Beyond the Tea Party: IRS and DHS Information Sharing and How it Might Affect Inbound Travel to the United States

By

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Mr. Klasing is admitted to practice before all California State Courts, the United States District Court for the Central District of California and the United States Tax Court.

Mr. Klasing's education includes a bachelor's degree in business administration, with an emphasis in accounting, from California State University Los Angeles, a master's degree in taxation from Golden GateUniversity and a Juris Doctor from Western State University College of Law.

Having earned a master's degree in taxation with an emphasis in the gift and estate tax arena, along with having taken classes in Law School on Estate's, Trusts and California Community Property, Mr. Klasing practices in the estate, trust and accounting areas.

Mr. Klasing's professional involvement includes serving as the current chair of the California State Bar Association, Tax Procedure and Litigation Committee, the current chair of the Orange County Bar Association Taxation Section. He is also a member of the American Bar Association Tax Section; the Orange County Bar Association, Tax, Business and Corporate Law, Trust & Estate Sections, the California Society of Certified Public Accountants State Committee on Taxation and the American Association of Attorney Certified Public Accountants. He is an "A" rated current member of the Better Business Bureau. He has a 10.0 AVVO rating (Superb)

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Practice Areas

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Mr. Milikowsky is recognized in the legal and business community for his experience and knowledge in the area of taxation and financial analysis. Mr. Milikowsky represents business owners and individuals in IRS and California State tax audits involving income tax, payroll tax, and sales tax as well as high dollar collection matters. Mr. Milikowsky also represents individuals in matters involving money laundering and offshore bank account and asset reporting to minimize criminal exposure.

In 2009, Mr. Milikowsky participated in the Washington, D.C. Delegation in conjunction with the California State Bar, Tax Section. There, he presented proposal to the U.S. Treasury Department, Internal Revenue Service, and Congressional subcommittee staff members relating to "Qualified Amended Returns." The Tax proposal recommended the adoption of a “safe harbor” to allow taxpayers to file a Qualified Amended Return to correct an error on an original return discovered after an audit, thereby waiving accuracy-related penalties under IRC 6662.

Previously, Mr. Milikowsky was a litigation attorney representing government entities and businesses in civil litigation matters.

I. Introduction to Treasury Enforcement Communications System (TECS)

A. Overview of TECS

The Treasury Enforcement Communications System (TECS) is a database maintained by Department of Homeland Security's ("DHS") component, US Customs and Border Protection, to share information that include temporary and permanent enforcement, inspection, and operational records relevant to the antiterrorism and law enforcement mission of CBP and numerous other federal agencies.

The Internal Revenue Service (the "Service") shares information with DHS. If a taxpayer has an unpaid tax liability and is subject to a resulting Notice of Federal Tax Lien, the IRS may submit identifying taxpayer information to TECS. The database allows the DHS to identify taxpayers with unpaid tax assessments who are traveling to the United States for business, employment, or personal reasons (Internal Revenue Manual (IRM) § 5.1.18.14).

Taxpayers traveling to the United States with unpaid U.S. tax assessments can be detained at the border, questioned, and flagged for follow-up enforcement. The IRS has established procedures to facilitate tax collection from taxpayers who live outside the United States. Taxpayers traveling to the United States with unpaid tax assessments increasingly are being detained at the border.

TECS allows DHS to identify taxpayers with unpaid tax assessments who are traveling to the United States for business, employment, or personal reasons. [1]

1. Which "Status" of individuals are covered by TECS?

    a. TECS typically applies to non-US Citizens and US citizens living abroad who have an unpaid tax liability. However, US citizens and residents[2] may also be added to TECS if the IRS has been unable to contact the taxpayer and they are believed to be travelling outside the US. A U.S. or non-U.S. person whom the IRS has been unable to contact may be unaware of an assessed but unpaid federal tax liability until the person goes through U.S. Customs and is detained by Immigration and Customs Enforcement ("ICE").Under these rules, even an undocumented (illegal) alien under the immigration laws who

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[1] I.R.M. § 5.1.18.14.

[2] US immigration laws refer to aliens as immigrants, non-immigrants, and undocumented (illegal) aliens. U.S. tax laws refer only to resident and nonresident aliens. A resident alien's income is generally subject to tax in the same manner as a U.S. citizen. If you are a resident alien, you must report all interest, dividends, wages, or other compensation for services, income from rental property or royalties, and other types of income on your U.S. tax return. These amounts must be reported whether from sources within or outside the United States. A nonresident alien (with certain narrowly defined exceptions) is subject to federal income tax only on income which is derived from sources within the United States and/or income that is effectively connected with a U.S. trade or business. I.R.C. § 7701(b).

satisfy the "Substantial Presence Test" will be treated for tax purposes as a resident alien.[3]

2. Requirements to be entered into TECS (i.e. individualswith a federal tax lien/liability).
    a. There are two requirements for taxpayer information to be included in TECS:
        (1) The individual taxpayer must live outside the United States[4]; and
        (2) The individual taxpayer must have an existing filed federal tax lien (IRM § 5.1.18.14).[5]

3. Consequences for individuals included in the TECS database.
    a. Detained at border
    b. Questioned at the border about:[6]
        (1) Taxpayer's address while in the US
        (2) Nature of the visit
        (3) Transportation of any currency over $10,000
        (4) Any other available travel or asset information:
            (i) Vehicle registration information
            (ii) Taxpayer's employment relationships in the US
            (iii) Personal services performed in the US
            (iv) Assets held in the US
    c. Flagged for follow up enforcement

    To help alleviate the compliance problem of collecting delinquent taxes from taxpayers who, because they reside outside the jurisdiction of U.S. Courts, are not subject to ordinary administrative and judicial collection procedures, the Service has a contact program which involves entering the names of certain nonresident delinquent taxpayers in TECS. This assists the Service to contact nonresident

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[3] You will be considered a U.S. resident for tax purposes if you satisfy the "substantial presence test" for the calendar year. To meet this test, you must be physically present in the United States on at least: 31 days during the current year, and 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting: (a) All the days you were present in the current year, (b) 1/3 of the days you were present in the first year before the current year, and (c) 1/6 of the days you were present in the second year before the current year.

[4] The individual must either: a) live outside the US and commonwealth/territories; b) is about to depart to reside in a foreign country; or (c) live in the US and cannot be located by the IRS and believed to be traveling outside the US on a frequent basis.

[5] A federal tax lien is generally filed after taxes have been assessed by the Internal Revenue Service.

[6] U.S. Customs agents (ICE agents) may detain these individuals to ascertain what assets they have in the United States, the duration of their trip, where they are staying, vehicle registration information, and similar information. Agents also may inquire about the taxpayer's employment relationships in the United States or any personal services performed in the United States to establish wage garnishment opportunities. Thereafter, U.S. Customs agents will alert an IRS coordinator and transmit this information through a referral program. Typically, an investigation request will be sent to an IRS agent in the region in which the taxpayer is traveling to follow up with the taxpayer (IRM § 5.1.18.14).

delinquent taxpayers who routinely travel to the United States for business, employment, or personal reasons.

The objective of the contact program is to improve tax administration and compliance by:

- Collecting delinquent taxes.
- Securing delinquent returns.
- Identifying cases with criminal potential for referral to CI.

The success of the program depends on timely collection actions by the district offices.

d. Disclosure of an individual's tax return information.

IRC Sec. 6103 does not specifically authorize the disclosure of return information that already is part of the public record. However, the U.S. Supreme Court ruled in a line of cases that there is no reasonable expectation of privacy for matters that are part of the public record. *SeeNixon v. Warner Communications, Inc.,* 435 U.S. 589 (1978); *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975); and *Craig v. Harney*, 331 U.S. 367 (1947). Consequently, the IRS takes the position that the disclosure of information taken from the public record is not an unauthorized disclosure under IRC§6103. Under this position, information reflected in a properly filed Notice of Federal Tax Lien is part of the public record and may be submitted to TECS without violating disclosure laws.

