POIU)

# IRS VOLUNTARY DISCLOSURES

## Disqualifying Factors

IRM 9.5.11.9.5 (12-02-2009)

- Are you currently the subject of a criminal investigation or civil examination? (If yes, specify)
- Has the IRS notified you that it intends to commence an examination or investigation? (If yes, specify)
- Are you under investigation by any law enforcement agency? (If yes, specify)
- Is the source of any of your income from illegal activity? (The IRS voluntary disclosure practice does not apply to taxpayers with illegal source income.) (If yes, specify)
- Do you have any reason to believe that the IRS has obtained information concerning your tax liability? (If yes, specify)

# IRS VOLUNTARY DISCLOSURE PRACTICE

Examples of timely voluntary disclosures include . . .

IRM 9.5.11.9 (12-02-2009)

(6) Examples of timely voluntary disclosures include:

(A). A letter from an attorney which encloses amended returns from a client which are complete and accurate (reporting legal source income omitted from the original returns), which offers to pay the tax, interest, and any penalties determined by the IRS to be applicable in full and which meets the timeliness standard set forth above.

This is a voluntary disclosure because all of the elements of a voluntary disclosure have been met



**Department of Justice**  
**VOLUNTARY DISCLOSURE POLICY**

Section 4.01, Criminal Tax Manual, U.S. Department of Justice (2008)

Whenever a person voluntarily discloses that he or she committed a crime before any investigation of the person's conduct begins, that factor is considered by the Tax Division along with all other factors in the case in determining whether to pursue criminal prosecution.

If a putative criminal defendant has complied in all respects with all of the requirements of the Internal Revenue Service's voluntary disclosure practice, the Tax Division may consider that factor in its exercise of prosecutorial discretion. It will consider, *inter alia*, the timeliness of the voluntary disclosure, what prompted the person to make the disclosure, and whether the person fully and truthfully cooperated with the government by paying past tax liabilities, complying with subsequent tax obligations, and assisting in the prosecution of other persons involved in the crime.

# Department of Justice

## POLICY DIRECTIVES AND MEMORANDA

### Section 3, Policy Directives and Memoranda

#### Tax Division, U.S. Department of Justice (02/17/1993)

. . . the Service's voluntary disclosure policy remains, as it has since 1952, an exercise of prosecutorial discretion that does not, and legally could not, confer any legal rights on taxpayers.

If the Service has referred a case to the Division, it is reasonable and appropriate to assume that the Service has considered any voluntary disclosure claims made by the taxpayer and has referred the case to the Division in a manner consistent with its public statements and internal policies. As a result, our review is normally confined to the merits of the case and the application of the Department's voluntary disclosure policy set forth in Section 4.01 of the Criminal Tax Manual

# ***REPRESENTING INTERNATIONAL CLIENTS***

## **Lesser Known International Tax Forms covered in subsequent slides**

- Form 706-NA and 709
- Form 926
- Form 8865
- Form 5472
- Form 5471
- Form 3520-A
- Form 3520
- FBARs and Form 8938
- Primer on Subpart F and PFICs and Form 8621

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Tax Returns and Information Reporting**
  - **Form 706-NA: Generally, if > \$60,000**
  - **Form 709**
    - **>\$14,000, future interests, or noncitizen spouses >\$143k**
  - **Form 3520 Annual Return to Report Transactions with Foreign Trusts and Recipient of Certain Foreign Gifts**
    - **>\$100,000 from a nonresident alien individual (NRA) or foreign estate (FE) (Must aggregate gifts from related foreign persons) as gifts or bequests**
    - **>\$15,102 (2013) from foreign corporations or partnerships (including foreign persons related to such foreign corporations or partnerships)**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Form 926 Return by a U.S. Transferor of Property to a Foreign Corporation (IRC Section 6038B).**
  - Taxpayers are required to report transfers of property to foreign corporations and other information under IRC Section 6038B.
  - Penalty is 10% of the value of property transferred, up to a maximum of \$100,000 per return, with no limit if the failure to report the transfer was intentional

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships: IRC Sections 6038, 6038B, and 6046A.**
  - **U.S. persons with certain interests in foreign partnerships use this form to report interests in and transactions of foreign partnerships, transfers of property to the foreign partnerships, and acquisitions, dispositions, and changes in foreign partnership interests under IRC Sections 6038, 6038B, and 6046A.**
  - **Penalties include \$10,000 per return, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return, and ten percent of the value of any transferred property that is not reported, subject to a \$100,000 limit.**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FORM 5472 – Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business**
  - **Who must file? Reporting corporation must file if it had a reportable transaction with a foreign or domestic related party—virtually all types of transactions including loans**
  - **\$10,000 penalty. Penalty increases by \$10,000 per each 30 days after IRS notice.**
  - **Potential criminal penalties. 7203, 7206, and 7207**

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FORM 5471 – Information Return of U.S. Persons with Respect to Certain Foreign Corporations**
  - Who must file? Certain U.S. persons who are shareholders, officers, or directors of a foreign corporation.
  - Foreign corporation includes International Business Company or limited liability company that does not elect to be treated as a partnership or disregarded entity.
  - U.S. person includes U.S. citizen or resident or a U.S. corporation, partnership, trust or estate.



# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FORM 5471 - Five (5) Categories**

- Category 1: Repealed in 2004.
- Category 2: U.S. citizen or resident who is a director or officer in a foreign corporation *and* a U.S. person (e.g., could be a different U.S. person) has acquired stock meeting the 10% ownership requirement (e.g., reaches 10%) or an additional 10% or more (by vote or value) of the outstanding stock of a foreign corporation.
  - U.S. person acquires stock in a foreign corporation when that person has an unqualified right to receive the stock even though the stock is not issued.

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FORM 5471 - Category (1) to (5) Filers**

- For Category 2 and 3:

- Stock ownership is met by vote or value.
- U.S. person is a U.S. citizen or resident, partnership, domestic corporation, domestic estate or trust.

- Category 3:

- U.S. person acquires additional stock to reach 10%
- U.S. person acquires additional stock of at least 10%
- A person is treated as U.S. shareholder under 953(c) of a foreign corporation (i.e., captive insurance company)
- A person become a U.S. person while meeting 10% ownership requirement
- A U.S. person disposes of stock to less than the stock ownership requirement, e.g., falls below 10%

# *REPRESENTING INTERNATIONAL CLIENTS*

- **FORM 5471 - Category (1) to (5) Filers**

- For Category 4:

- *A U.S. person who had control* of a foreign corporation for at least 30 consecutive days during accounting period of foreign corporation.
- U.S. person in Categories 2 and 3 above include U.S. persons *plus* nonresidents electing to be treated as a resident under 6013(g) and nonresidents who become U.S. residents during year and are married at close of year to a U.S. citizen or resident.
- “Control” is > 50% of combined voting power or value.
- If a person controls a corporation that in turn owns >50% of the combined voting or value of another corporation, such person is in control of the second corporation.

# *REPRESENTING INTERNATIONAL CLIENTS*

- **FORM 5471 - Category (1) to (5) Filers**
  - For Category 5:
    - A *U.S. shareholder* who owns stock in a controlled foreign corporation (CFC) for 30 consecutive days or more, *and* who owned that stock on the last day of the year.
    - U.S. shareholder is a U.S. person who owns (directly, indirectly, or constructively) within 958(a) *and* 10% or more of the combined voting power of CFC, *or*
    - Owns (directly, indirectly, or constructively) any stock of a CFC (defined under 953(c)(1)(B) and 957(b)) that is also a captive insurance company

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FORM 5471 - Category (1) to (5) Filers**
  - For Category 5:
    - U.S. person is same as Categories 2 and 3 (not 4)
    - CFC is a foreign corporation that has U.S. shareholders that own (directly, indirectly, or constructively) within 958(a) and (b) on any day of the foreign corporation's tax year >50% of combined voting power or value.