Taxpayers who reside outside the United States may not be aware of outstanding federal tax liabilities if the address on record for the taxpayer is outdated or otherwise incorrect. Consequently, tax advisers with clients who reside outside the United States should ensure that the correct address for the taxpayer is used on the client's tax returns and, if the client no longer is required to file U.S. returns, that the IRS still is able to contact the taxpayer to discuss previously filed returns. Taxpayers should be advised that the failure to keep the IRS apprised of a change in mailing address may result in a surprise from DHS when the taxpayer seeks to enter the United States.

4. Removing a taxpayer's records from TECS.

To remove a taxpayer from TECS, the following must occur:

1. Tax liability is satisfied;
2. Taxpayer enters into IRS approved payment arrangements to satisfy the tax liability, including installment agreement;
3. Taxpayer submits an Offer in Compromise, which has been accepted;

4. Taxpayer is deceased and death is verified

II. Pre-Immigration Tax Planning and Concerns

A. Taxation on world-wide income
   1. Tax treaties
   2. Deferral or acceleration of income, recognition of assets with built in gains, losses, and deductions.

B. Foreign trusts
   1. Types of foreign trusts
   2. Immigrant as a grantor or beneficiary of foreign trust.

C. Minimizing the transfer tax

D. Minimizing the gross estate (estate tax)

E. Brining cash in/out of the US
   1. Cash transportation rules

F. Reporting requirements: foreign accounts, assets, business entities

Seeking, Retaining or Relinquishing U.S. Permanent Residence Status Should Only be Contemplated After First Evaluating Tax and Estate Considerations!

Many multinational executives, managers, entrepreneurs, and investors fail to account for the tax and estate consequences that naturally follow from their attainment or relinquishment of U.S. immigration status or a decision as to taking up U.S. residence. Before seeking or retaining U.S. temporary or permanent residence status, a foreign national and their immigration counsel should be aware of the U.S. tax and estate law issues which are associated with that status

Income and Transfer Tax Consequences Associated with Immigration Decisions

Once an immigrant obtains a green card, he or she faces immediate and profound income and transfer tax issues that should be planned for to avoid the most commonly suffered income and transfer tax pitfalls. With respect to income tax, a permanent resident is deemed to be an income tax resident of the U.S. for as long as the green card is retained even prior to their physical presence in the U.S. All of the permanent resident's worldwide income becomes subject to U.S. income tax even on assets earned and held entirely outside the U.S. prior to immigrating to the U.S. Because the foreign national is usually a citizen of one or more other countries, he or she may become subject to double or triple taxation. The U.S. foreign tax credit and possible income tax treaties with the country(s) they just immigrated from may provide a level of relief from double or triple taxation but advanced planning should be employed to minimize these effects.

Much less intuitive and often surprising to the permanent resident is the applicability of U.S. transfer taxes, which include gift, estate, and generation-skipping transfer taxes upon becoming domiciled in the U.S. Once deemed to be domiciled in the U.S., the foreign national will be faced with inheritance taxes on the gratuitous transfer of assets to their spouse, children, grandchildren and others, with generally the same rates of taxation, exemptions and deductions as a U.S. citizen. A transfer to a non-U.S. citizen spouse will not be subject to the unlimited marital transfer exemption that is otherwise available where the spouse is a U.S. citizen however an estate tax treaty may be available to enhance the available deductions and exemptions.

If the foreign national engages in pre-immigration estate planning they may be able to take affirmative steps before becoming a U.S. domicile for transfer tax purpose and thus avoid the imposition of some or all U.S. transfer taxes.

The Exit Tax

The taking of a foreign executive or managerial post, need to provide for foreign aging parents, seeking of alternate lifestyle / political factors can result in a decision to return or move abroad permanently and a corresponding decision to voluntarily relinquish permanent resident status or renounce citizenship.

Since June 17, 2008, the United States has imposed a potentially financially devastating "exit" or "expatriation" tax on permanent residents who give up their green cards and on U.S. citizens who renounce their citizenship. For the permanent resident to be subject to exit taxation under this “covered expatriate” regime, they must have held the green card for any part of eight of the previous fifteen years prior to turning in their green card. Additionally, they must have either a worldwide net worth of $2,000,000 or more, or an average U.S. net income tax liability over the previous five calendar years of $147,000 or greater.

The covered expatriate exit tax regime includes both an income tax and an inheritance tax element. The income tax element consists of a deemed "mark- to-market" tax on the inherent gain generally involving all of the covered expatriate's worldwide assets. The deemed gains are classified as long-term capital gain, short-term capital gain or ordinary income. The first $636,000 of gain is exempted via a proportionate allocation among the covered expatriate’s assets.

The inheritance tax element applies when subsequent gratuitous transfers occur from a covered expatriate to U.S. citizens or residents. These recipients often include children who have been educated in the U.S. and stay for career or marital reasons. Any lifetime gift or inheritance at death by a covered expatriate will be taxed at the maximum gift or estate tax rate then in effect.

If the covered expatriate chooses to make gifts to U.S. citizen’s or residents through a U.S. domestic trust, the trust will be subjected to inheritance tax upon receipt of such gifts, regardless of the actual citizenship or residency of the U.S. domestic trust’s beneficiaries. If a foreign trust is used to make gifts by covered expatriate’s the U.S. citizen or resident beneficiary will be forced to pay inheritance tax as distributions are received from the trust.

Because of the covered expatriate exit tax regime, careful exit planning should be undertaken before a green card is turned in or citizenship is renounced. While it is often very difficult to entirely remove oneself from the U.S. tax system, with proper exit planning the associated tax bite can be avoided or minimized through the use of trusts and asset transfers.

Abandonment or Revocation of Green Card Status

The right to expatriate can be seen as an important check on the powers of government where

expatriates vote with their feet to send a message to the government that its tax regimes may be too onerous. It is settled constitutional and international law that an individual has the right to expatriate from the United States.

The abandonment of a green card will not terminate the alien's resident alien status for federal income tax purposes unless the abandonment is officially recognized by the U.S. immigration authorities by means of either an administrative or judicial determination.If the resident alien simply ceases using the green card without first informing the U.S. immigration authorities and allows it to become invalid via the mere passage of time he or she will continue to be classified as a resident alien for U.S. tax and information reporting purposes.

Abandon of permanent resident status can take place at a U.S. Consulate or Embassy or at the airport in front of a U.S. Customs and Border Protection (CBP) officer. Each U.S. Consulate or Embassy has its own abandonment procedure including the potential for a mail-in process. Both methods involve the Completion and submission of an I-407 abandonment form plus the original permanent resident card.

The execution of the I-407 should best be witnessed by a U.S. government official who will wish to ensure that the abandonment is willingly and knowledgeably made. Any former citizen of the United States who officially renounces United States citizenship and who is determined to have renounced U. S. citizenship for the purpose of avoiding taxation by the U. S. is subsequently inadmissible to the U.S. and this is reflected where a number of visa application forms still ask whether a visa applicant has ever renounced U.S. citizenship for tax reasons. Because the government stands to lose tax revenue as a result of a well-planned expatriation, it may later question the propriety of an expatriation. A person that wishes to ensure that his or her expatriation can withstand subsequent questioning must refrain from acting in any manner that might give a court the opportunity to doubt the non-tax intentions to expatriate.For this reason non-tax reasons for renunciation, should be recorded on a notarized, contemporaneous affidavit to the I-407.

Revocation of Green Card Status

The permanent resident status of an alien may be administratively or judicially revoked or rescinded. A Green Card is effectively revoked or rescinded for tax purposes when a final administrative or judicial order of exclusion or deportation is issued.

Attaining U.S. Permanent Resident Status

For high net worth individuals, the most common routes to achieving U.S. permanent resident status are via an employment-based process or via sponsorship by a family member who is a U.S. citizen or lawful permanent resident. Accordingly many foreign nationals arrive in the U.S. under a work visa status.