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FORM 5471 – IRC Sections 6038 and 6046**
  - IRC 6038 Controlled Foreign Corporations
    - Categories 4 and 5
    - Generally, IRC Section 318 Attribution applies
      - Certain exceptions to prevent attribution from nonresidents under IRC Sections (c)(1) and (2)
  - IRC 6046 Returns as to Organization or Reorganizations of Foreign Corporations and as to the Acquisition of Their Stock
    - Categories 2 and 3
    - Generally, much broader & deeper attribution rules than 318, like 267, e.g., full lineal ancestors and descendants, ***siblings and attribution from nonresidents***

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FORM 5471 – IRC Sections 6038 and 6046**
  - Separate Schedules
    - Schedule J (Categories 4 and 5)
    - Schedule M (Category 4)
    - Schedule O, Part I (Category 2)
    - Schedule O, Part II (Category 3)
  - Certain Exceptions
    - One person can file applicable schedules for other persons who have same filing requirements
    - Other limited exceptions

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FORM 5471 – IRC Sections 6038 and 6046**
  - \$10,000 penalty. Penalty increases by \$10,000 per each 30 days after IRS notice up to \$50,000.
  - Reduction of 10% of foreign taxes under IRC Sections 901, 902, and 960. Additional 5% reduction after IRS notice for each 3 months or fraction thereof, failure continues
  - Potential criminal penalties. 7203, 7206, and 7207



# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FORM 3520-A: Annual Information Return of a Foreign Trust With a U.S. Owner**
- Who must file? A foreign trust with a U.S. owner must annually file Form 3520-A.
- Each U.S. person treated as an owner of any portion of the foreign trust must file Form 3520-A and provide required annual statements to its U.S. owners and beneficiaries.
- Penalty is greater of \$10,000 or 5% of gross value of trust portion owned by U.S. person

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FORM 3520 Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts (and Inheritances)**
- Responsible party for reporting a reportable event or held an outstanding obligation of a related foreign trust
- U.S. person treated as owner of any part of the assets of a foreign trust under Sections 671-679
- U.S. person received (directly or indirectly) from a foreign trust or related foreign trust held an outstanding obligation issued by taxpayer.

# *REPRESENTING INTERNATIONAL CLIENTS*

- **FORM 3520 Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts (Cont'd)**
- U.S. person and received more than \$100,000 from a nonresident or foreign estate that were treated as a gift or bequest. Caveat: May have to aggregate related gifts or bequests.
- U.S. person received more than \$15,102 from foreign corporations or foreign partnerships that were treated as gifts.

# ***REPRESENTING INTERNATIONAL CLIENTS***

- **FORM 3520 Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts**
  - Penalties: Greater of \$10,000 or 35% of gross value transferred to foreign trust or 35% of gross value of distributions or 5% of the gross value of portion of trust assets owned by U.S. person
  - Penalty for gifts: 5% of the gifts for each month not to exceed 25%
  - IRC Section 6662(j): Penalty for undisclosed foreign financial asset understatements

***REPRESENTING INTERNATIONAL CLIENTS:  
STATEMENT OF SPECIFIED FOREIGN FINANCIAL  
ASSETS (SFFAs)  
IRS Form 8938 / Code § 6038D***

- Form 8938 to attached to and filed with the income tax return
- Filed by the due date for the income tax return, including extensions
- NOT required if no requirement to file income tax return

***REPRESENTING INTERNATIONAL CLIENTS:  
STATEMENT OF SFFAs  
Who Must File Form 8938 ?***

- **“SPECIFIED PERSONS”** – Generally U.S. citizens and residents, certain resident aliens and others (Final Regulations to include domestic entities)
  - **Having an interest in “SPECIFIED FOREIGN FINANCIAL ASSETS” (SFFA)** – Generally, a Specified Person has such an interest if the income or income items, if any, would be required to be reported on their return
  - **If a value exceeding the “THRESHOLD AMOUNT”**

# ***REPRESENTING INTERNATIONAL CLIENTS: STATEMENT OF SFFAs***

## **What is a Specified Foreign Financial Asset?**

- **SFFAs include:**
  - Financial accounts in a foreign financial institution
  - Stock or securities issued by a non-U.S. person
  - Financial instrument or contract issued by or with a non-U.S. person
  - Any interest in any foreign entity
  - Any interest in foreign partnerships, trusts, estates, pensions, life insurance with cash surrender value, options, etc.

# ***REPRESENTING INTERNATIONAL CLIENTS: STATEMENT OF SFFAs***

## **What is NOT a Specified Foreign Financial Asset?**

- **SFFAs do NOT include:**
  - Foreign personal residence or rental real estate unless held in a foreign entity
  - Foreign currency
  - Shares in a U.S. financial institution or a U.S. mutual fund that owns foreign stocks or securities
  - Financial account at a U.S. branch of a foreign financial institution



***REPRESENTING INTERNATIONAL CLIENTS:***  
**STATEMENT OF SFFAs**  
**Asset Threshold - Form 8938**  
**If Living in the U.S.**

- **Single or Married - Separate Return**
  - Value *exceeds* \$50,000 on the last day of the year or \$75,000 at any time during the year
- **Married - Joint Return**
  - Value *exceeds* \$100,000 on the last day of the year or more than \$150,000 at any time during the year

***REPRESENTING INTERNATIONAL CLIENTS:***  
**STATEMENT OF SFFAs**  
**Asset Threshold - Form 8938**  
**If Living Outside the U.S.**

- **Single or Married- Separate Return**
  - Value *exceeds* \$200,000 on the last day of the year or \$300,000 at any time during the year
- **Married - Joint Return**
  - Value *exceeds* \$400,000 on the last day of the year or more than \$600,000 at any time during the year
- **“Living Abroad”** – Bona fide resident of a foreign country for an entire tax year, or present in a foreign country for at least 330 days during any consecutive 12 month period ending in the reported tax year

# ***REPRESENTING INTERNATIONAL CLIENTS: STATEMENT OF SFFAs Form 8938, “Statement of Specified Foreign Financial Assets”***

- **Form 8938 is filed in addition to Fincen Form 114 (former TDF 90-22.1) (FBAR)** – FBARs are due June 30 of the following year and filed in Detroit.
- **Form 8938 is NOT REQUIRED** if the SSFA is otherwise reported on Form 3520, Form 3520-A, Form 5471, Form 8621, Form 8865, or Form 8891
- **Penalty for Failure to File**
  - \$10,000
  - Continuing failure to file more than 90 days after notice mailed by IRS - \$10,000 per 30 day period (or part thereof) after said 90 days up to \$50,000 maximum
  - Reasonable cause exception but exposure to civil penalties or criminal sanctions in foreign jurisdiction is not reasonable cause

# ***REPRESENTING INTERNATIONAL CLIENTS: FBAR OVERVIEW***

## **Report of Foreign Bank and Financial Accounts Form TD F 90-22.1**

- U.S. citizens, residents or a person in and doing business in the U.S. must file an FBAR with the government if they have a financial account in a foreign country with a value exceeding \$10,000 at any time during the calendar year

# ***REPRESENTING INTERNATIONAL CLIENTS: FBAR OVERVIEW***

- US Citizens and residents must report and pay taxes on worldwide income
- FBAR is not a tax return – it is an information report filed with the Treasury
- Deadline for filing FBAR is on or before June 30th the following year
  - NO extensions granted
- FBAR is NOT attached to taxpayer's individual income tax return
- Criminal penalties: Government has brought numerous cases including against beneficiaries