The immigration process for high net worth immigrants involves the expertise nd skill sets of both immigration and tax lawyers because of the many hidden tax and compliance traps that can ensnare even the most diligent immigrant.

Retaining U.S. Permanent Resident Status

To retain U.S. permanent resident status generally involves not spending beyond 180 consecutive days outside the U.S. and not committing crimes. However, permanent residency can be lost by a criminal conviction or plea leading to deportation, returning to live abroad without obtaining a re-entry permit to proactively register a temporarily foreign residence thus not maintaining sufficient ties to the United States, and by failing to file income tax returns as a resident during years temporarily worked abroad.

The Reach of U.S. Transfer Taxation to Non Resident Non-Citizen Foreign Investors and Policy Considerations

U.S. transfer taxes include gift tax, generation-skipping transfer tax and estate tax and can apply during the life or at the death of a Non Resident Non-Citizen in limited circumstances. The transfer taxation of foreign investors within the U.S. is one of the most sophisticated topics in U.S. taxation. From a policy perspective a balance is attempted to be achieved between the goals of assessing and imposing transfer taxation on nonresident non-citizens on the one side and attracting their investment dollars into the U.S. economy on the other. To this end the Internal Revenue Code contains several statutory exemptions from U.S. transfer taxes for certain types of domestic investments that are held by the Non Resident Non-Citizen.

High-net-worth nonresident non-citizens often invest in U.S.-situs investments to maintain a balanced and diversified international portfolio as the U.S. is considered one of the safest places on earth to make investments.They often educate their children at American colleges and Universities or run U.S. businesses, which often results in their having U.S. resident children. It is also common for high-net-worth nonresident non-citizens to spend recreational time within the United States and, therefore, they may own valuable U.S. vacation properties, and other U.S.-situs recreational property such as yachts.

As a general rule, U.S. transfer tax code only reaches their property that has U.S. situs, and the code contains several exclusions that further restrain the reach of U.S. transfer taxation. Consequently nonresident non-citizens may be able to plan their financial affairs to reduce or eliminate U.S. transfer taxes. The Non Resident Non Citizen's domiciliary status is the single most important factor at play in limiting the reach of U.S. transfer taxes as the attainment of U.S. domiciliary status, by becoming a resident of the U.S., opens up the Non Resident Non-Citizen to global U.S. transfer taxation.

The Reach of U.S. Transfer Taxation to U.S. Residents (U.S. Domicile) and U.S. Citizens

A legal determination of whether an individual is a U.S. citizen is made by looking to the U.S. Constitution, the Immigration and Nationality Act,and the cases and regulations found thereunder.Sections 2033 through 2044 of the Internal Revenue Code indicate the types of

property interests that are includible in the gross estate of a decedent that are subject to transfer taxes. In general, all property interests, wherever situated in the world, must be included in the gross estate of a U.S. citizen or resident, even if he or she lived and died abroad.Moreover, gift tax applies to all transfers by gift of property, wherever situated in the world, by an individual who is a citizen or resident of the United States. Naturalized U.S. citizens are not treated any differently than native-born citizens. Dual citizens are taxed as U.S. citizens and any other citizenship is generally ignored for U.S. transfer tax purposes.

Where a non-U.S. citizen is considered a resident, by being domiciled in the U.S., the Code reaches worldwide to all transfers of his or her property, wherever such properties are located at the time of the transfers whether during life or at death. In addition, the transfer taxes of the state in which such a client is resident or owns property may apply as well.

Regulatory Definition of Domicile

Congress has not specifically defined transfer tax definitions for the terms “resident” and “nonresident.” The internal revenue regulations rather define the concept of “domicile.” A resident for transfer tax purposes is a decedent who, at the time of his or her death, had his or her domicile in the United States,”and a nonresident decedent is a decedent who, at the time of his or her death, had his or her domicile outside the United States. The regulations state that a person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing themselves therefrom. They state further that residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.In general, the domicile of an individual is his or her true, fixed, and permanent home and place of habitation. It is the place to which, whenever he or she is absent, he or she has the intention of returning.

The Difference Between Income and Transfer Tax Definitions of Residency

The income tax and transfer tax residency definitions are completely different. The transfer tax sense of the term “resident” focuses on the “squishy” concept of “domicile” within the United States, whereas the income tax definition of “resident alien” focuses on an objective set of finite standards defined under IRC §7701(b). A single individual may simultaneously be <u>a resident</u> alien for income tax purposes <u>but not a resident</u> for transfer tax purposes, <u>and vice versa</u>. IRC §7701(b) establishes these standards as follows:

1. Under IRC §7701(b)(1)(A)(i)an individual who has been issued a “green card” is immediately classified as a resident alien even before he takes up domicile in the U.S.
2. Under IRC §7701(b)(1)(A)(ii), (3) via the “substantial presence” test, a nonimmigrant alien is generally classified as a resident alien if he spends 183 days or more in the United States during the calendar year or as determined under a special “lookback” formula that considers the two preceding calendar years and the current calendar year (three years looked at in total).However, both tests contain numerous special rules and exceptions.

See: http://www.irs.gov/Individuals/International-Taxpayers/Substantial-Presence-Test for full details:

Substantial Presence Test

You will be considered a U.S. resident for tax purposes if you meet the substantial presence test for the calendar year. To meet this test, you must be physically present in the United States on at least:

1. 31 days during the current year, and
2. 183 days during the 3-year period that includes the current year and the 2 years immediately before that, counting:
   - All the days you were present in the current year, and
   - 1/3 of the days you were present in the first year before the current year, and
   - 1/6 of the days you were present in the second year before the current year.

Example:

You were physically present in the United States on 120 days in each of the years 2007, 2008, and 2009. To determine if you meet the substantial presence test for 2009, count the full 120 days of presence in 2009, 40 days in 2008 (1/3 of 120), and 20 days in 2007 (1/6 of 120). Since the total for the 3-year period is 180 days, you are not considered a resident under the substantial presence test for 2009.

The chart below summarizes all the possible ways in which U.S. federal transfer and income tax can apply to individuals based on their residency and domicile status:

(Type of U.S. Federal Tax)	(Residency / Domicile Status)			
	NDA/NRA	NDA/RA	DA/RA	DA/NRA
Transfer Taxes	U.S.-situs assets only	U.S.-situs assets only	Worldwide assets	Worldwide assets
Income Tax	U.S. source income	Worldwide income	Worldwide income	U.S. source income

NDA = “non-domiciled alien”
NRA = “nonresident alien”
DA = “domiciled alien”
RA = “resident alien”

Tax Treaty, Visa Based and Special Rules for Canadian and Mexican Resident Overrides to the 7701(b) substantial presence test

To confuse matters even more an alien who is properly classified as a resident alien under IRC §7701(b) may be none the less be reclassified as a non-resident alien for income tax purposes under the “tie-breaker” rules of a possible income tax treaty between their former country and the United States. This phenomenon usually occurs (if at all) in the year that the alien either

moves into or out of the U.S. because of time spent in the U.S. either before or after the move although it may also occur where an alien has lived in the U.S. for the entire calendar year. A tax treaty may also reclassify a U.S. green card holder living abroad as a treaty country resident even where it would violate U.S. immigration laws to take that position which could cause a loss of the green card. Additionally, IRC §7701(b) contains exceptions for aliens in the U.S. under nonimmigrant visas that may override the 7701(b) substantial presence test subject to special rules aliens holding A, F, G, J, M and Q-visas. Lastly, nonimmigrant aliens from Canada and Mexico may be admitted without a nonimmigrant visa under the "visa waiver" program as tourists or as temporary business visitors for up to 90 days a year using a border crossing card.