***REPRESENTING INTERNATIONAL  
CLIENTS:  
FBAR OVERVIEW  
Filing Requirements***

- **A United States person must file an FBAR if that person has:**
  - A financial interest in;
  - Signature authority over; or
  - Any other authority over any financial account(s) in a foreign country if their aggregate value exceeds \$10,000 at any time during the calendar year

# ***REPRESENTING INTERNATIONAL CLIENTS: FBAR OVERVIEW Who Must File?***

- **FinCen Form 114 (Effective 1/1/14)  
(Former Form TD F 90-22.1)**
  - U.S. individuals and entities must report “financial interest” in offshore “financial accounts” with value of \$10,000 or greater
    - Direct and indirect ownership
  - Must also report signature or other authority over offshore accounts
  - Generally filed electronically on or before June 30 of the following year; no extensions

# ***REPRESENTING INTERNATIONAL CLIENTS: FBAR OVERVIEW***

## **Sanctions - Civil Penalties**

- FBAR -- penalties up to ***50% of account balances per year*** for willful failure to file
  - Six year SOL
  - Non-willful penalties, e.g., \$10,000
  - Need to reduce to judgment
  - Mitigation guidelines for smaller accounts
  - Domestic Streamline Program – 5% (non-willful)
  - Reasonable Cause



# ***REPRESENTING INTERNATIONAL CLIENTS: FBAR OVERVIEW***

## **Sanctions - Civil Penalties**

- FBAR -- penalties up to ***50% of account balances per year*** for willful failure to file (Cont'd)
  - Government imposed 50% penalty four (4) times in a Florida case. ***Zwerner***: Jury verdict for 150% - 3 years of maximum 50% penalty
- Definition of Willfulness
  - ***Williams & McBride*** opinions broaden the test
    - What did the return preparer know?
    - Was the box checked “no”?
    - Badges of fraud – concealment, tax loss, etc.

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **SUBPART F**

- Certain types of income generated by a controlled foreign corporation (CFC) are currently included in income by U.S. shareholders without regard to actual distributions including:
  - Pro rata share of Subpart F income
    - For example, certain passive or highly mobile income
  - Increase in earnings that the CFC has invested in U.S. property

# ***REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS***

- **SUBPART F**

- A CFC is any foreign corporation of which  $> 50\%$  of total *voting power or value* is owned by U.S. Shareholders (USSH) on any day of tax year
- Applies to a foreign corporation which was a CFC for an uninterrupted period of 30 days or more during tax year

# ***REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS***

- **SUBPART F**

- U.S. Shareholder (USSH) is a U.S. person who owns (directly or indirectly) 10% or more of ***voting*** stock of the foreign corporation
  - Attribution rules similar to IRC Section 318, i.e., spouse, children, grandchildren, parents, and certain entities
  - For indirect ownership, no minimum ownership but pro rata. Does ***not*** apply through U.S. entities.
  - Generally includes options

# ***REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS***

- **SUBPART F**

- U.S. shareholder (USSH) must include pro rata share of Subpart F income *plus* CFC earnings invested by CFC in U.S. Property.
- USSH includes income at ordinary rates.
  - In some cases may be reduced by foreign tax credits
- USSH who pays tax on Subpart F income is not again taxed when earnings are distributed as dividends.
- USSH is also not taxed again if previously-taxed Subpart F earnings is invested by CFC in U.S. Property

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **SUBPART F**

- If CFC stock is transferred by USSH after inclusion of Subpart F income but before actual distribution of previously taxed income, the transferee shareholder is generally exempt from U.S. tax upon distribution
- Income and earnings of a CFC not expressly covered by Subpart F are subject to general rules of tax, i.e., when actually distributed to shareholders.