Temporary Stay in U.S. Estate and Tax Planning

If a high net worth non-U.S. citizen plans to temporarily move to the United States, he or she should be concerned with two often overlooked U.S. income and transfer tax issues:

1. The likelihood that his or her foreign and U.S. assets could be subject to federal estate tax if he or she dies unexpectedly while in the United States under the U.S. domicile concept.
2. The likelihood that his or her worldwide income may become subject to federal income tax if he or she becomes classified as a resident alien for income tax purposes under 7701(b).

Temporary stay income and transfer tax planning becomes necessary when:

1. Under the substantial presence test the high net worth individual is likely to eventually become classified as a resident alien for income tax purposes due to the mere passage of time.
2. Classification as a non-domiciled alien for estate tax purposes is probable where he or she is present in the U.S. under a:
   a. Non-immigrant work visa and
   b. Has not applied for a green card which would evidence the intent to stay permanently.

Under the above factors, a resident alien may be "domiciled" outside the United States for many years thus keeping his foreign situs assets from being subjected to U.S. worldwide transfer taxes and thus limiting his or her exposure to the potential estate tax that existed before he or she temporarily moved to the United States surrounding his or her pre-move U.S. Situs Assets.

Temporary stay planning is usually not necessary for students as the ordinarily remain classified as nonresident aliens for income tax purposes for the duration of his or her U.S. studies.

Note: Whenever a foreigner become classified as a resident alien or a newly minted U.S. citizen and has a direct or indirect ownership or beneficial interest in any kind of foreign asset, entity or account such as foreign trusts, partnerships, mutual funds, bank accounts, income producing assets or receives foreign gifts, the applicable U.S. reporting rules should always be carefully considered <u>as potential financially devastating and draconian penalties and associated criminal exposure for income tax evasion and willful non reporting can quickly arise **long before** the</u>

foreigner acclimates to the U.S. tax and reporting regimes. To compound matters only the most sophisticated of U.S. tax advisors will be aware of these requirements so be aware of the negligent referral litigation that has transpired in the past not to mention **your own exposure as immigration attorneys.**This is the hottest issue before the IRS at present!

Planning for the Exposure to Estate Tax during a Temporary Stay in the U.S.

Temporary stay estate tax planning often involves forming a foreign holding vehicle, entity, trust or company to own any U.S.-situs assets prior to beginning the temporary stay in the U.S. before incurring this expense the non-immigrant alien should first consider the extent to which an existing estate tax treaty might protect him or her from potential estate taxes during his or her U.S. stay and his home countries rules regarding transfers to these vehicles. The types of U.S.-situs assets that may need to be held by a foreign entity include U.S.-situs equities, real property and tangible personal property for example. During the period where a non-domiciled, nonresident alien is effectively exempt from U.S. income tax in his own name, he will not realize any U.S.-source income in his own name and instead only his or her foreign holding company will be subject to income tax on certain U.S.-source income under in its own name.

The use of foreign holding companies for estate planning purposes can lead to adverse U.S. income tax complications where the non-domiciled alien owner of the foreign holding company unexpectedly becomes a resident alien for income tax purposes during a temporary stay in the U.S via the substantial presence test. Where a non-domiciled but now resident alien owns the stock of a foreign holding company, the foreign holding company will become subject to the U.S. anti-tax deferral regimes governing controlled foreign corporations and passive foreign investment companies found in Subpart F of the internal revenue code.

Note: U.S. real property is always subject to estate tax in the hands of a non-domiciled alien, because no estate tax treaty exempts U.S.-situs real property from estate tax.

When a non-domiciled alien transfers U.S.-situs property into a properly structured and maintained foreign trust, the assets transferred should be protected from estate tax if he or she dies unexpectedly during his U.S. stay because the assets are not in his or her own name at the time of his or her death. The transfer of U.S. –situs assets must be conducted in a manner that constitutes a "completed gift" for U.S. gift tax purposes. Ordinarily the grantor will want to be a beneficiary of the trust as to both income and corpus, so that the trust can make distributions of income and corpus to him from time to time as needed for personal expenses while he is a resident alien.

Gift Tax Risk if Grantor Transfers U.S.-Situs Tangible Property to a Foreign Holding Vehicle.

The non-domiciled alien grantor should be careful when transferring any U.S. situs property to a foreign holding company, entity or trust that could be subject to U.S. federal gift tax at the time of the transfer. Where gift tax applies it will only be imposed to the extent that the applicable gifts exceed any exemption amount which may be modified by treaty.

Note: Under §2501(a)(2), no gift tax is imposed on a gift of U.S.-situs property that is "intangible" property by a non-resident non domiciled alien grantor like stock in a U.S. corporation but if he or she dies holding the U.S. stock in his or her own name, estate tax will be imposed on the stock.

Gift tax can be imposed inadvertently in several situations such as where a non-domiciled alien funds a trust before, during or after a temporary U.S. stay. For example prior, during or after, the temporary stay in the U.S., a non-domiciled alien may transfer U.S.-situs tangible property titled in his own name into a foreign trust.

Where U.S.-situs property is already owned by the non-domiciled, non-resident alien prior to a temporary stay in the U.S., it may be possible to avoid gift tax through advance planning. If after moving to the United States the grantor of a foreign trust wishes to buy a personal residence in the name of the foreign trust, he or she could first contribute cash to the trust and then arrange for the trust to buy the U.S. personal residence in its own name.If the individual were to first purchase the residence in his or her own name and then contributed it to a foreign trust gift tax would apply.

Planning to Ensure Non-Domiciled Alien Status

It is paramount to ensure that the grantor of the foreign trust is classified as a non-domiciled alien on any date on which he makes contributions to the trust. If not, gift tax could be imposed on even foreign-situs property or U.S.-situs intangible property which would ordinarily be exempt from gift tax where the contribution is made by a non-domiciled alien.

Note: It may not be desirable for an alien to be classified as a non-domiciled alien in all situations. For example, where a non-domiciled alien dies and owns only U.S.-situs property in his own name, only the first $60,000 is exempt from estate tax under IRS §§2101–2102, whereas if the alien is considered a domiciled alien for estate tax purposes, a $5,250,000 estate tax exemption will apply.

Although there are no safe harbor rules that define how long a non-immigrant alien without a green card can remain in the U.S. and still be considered not to have established domicile here, the longer he or she remains in the United States the greater the likelihood they will be held to be domiciled here for transfer tax purposes.

Planning for a Permanent Stay in the U.S. for Income and Transfer Tax Purposes

If a high net worth non-U.S. citizen plans to move permanently to the United States, he or she will generally have the same objectives discussed above as the individual who plans to only move temporarily to the United States. They universally desire to shelter his or her pre move foreign income or excludable U.S. income from U.S. federal income and transfer tax for as long as possible so the structure he or she forms will ordinarily have to remain in place until he or she dies or longer if a dynasty trust is contemplated. Although it is generally possible for the individual to avoid U.S. transfer taxes through a properly structured estate plan established well before the move to the U.S., it often proves much more difficult for him or her to legally avoid

income tax on his or her pre move foreign or excludable U.S. income, because he or she will become a "United States person" for income tax purposes following the move.

A foreign holding company or entity generally will not be effective to protect him or her from U.S. transfer or income taxes once he has becomes a domiciled resident alien or U.S. citizen. The reason for this is that at some point following the move, U.S. transfer and income taxes will attach to his or foreign-situs assets as well as on his U.S.-situs assets, and his foreign-situs assets will include the ownership of the foreign holding company or entity.

The most effective way to avoid U.S. transfer taxes (but not income taxes) will be if while he or she is still a non-domiciled non-resident alien a trust if funded in a manner where its corpus will not be included in his or her gross estate upon death. Both U.S.-situs and foreign-situs assets should be funded in this manner but watch out for any applicable gift tax on U.S.-situs assets. The grantor's control over the trust and interest in the trust's income must be minimized so as to reduce the exposure to an attack by the IRS that the grantor is a de facto owner of the trust which would expose the trust's assets to the U.S. gift, generation-skipping and transfer taxes regimes during the grantor's lifetime and especially at death. As a result of this exposure, the noncitizen immigrant will have to give up substantial legal control over the assets funded to the trust, and can never regain full control over the trust corpus or income.