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **SUBPART F**
  - Subpart F Income includes the following
    - Insurance income (§ 953)
    - Foreign base company income (§ 954)
    - International boycott factor income (§ 999)
    - Illegal bribes
    - Income derived from a § 901(j) foreign country

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **SUBPART F**
  - Foreign Base Company Income includes;
    - Foreign Personal Holding Company Income
    - Foreign Base Company Sales Income
    - Foreign Base Company Services Income
    - Foreign Base Company Oil Related Income



# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **SUBPART F**

- Foreign Personal Holding Company Income

- Dividends, interest, royalties, rents and annuities
- Net gains from sale or exchange of property that give rise to (a) above types of income; (b) property that do not give rise to income; and (c) interests in trusts, partnerships, and REMICs.
- Net gains from commodity transactions
- Net gains from foreign currency transactions
- Income that is equivalent to interest
- Income from notional principal contracts and
- Payments in lieu of dividends
- Exceptions

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **SUBPART F**

- Foreign Base Company Sales Income

- Generally income from sale of property for use, consumption or disposition outside CFC's country of organization but only if CFC purchases or sells goods on behalf of related person.
  - Doesn't include income manufactured or sold for use in the country of incorporation regardless of related party.
  - Special branch rule for activities outside country of incorporation

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **SUBPART F**
  - Foreign Base Company Services Income
    - Generally income from services performed outside CFC's country of organization for or on behalf of a related person.

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **SUBPART F**

- Foreign Base Company Sales Income and Foreign Based Company Services Income requires a related person
  - A related person is any individual, corporation, trust, or estate that controls or is controlled by CFC, or any individual, corporation, trust, or estate that is controlled by same person(s) that control CFC.
    - Control with respect to a corporation means more than 50% of the corporation's stock.
    - Control with respect to a partnership, trust, or estate means more than 50% of the value of the beneficial interests of such entity.
    - Indirect and constructive ownership rules apply

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **SUBPART F**

- Investment in U.S. Property includes

- Tangible property located in U.S.
- Stock of a U.S. corporation
- An obligation of a U.S. person
  - Person pledges CFC's stock as security for an obligation of a U.S. person
  - A CFC guarantees an obligation of a U.S. person
  - Exceptions for U.S. government obligations, bank deposits, certain export property, certain trade or business obligations, and stock or debt of certain unrelated U.S. corporations
- Right to use intellectual property in U.S.

# ***REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS***

- **SUBPART F**

- Gain on sale of CFC stock (IRC Section 1248)
  - Re-characterizes gain on sale of stock as a dividend
  - If U.S. person sells or exchanges stock in foreign corporation, or receives a distribution from a foreign corporation that is treated as an exchange of stock, and at any time during the 5 years ending on the sale or exchange, (a) the foreign corporation was CFC, and (b) the U.S. person was a U.S. shareholder, any gain recognized on sale of stock is re-characterized as a dividend to extent of E & P of foreign corporation accumulated while U.S. person held stock while a CFC.

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **SUBPART F**

- Gain on sale of CFC stock (IRC Section 1248) (Cont'd)
  - If a CFC is treated as having gain from the sale or exchange of stock in a foreign corporation, the gain is treated as a dividend to the same extent that it would have been treated if the CFC were a U.S. person.
  - For purposes of E & P, amounts previously subject to U.S. tax are excluded.

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **PASSIVE FOREIGN INVESTMENT CORPORATIONS (PFICs)**
  - Like Subpart F, an anti-deferral regime:
    - (1) Excess Distribution Rules;
    - (2) Qualified Electing Fund; and
    - (3) Marked to Market.
  - Applies to foreign corporations where the U.S. person is not a 10% shareholder subject to current inclusion under Subpart F. IRC Section 1297(e)



# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **PASSIVE FOREIGN INVESTMENT CORPORATIONS (PFICs) (Cont'd)**
  - PFIC is a foreign corporation with either:
    - 75% or more of gross income is passive income, or
    - 50% or more of average assets produce passive income
      - Assets measured by FMV for publicly-traded foreign corps.
      - Adjusted bases if not publicly-traded foreign corporation