A. Pre-Immigration Tax Planning

As noted above, the U.S. subjects its citizens and permanent residents to federal income tax on their worldwide income, which includes foreign source income. However, that income is not subject to tax prior to becoming a citizen or resident. Therefore, the strategy for pre-immigration income tax planning involves accelerating the realization of foreign source income prior to immigration to avoid U.S. income tax, and deferring losses and deductible expenses until after immigration so that they may be used to offset post immigration gains. If the immigrant's current place of residence or country also unfavorably taxes income, then the use of an intermediary tax haven should be used as a temporary place of residence and divestiture before immigrating to the U.S.

Accelerating income typically involves collecting outstanding amounts that may be due, such as accounts receivables, stock options, accumulated earnings from foreign entities, taxable deferred compensation plans, and notes held from installment sales. Where practical, these assets may also be sold at their present fair market value and the proceeds transferred to the individual before immigration.

In addition, where the immigrant has foreign assets with substantial built in gain, those assets do not receive a step up in basis upon obtaining U.S. citizenship or permanent residence status. Consequently, those assets should be disposed of and reacquired at a higher cost basis prior to immigration to avoid U.S. taxation on the built in gain. However, in order for the sale to be respected the transaction should be entirely bona fide and well documented, with no implied obligation for repurchase or cancellation.

In direct contrast to accelerating realization of built in gain and income, built in losses and deductible expenses should be deferred until U.S. residency status is achieved in order to shelter

post-immigration income and gain. This includes disposition of loss property and (where practical) deferred incurral or payment of deductible expenses, as business expenses are generally only deductible in the year in which they are paid or incurred.[7]
As mentioned previously, the U.S. taxes its citizens and residents on nearly all types of gratuitous wealth transfers. Therefore, where the value of the immigrant's gross estate exceeds the applicable exclusion amount (currently $5,250,000 for 2013), the goal of pre-immigration estate planning is to reduce the value of the gross estate of the immigrant prior to residency. This is typically done in several ways.

For U.S. situs tangible personal property such as cash or other valuables, physically relocating such property outside of the U.S. (thereby transforming it into non-U.S. situs property) before transfer ensures avoidance of U.S. transfer taxes. For U.S. situs real property, any gratuitous transfer will be subject to U.S. transfer tax, therefore it is critical that tax planning take place well before acquisition. As U.S. transfer tax does not reach stock held by a non-resident alien in a foreign corporation, planning in this area typically involves the formation of a foreign corporation to acquire and hold U.S. situs property. By converting U.S. situs property ownership into non-U.S. situs property ownership (e.g. foreign stock), U.S. transfer taxes may be avoided. In order for this arrangement to be respected, it must be properly planned, documented, and maintained.

Foreign assets can also be gifted directly to future beneficiaries or transferred to a trust prior to residency (free of U.S. transfer taxes) in order to reduce the value of the gross estate. However, given the numerous anti-avoidance rules, transfers to trust should be undertaken with great care to avoid having trust income taxed to the grantor.

For example, if a non-resident alien makes a gratuitous transfer to a foreign trust with a U.S. beneficiary and within 5 years of the transfer obtains U.S. citizenship or permanent residence status, any income attributable to the property transferred to the trust will be taxable to the grantor.[8] In addition, the general grantor trust rules also apply to pre-immigration trusts. Therefore, even in cases where a pre-immigration trust was funded more than 5 years prior to obtaining U.S. citizenship or residency status, if the grantor has retained any interest as enumerated under Code sections 673 through 677 (e.g. reversionary interest greater than 5%, power of revocation, or power to direct the distribution of trust income or corpus), trust income will be taxable to the grantor under the grantor trust rules. Pre-immigration planning in the above case should therefore involve amending and removing any retained interests in a foreign trust that may result in trust income being taxable to the grantor.

Also, where a foreign trust does not distribute all of its distributable net income ("DNI") for the current year, the undistributed DNI will become undistributed net income or ("UNI.") The relevance of UNI in an immigration context is that an immigrant who becomes a U.S. beneficiary of a foreign trust with substantial UNI is subject to the onerous tax consequences of the "throwback rule" under IRC section 666 and 667. The throwback rule is designed to cause the U.S. beneficiary of a foreign trust to pay approximately the same income tax that would have been imposed if the trust had distributed all of its DNI on an annual basis as opposed to

[7] IRC section 162
[8] IRC section 679(a)(4)

accumulating income in the trust. The effect of this is that the U.S. beneficiary is subject to ordinary income tax rates on capital gains earned by the trust and interest on any distributions of UNI made after the residency date.[9] Pre-immigration planning in this context may include accelerating distributions of UNI prior to residency in order to reduce or eliminate UNI and avoid the throwback rule.

III. FBAR

A. Filing considerations/prerequisites – preparing your client

The FBAR filing requirements, authorized under one of the original provisions of the Bank Secrecy Act, have been in place since 1972. In 2003, the IRS was delegated the authority to enforce FBAR requirements and penalties through the passing of the Patriot Act.

The FBAR form is used to report a financial interest in, or signature or other authority over, one or more financial accounts in foreign countries. No report is required if the *aggregate* value of the accounts does not exceed $10,000. The value of the account is based on the foreign currency exchange rate (normally on December 31st of a each year).

The FBAR is not filed with a taxpayer's federal income tax return. The granting, by the IRS, of an extension to file federal income tax returns does not extend the due date for filing an FBAR. You may not request an extension for filing the FBAR. The FBAR is an annual report and must be **received** by the Department of the Treasury in Detroit, MI **on or before June 30th** of the year following the calendar year being reported. Beginning July 1, 2013, all FBAR forms must be electronically filed.

1. Who Must File

United States persons are required to file an FBAR if:

a. The United States person had a financial interest in or signature authority over at least one financial account located outside of the United States; and
b. The aggregate value of all foreign financial accounts exceeded $10,000 at any time during the calendar year to be reported.

United States person means:
United States citizens; United States residents; entities, including but not limited to, corporations, partnerships, or limited liability companies created or organized in the United States or under the laws of the United States; and trusts or estates formed under the laws of the United States.

2. What Types of Accounts Must Be Reported?

[9] IRC section 668

A person who holds a foreign financial account may have a reporting obligation even though the account produces no taxable income.

A financial account includes, but is not limited to: securities, brokerage, savings, demand, checking, deposit, time deposit, or other account maintained with a financial institution (or other person performing the services of a financial institution). A financial account also includes a commodity futures or options account, an insurance policy with a cash value (such as a whole life insurance policy), an annuity policy with a cash value, and shares in a mutual fund or similar pooled fund (i.e., a fund that is available to the general public with a regular net asset value determination and regular redemptions

A foreign financial account is a financial account located outside of the United States.

3. What is a Financial Interest

A United States person has a financial interest in a foreign financial account for which:

a. The United States person is the owner of record or holder of legal title, regardless of whether the account is maintained for the benefit of the United States person or for the benefit of another person; or
b. the owner of record or holder of legal title is one of the following:

    (1) An agent, nominee, attorney, or a person acting in some other capacity on behalf of the United States person with respect to the account;

    (2) A corporation in which the United States person owns directly or indirectly: (i) more than 50 percent of the total value of shares of stock or (ii) more than 50 percent of the voting power of all shares of stock;

    (3) A partnership in which the United States person owns directly or indirectly: (i) an interest in more than 50 percent of the partnership's profits (e.g., distributive share of partnership income taking into account any special allocation agreement) or (ii) an interest in more than 50 percent of the partnership capital;

    (4) A trust of which the United States person: (i) is the trust grantor and (ii) has an ownership interest in the trust for

United States federal tax purposes. See 26 U.S.C. sections 671-679 to determine if a grantor has an ownership interest in a trust;

(5) A trust in which the United States person has a greater than 50 percent present beneficial interest in the assets or income of the trust for the calendar year; or

(6) Any other entity in which the United States person owns directly or indirectly more than 50 percent of the voting power, total value of equity interest or assets, or interest in profits.

B. **Penalties for Failure to File an FBAR**:

Depending on a taxpayer's particular facts and circumstances, the following penalties could apply:

- A penalty for failing to file the Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts, commonly known as an "FBAR"). United States citizens, residents and certain other persons must annually report their direct or indirect financial interest in, or signature authority (or other authority that is comparable to signature authority) over, a financial account that is maintained with a financial institution located in a foreign country if, for any calendar year, the aggregate value of all foreign accounts exceeded $10,000 at any time during the year. Generally, the civil penalty for willfully failing to file an FBAR can be as high as the greater of $100,000 or 50 percent of the total balance of the foreign account per violation. See 31 U.S.C. § 5321(a)(5). Non-willful violations that the IRS determines were not due to reasonable cause are subject to a $10,000 penalty per violation.
- Beginning with the 2011 tax year, a penalty for failing to file form 8938 reporting the taxpayer's interest in certain foreign financial assets, including financial accounts, certain foreign securities and interests in foreign entities, as required by I.R.C. §6038D. The penalty for failing to file each one of these information returns is $10,000, 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.
- A penalty for failing to file Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. Taxpayers must also report various transactions involving foreign trusts, including creation of a foreign trust by a United States person, transfers of property from a United States person to a foreign trust and receipt of distributions from foreign trusts under IRC § 6048.This return also reports the receipt of gifts from foreign entities

under section 6039F.The penalty for failing to file each one of these information returns, or for filing an incomplete return, is the greater of $10,000 or 35 percent of the gross reportable amount, except for returns reporting gifts, where the penalty is five percent of the gift per month, up to a maximum penalty of 25 percent of the gift.

- A penalty for failing to file Form 3520-A, Information Return of Foreign Trust With a U.S. Owner. Taxpayers must also report ownership interests in foreign trusts, by United States persons with various interests in and powers over those trusts under IRC § 6048(b).The penalty for failing to file each one of these information returns or for filing an incomplete return, is the greater of $10,000 or 5 percent of the gross value of trust assets determined to be owned by the United States person.
- A penalty for failing to file Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations. Certain United States persons who are officers, directors or shareholders in certain foreign corporations (including International Business Corporations) are required to report information under IRC §§ 6035, 6038 and 6046.The penalty for failing to file each one of these information returns is $10,000, 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.
- A penalty for failing to file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Taxpayers may be required to report transactions between a 25 percent foreign-owned domestic corporation or a foreign corporation engaged in a trade or business in the United States and a related party as required by IRC §§ 6038A and 6038C. The penalty for failing to file each one of these information returns, or to keep certain records regarding reportable transactions, is $10,000, with an additional $10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency.
- A penalty for failing to file Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation. Taxpayers are required to report transfers of property to foreign corporations and other information under IRC § 6038B. The penalty for failing to file each one of these information returns is ten percent of the value of the property transferred, up to a maximum of $100,000 per return, with no limit if the failure to report the transfer was intentional.
- A penalty for failing to file Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships. United States persons with certain interests in foreign partnerships use this form to report interests in and transactions of the foreign partnerships, transfers of property to the foreign partnerships, and acquisitions, dispositions and changes in foreign partnership interests under IRC §§ 6038, 6038B, and 6046A. Penalties include $10,000 for failure to file each 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.

- Fraud penalties imposed under IRC §§ 6651(f) or 6663. Where an underpayment of tax, or a failure to file a tax return, is due to fraud, the taxpayer is liable for penalties that, although calculated differently, essentially amount to 75 percent of the unpaid tax.
- A penalty for failing to file a tax return imposed under IRC § 6651(a)(1). Generally, taxpayers are required to file income tax returns. If a taxpayer fails to do so, a penalty of 5 percent of the balance due, plus an additional 5 percent for each month or fraction thereof during which the failure continues may be imposed. The penalty shall not exceed 25 percent.
- A penalty for failing to pay the amount of tax shown on the return under IRC § 6651(a)(2). If a taxpayer fails to pay the amount of tax shown on the return, he or she may be liable for a penalty of .5 percent of the amount of tax shown on the return, plus an additional .5 percent for each additional month or fraction thereof that the amount remains unpaid, not exceeding 25 percent.
- An accuracy-related penalty on underpayments imposed under IRC § 6662. Depending upon which component of the accuracy-related penalty is applicable, a taxpayer may be liable for a 20 percent or 40 percent penalty.

C. Recent Developments in Case Law

1. U.S. v. McBride, (D. Utah, 2012)
2. United States v. Williams, (4th Cir. 2012)
3. Tax Court Lacks Jurisdiction to resolve FBAR matters under Title 31.
4. *Kawashinma v. Holder*, 565 US ____ (2012), decided February 21, 2012. This case was heard by the US Supreme Court, which held FBAR Violations are a Deportable Offense

IV. Other Information Reporting Requirements

A. Form 8865: Return of U.S. Persons With Respect to Certain Foreign Partnerships

Form 8865 must be filed with the income tax return of the U.S. person for the tax year in which the reportable event occurs. Except as otherwise stated in the Regulations, Form 8865 must be filed by any U.S. person who:

1. Acquires any interest in a foreign partnership.
2. Disposes of any portion of his interest in a foreign partnership.
3. Has an interest in a foreign partnership that changes substantially.

A $10,000 penalty is imposed for each failure to furnish the required information within the time prescribed. If the information is not filed within 90 days after the IRS has mailed notice of the failure to the U.S. person, an additional $10,000 penalty (per foreign partnership) is charged for each 30-day period, or fraction thereof. The additional penalty is limited to a maximum of $50,000 for each failure.

B. Form 8858: Information Return of U.S. Persons with Respect to Foreign Disregarded Entities

Form 8858 is filed by U.S. persons that own 100% of a foreign disregarded entity ("FDE,") either directly or constructively as a tax owner. An FDE is an entity that is not created or organized in the United States and that is disregarded as an entity separate from its owner for federal income tax purposes. The tax owner of an FDE is the person that is treated as owning the assets and liabilities of the FDE for federal income tax purposes. The following U.S. persons must file Form 8858:

1. U.S. persons that are tax owners of FDEs at any time during the U.S. person's taxable year or annual accounting period.
2. U.S. persons that are required to file Form 5471 with respect to a controlled foreign corporation and the controlled foreign corporation is the owner of the FDE.
3. U.S. persons that are required to file Form 8865 with respect to a controlled foreign partnership and the controlled foreign partnership is the owner of the FDE.

A $10,000 penalty is imposed for each annual accounting period of each CFC or CFP for failure to furnish the required information within the time prescribed. If the information is not filed within 90 days after the IRS has mailed a notice of the failure to the U.S. person, an additional $10,000 penalty (per CFC or CFP) is charged for each 30-day period, or fraction thereof, during which the failure continues after the 90-day period has expired. The additional penalty is limited to a maximum of $50,000 for each failure.

C. Form 926: Return by a U.S. Transferor of Property to a Foreign Corporation

Each U.S. person who transfers property to a foreign person in connection with certain exchanges or distributions must furnish to the IRS, at the time and in the manner prescribed by the Regulations, any information about the exchange or distribution that IRS requires.

Reporting is thus required if the U.S. person:

1. Transfers property to a foreign corporation in a tax-free exchange.
2. Distributes property in complete liquidation to a non-U.S. person.

3. Transfers property or cash to a foreign corporation where immediately after the transfer the U.S. person holds directly, indirectly, or by attribution at least 10% (by total vote or total value) of the foreign corporation, or the amount of cash transferred by the U.S. person or any related person to the foreign corporation during the 12-month period ending on the date of the transfer exceeds $100,000.