# ***REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS***

- **PFICs – EXCESS DISTRIBUTION RULES**
  - U.S. shareholder is generally subject to U.S. tax plus an interest charge reflecting the deferral of tax, upon receipt or a disposition of stock (the *Excess Distribution Rules*)
- **PFICs – Qualified Electing Fund (QEF)**
  - If a QEF election is made, the U.S. shareholder is subject to U.S. tax currently on the shareholder's pro rata share of PFIC total earnings; a separate election can be made to defer tax with an interest charge on income not currently received by the shareholder.
    - QEF Benefit: Can flow through capital gains, foreign source income v. U.S. source income, et al.

# ***REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS***

- ***PFICs – Marked to Market***
  - If PFIC stock is marketable, can elect mark-to-market each year and currently include income (loss) based upon FMV at year end v. adjusted basis
  - Constructive ownership applies in determining PFIC ownership including PFIC stock owned by a partnership, corporation, or another PFIC
  - “Once a PFIC, always a PFIC” unless U.S. person takes costly step to purge taint. However, “once a PFIC, always a PFIC” doesn’t apply to U.S. person treated as QEF for entire holding period or PFIC stock that is mark-to-market.

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **PFICs**
  - For PFIC 75% income test, exceptions apply to certain active business banking, insurance income, and certain active securities business.
  - Special PFIC exceptions apply to start-up companies and corporations changing business during year
  - If a foreign corporation owns at least 25% of another foreign corporation, look through applies to proportionate share of second foreign corporation's assets or income in determining PFIC for first corporation

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **PFICs**
  - PFIC rules can apply even if against common sense---certain sales and service corporation because of small amount of hard assets.
    - Tip: Sometimes advantageous to defer collecting ARs which are considered active assets v. cash which is a passive asset.

# ***REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS***

- **PFICs tax treatment**

- U.S. shareholder is subject to U.S. tax and an interest charge at the time the shareholder receives an *excess distribution* from a PFIC
- An *excess distribution* recognizes gain from an *excess distribution* from distribution or disposition of PFIC stock and is treated as earned pro rata over the shareholder's holding period and is taxed at the highest tax rate in effect for each respective year. Interest is computed at the respective underpayment rates.

# *REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS*

- **PFICs: Qualified Electing Fund (QEF)**
  - U.S. shareholder currently includes in gross income the shareholder's pro rata share of PFIC's total earnings and profits accrued on and after election date.
  - Amount currently included is divided between pro rata share of PFIC's ordinary earnings and PFIC's net capital gain, U.S. and Foreign Sourced.
  - Characterizations made under IRC, e.g., capital gains, foreign source income v. U.S. source income, et al.
  - U.S. shareholder includes income ratably over year but if records accurately show on a daily basis, can use actual daily basis.

# ***REPRESENTING INTERNATIONAL CLIENTS: PRIMER OF SUBPART F AND PFICS***

- **PFICs: *Qualified Electing Fund (QEF)***
  - Distribution of earnings and profits previously taxed is not taxed as a dividend.
  - Basis in stock increased by income included and decreased by distributions previously taxed.
  - U.S. shareholders can elect to defer tax on amounts currently included in income but for which no current distributions have been received. Treated as election to extend time for payment of tax. Interest applies. Disposition of stock accelerates payment.



# ***REPRESENTING INTERNATIONAL CLIENTS***

## ***IRS' and DOJ's Focus on Asia***

**Stay Tuned!**

**Kurt Kawafuchi, Esq.**

**Hochman, Salkin, Rettig, Toscher & Perez, P.C.**

**Office: (310) 281-3288**

**Cell: (808) 258-3383**

**Fax: (310) 859-1430**

**Email: [kawafuchi@taxlitigator.com](mailto:kawafuchi@taxlitigator.com)**

**Visit our website at [www.taxlitigator.com](http://www.taxlitigator.com).**