Taxpayers are subject to a penalty for failing to file equal to 10% of the fair market value of the property at the time of the exchange or transfer. The penalty will not apply if the failure to file is due to reasonable cause and not willful neglect. In addition, the penalty is limited to $100,000 unless the failure to comply was due to intentional disregard.

D. Form 3520: Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts

U.S. persons are required to file Form 3520 when:

1. A U.S. person creates a foreign trust.
2. Upon the death of a U.S. person when the decedent was treated as the owner of any portion of a foreign trust under the grantor trust rules, or any portion of a foreign trust was included in the decedent's gross estate.
3. Certain transfers of money or property (directly or indirectly) to a foreign trust by a U.S. person (whether or not another person is treated as owning a portion of the trust under the grantor trust rules), including a transfer due to death. Transfers to foreign trusts are reportable if the transfer is gratuitous, i.e., any transfer other than a transfer for fair market value (FMV) (including certain trust obligations), or a corporate or partnership distribution. A gratuitous transfer also includes any direct or indirect transfer that is structured with a principal purpose of avoiding the I.R.C. § 679 rules for foreign trusts with U.S. beneficiaries or the I.R.C. § 6048 foreign trust information reporting rules.

Generally, the penalty for failure to file is equal to the greater of $10,000 or 35% of the gross value of any property transferred to a foreign trust, or 5% of the gross value of the portion of the trust's assets treated as owned by a U.S. person.

E. Form 3520A: Annual Information Return of Foreign Trust with U.S. Owner

A U.S. person who at any time during the tax year is treated as the owner of any portion of a foreign trust under the grantor trust rules, must submit information to the IRS with respect to the foreign trust and is responsible for ensuring that the trust files a return for the year. The annual information return must be made on Form 3520A. Form 3520A must be filed and the required statements furnished to the U.S. grantors and U.S. beneficiaries by the fifteenth day of the third month after the end of the trust's tax year (or later, if pursuant to an extension of time to file).

If the foreign trust fails to file a timely Form 3520A, or does not furnish all of the information required by section 6048(b) the U.S. owner is subject to an initial penalty equal to the greater of $10,000 or 5% of the gross value of the portion of the trust's assets treated as owned by the U.S. person at the close of that tax year.

2012 OFFSHORE VOLUNTARY DISCLOSURE INITIATIVE ("OVDI")

A. Reasons for Participating in the OVDI Program

There are several very good reasons to consider making a 2012 offshore voluntary disclosure regarding your foreign accounts:

1. The IRS is actively investigating foreign banks that are suspected of promoting income tax evasion by U.S. citizens via promising not to report the existence of a foreign account or the income that is generated by, or run through the account, to the U.S. Government to induce deposits being made to the foreign bank. This is the complained of behavior that led to the UBS investigation and lawsuit. A tremendous amount of leads were generated by all of the proceeding voluntary disclosures surrounding foreign accounts for the 2008 and 2011 versions of the program.
2. Recently enacted legislation called FACTA will basically coerce all foreign banks starting in 2014 into reporting the existence of U.S. account holders or be faced with receiving only 70% of the funds transferred to them by U.S. banks from U.S. residents rather than the full 100%. The difference will be back up withholding of 30% for not offering transparency to the U.S. Government. Moreover, the United Kingdom has finalized a FATCA pact, pending approval by parliament while France, Germany, Italy, Spain, Switzerland and Japan have pending agreements and the Treasury is negotiating with at least 40 other countries for FATCA agreements.
3. Taxpayers who do not submit a voluntary disclosure run the risk of detection by the IRS and the imposition of substantial penalties (delineated below), including the fraud penalty and foreign information return penalties, and an increased risk of criminal prosecution. The application of a specific penalty depends on the particular facts and circumstances. Applicable penalties could include, but are not limited to:

    - A fraud penalty equal to 75% of the underpayment due to fraud.
    - A penalty for fraudulent failure to file a return of up to 75% of the amount of tax required to be shown on a return.
    - A penalty for failing to file the FBAR form, Form TD F 90-22.1.

- A penalty for failing to file information returns for foreign trusts and for receipt of certain foreign gifts as required by IRC §§ 6048 and 6039F.
- A penalty for failing to file Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations under IRC §§ 6035, 6038 and 6046.
- A penalty for failing to file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business, as required by IRC §§ 6038A and 6038C.
- A penalty for failing to file Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation as required by IRC § 6038B.
- Failure to file, failure to pay and accuracy related penalties could also be assessed against a taxpayer who does not participate in the initiative.

The biggest hammer that the IRS can hold over the head of taxpayers who do not participate in the 2012 OVDI is the **prospect of criminal prosecution** if the IRS learns that a taxpayer had unreported offshore income. To wield this hammer effectively the IRS remains actively engaged in ferreting out the identities of those with undisclosed foreign accounts. Moreover, this information is being made increasingly available to the IRS under tax treaties, through submissions by whistleblowers, and will become more available as the Foreign Account Tax Compliance Act (FATCA) and Foreign Financial Asset Reporting (new IRC § 6038D) take effect.

Congress has also armed the IRS with the a penalty regime that could easily result in a multiple of the value of any offshore account and offshore assets being assessed, in addition to the potential of doing 5 years in federal prison per count (up to five counts possible for a total of 25 years in jail), as well as having to pay for the cost of prosecution.

Generally, there is no **de minimis** unreported income exception to the offshore penalty. If an account generated **even minimal unreported offshore income** during the disclosure period, **it is subject to the offshore penalty.** However, an apparent exception to this rule is noted where the IRS recently announced that non-resident U.S. Taxpayers with less than $1,500 of unreported income will be given an alternate program to enter that offers less harsh terms than those included within the 2012 OVDI.

B. Prerequisites to Participating in the OVDI Program

If you still have not made a voluntary disclosure concerning your foreign account or income generating assets or entities, it is still possible to come forward and report them under the OVDI program so long as the following is true:

1. All income is from legal sources. Illegal source income may come from extortion, prostitution, and drug sales. Income tax evasion is legal source income for this purpose.
2. The government has not already received your name from a whistleblower or from its own sources. If you believe they might already have your name you still might be able to avoid criminal prosecution by coming forward before they act on the information they already have. A pre-check on your ability to enter the program will quickly allay any fear you may have, and qualifies as your entry date into the program before any disclosures are made other than you may have a generalized foreign or domestic reporting problem.
3. The IRS has not already opened up an audit against you.

C. Amnesty Under the 2012 OVDI Program

Taxpayers who are accepted into the 2012 OVDI program will be subject to a 20% accuracy related penalty, failure to file and pay penalties (where applicable), and a reduced "offshore" penalty in lieu of the penalties for failing to file FBARs.

Further, the offshore penalty under the 2012 OVDI program is 27.5% of the highest aggregate value in the offshore accounts (which may in certain circumstances also include foreign assets) during the covered period, as compared to a 25% penalty under the 2011 OVDI and 20% under the 2009 OVDP. The offshore penalty may be either 5% or 12.5% in limited circumstances.

V. FATCA

A. Overview
B. Consequences for immigrants

VI. Border Security, Economic Opportunity, and Immigration Modernization Act of 2013 (SB 744)

A. Highlights of the Senate Bill
   1. Registered Provisional Immigrant (RPI) status:
      a. **Eligibility criteria** includes requirement that RPI must pay all outstanding federal tax liability assessed by IRS and must pay taxes during the period of RPI status.
      b. **Ineligible for RPI status** – where a person is convicted of a felony (includes tax crimes). Tax evasion is considered an aggravated

felony pursuant to *Kawashinma v. Holder*, 565 US ____ (2012), decided February 21, 2012.

c. **Before a person who is in an RPI status can apply to change their status from an RPI to a lawful permanent resident (LPR), applicants must pay any outstanding federal tax liability that has been assessed by the IRS and must pay taxes during the period of RPI status.**

VII. IRS Civil Audit Process & Collections

A. Assessments

To collect taxes from a taxpayer, IRS must first "assess" a tax, which is a formal recording of tax liability. The IRS may not assess a tax until the taxpayer's procedural and appeals rights have been exhausted or lapsed.

Internal Revenue Code §6203, in turn, provides that assessment of taxes is made by recording the taxpayer's name, address and tax liability in the office of the Secretary of the Treasury (i.e., on the IRS's books of account).

An assessment can occur in various ways, including: a) "Self-assessment" (when a taxpayer files a return); b) Deficiency Assessment after an examination by the Service of a taxpayer's return (where a deficiency is found);[10] c) Jeopardy Assessment, which allows the Service to immediately asses taxes where the Service believes an assessment or collection of tax will be jeopardized by delay[11]

B. Statute of Limitations

The general rule is that the IRS must assess a tax within 3 years of when a return was filed. IRC §6501(a).

The exceptions are:

1. **6 year rule - Substantial omission of items from gross income**: An omission from gross income of an amount properly includible which is in excess of 25% of the gross income amount stated in a return. The IRS then has 6 years from the date the return was filed to assess taxes. The six 6 statute of limitations applies to the entire return, not just the omitted item.

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[10] The Internal Revenue Service cannot assess a tax "deficiency" without first sending a TP a written Notice of Deficiency (NOD). A "Deficiency" is an amount of tax the taxpayer allegedly owes to IRS in excess of amts. reported on TP's return. Deficiencies generally arise out of IRS audits

[11] Common situations where jeopardy assessment may be made where: a) taxpayer is believed to be departing quickly from U.S. or will conceal himself; b) a taxpayer is believed to be planning to quickly pace property beyond government reach by concealing the prop, removing it from country, dissipating it, transferring it to other persons, etc.; and c) the Internal Revenue Service believes a taxpayer's s financial solvency is imperiled.

2. **The taxpayer voluntarily agrees in writing to extend the statute of limitations.**

3. **Unlimited – no statute of limitations for the following**:
   a. **False or fraudulent return**. In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

      "Badges of fraud" may be considered in determining whether taxpayer filed fraudulent returns, which include:
      i. understatement of income;
      ii. inadequate records;
      iii. failure to file tax return;
      iv. implausible or inconsistent explanations of behavior;
      v. concealing assets;
      vi. failure to cooperate with taxing authority; and
      vii. engagement in illegal activities.

2. **Willful attempt to evade tax**. In case of a willful attempt in any manner to defeat or evade tax imposed by this title (other than tax imposed by subtitle A or B), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

   - *Adame's Estate v. C.I.R.,* 320 F.2d 811, 812 (5th Cir. 1963)
     A deceased taxpayer's failure to declare as income monies he diverted to himself from school funds controlled by him could not be considered as having been done with fraudulent intent to evade taxes such as would render his estate liable for deficiencies beyond period of limitations where, during years in question, money so illegally diverted was not taxable income.

   - *Woolf v. United States*, 578 F.2d 1103, 1104 (5th Cir. 1978). During 1963 and 1964, Woolf operated his own plastering business which employed several persons. During the last two quarters of 1963 and the first two quarters of 1964, he withheld payroll taxes and FICA taxes from his employees' salaries, but neither filed quarterly payroll tax returns nor paid any taxes to the government. On February 5, 1965, after the IRS began an investigation of Woolf, he filed payroll tax returns for the five quarters at issue. When the government later brought criminal charges against Woolf for willful failure to file returns, he pled guilty and agreed to an assessment made in October 1970.

3. **No return is filed**. In the case of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

4. **Termination of private foundation status.** Where a private foundation status is terminated, the tax (or a court proceeding to collect the tax) may be assessed at any time.

C. Criminal Exposure

Tax evasion, the most well known of crimes under the Internal Revenue Code, is a felony defined in §7201 as the willful attempt to evade or defeat any previous tax imposed by Title 26.

The basic elements of a prima facie case are: (1) the existence of a previous tax deficiency, (2) an affirmative act constituting an evasion or attempted evasion of the previous tax hit, and (3) willfulness.

Even if fraudulent concealment is established, a defendant cannot be convicted of previous tax evasion unless an additional previous tax actually is due. Moreover, absent other evidence of intent, failure to file return by itself does not constitute affirmative act. *U.S. v. Litwok*, 678 F.3d. 2012 (2d Cir. 4/30/12) (citing *U.S. v. Romano*, 938 F.2d 1569, 1573 (2d Cir. 1991).

Badges of Fraud – the IRS can infer a taxpayer's fraud from these acts:[12]

i. Understatement of income – not report all income
ii. Failure to keep adequate records (or keeping inadequate records)
iii. Failure to file[13]
iv. Implausible/inconsistent explanations of behavior
v. Hiding assets
vi. Non-cooperation with tax authorities
vii. Engaging in illegal acts
viii. Concealing illegality
ix. Dealing in cash (i.e. a business conducted almost entirely on a cash basis)
x. Failing to make estimated tax payments

[12] *Bradford v. C.I.R.,* 796 F.2d 303, 305 (9th Cir. 1986). In Bradford v. Commissioner, almost all of Bradford's and Salaman's operations were conducted on a cash basis. Although the laetrile smuggling generated a considerable amount of income, Bradford's 1973 tax return showed only his employment income. He did not file tax returns for the years 1974-1977. The Commissioner ultimately assessed Bradford $1,784,316 in tax deficiencies, $891,673 for fraud under 26 U.S.C. § 6653(b) (1982), and $98,001 for failure to file estimated taxes under 26 U.S.C. § 6654 (1982), for a total of $2,773,990.

[13] A willful failure to file a tax return is a misdemeanor pursuant to IRC § 7203. In cases where an overt act of evasion occurred, willful failure to file may be elevated to a felony under IRC § 7201, Tax Evasion. I.R.M. 25.1.7.1.

Failing to file an FBAR is a deportable offense. *Kawashinma v. Holder*, 565 US ____ (2012), decided February 21, 2012.

D. Options to resolve tax liability
   4. Installment Agreement;
   5. Offer in Compromise;
   6. Audit Reconsideration (reopen an audit to produce information that was not previously provided to the Service);
   7. Do Nothing

Cross Over's Between the Tax and Immigration Practice Areas

Taxes and Passports

Generally a passport will not be denied solely where back taxes are owed. The exceptions are found under 22 CFR 51.70. A passport will be denied where:

1. The IRS has started court or grand jury proceedings against you and you are subject to a subpoena;
2. The IRS has filed criminal felony charges against you; you are out on bond or there is a warrant for your arrest; or if a subpoena was issued by the IRS for a federal civil prosecution.

Cash on Hand Confiscated at the Airport or Dock.

The public is allowed to legally carry or mail any amount of money that they want into or out of the United States, but if it is more than $10,000 at one time, it must first (at a minimum) be reported to U.S. Customs and Border Protection. If not U.S. Customs is likely to confiscate the cash and it is theoretically possible that it never be returned because the transportation of money is a violation of the Currency and Foreign Transaction Reporting Act.

The confiscations usually takes place when a traveler is questioned by a U.S. Customs officer upon arrival at the international airport or dock if he or she was carrying over $10,000 in cash. When the traveler answer "yes", or the U.S. Customs officer finds that the passenger is lying about the amount of money on hand, the traveler and his or her luggage are searched. If over $10,000 U.S. in monetary instruments, including travelers checks and U.S. or foreign money, is discovered, and the required FINCEN Form 105 has not been previously filed and presented to the examining U.S. Customs officer, all of the money is likely to be seized on the spot!

The traveler is then forced to hire a customs attorney to pursue getting the money back. The administrative petition for this purpose requires proof of the legitimate source of the money and proof of the legitimate intended use of the money are required in the original From 105. Customs typically returns only 90% of the money.

It is important to note that there are no customs duties, taxes or other fees to be paid to U.S. Customs related to the international transportation of money but rather it is merely a reporting requirement to U.S. Customs.