Christopher J. Byrne PLLC
Attorney at Law | Certified Public Accountant

Memorandum

Re: Offshore Voluntary Disclosure Program

In today's globalized economy, with the mobility of individuals, many members of wealthy families have bank accounts, rental properties, stocks and securities and assorted other assets spread across the globe. Different jurisdictions have imposed reporting requirements and taxes on some of these assets. The United States taxes it's citizens and residents[1] on their worldwide income and imposes annual reporting of certain foreign assets. This can be problematic for members of global families with these world-wide assets as many individuals for one reason of another inadvertently have left one or more of these assets off of their U.S. income tax returns. Failure to come into U.S. tax compliance can result in adverse consequences.

Individuals who remain noncompliant are at risk of criminal and civil liability. Criminal charges related to tax returns include: tax evasion - I.R.C. § 7201, filing a false return – I.R.C. § 7206(1), failure to file an income tax return – I.R.C. § 7203, failure to file an Form TD F 90-22.1 *Report of Foreign Bank and Financial Accounts* ("FBAR") or willfully filing a false FBAR – 31 U.S.C. § 5322. Persons convicted of: tax evasion are subject to a fine of up to $250,000 and a prison term of up to five (5) years; filing a false return are subject to a fine of up to $100,000 and a prison term of up to one (1) year; failure to file an FBAR are subject to criminal fines of up to $500,000 and a prison term of up to ten (10) years. There are several civil penalties which will be imposed (as applicable) as a result of noncompliance. Some of these include: (1) failure to file an

[1] Green card holders and individuals who satisfy the substantial presence test without an applicable exception.

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FBAR – can result in civil penalty of the greater of $100,000 or fifty percent (50%) of the total balance of the foreign account; (2) failure to file Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts* – can result in a penalty of the greater of $10,000 or thirty-five percent (35%) of the gross reportable amount; (3) failure to file Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation* – can result in a penalty of ten percent (10%) of the value of the property transferred, up to $100,000 per return, but if the failure to report the transfer was intentional there is no limit; (4) failure to file a tax return due to fraud or underpayment of tax due to fraud – results in penalty up to seventy-five percent (75%) of the unpaid tax; (5) accuracy-related penalty on underpayments, I.R.C. § 6662 – results in a penalty of up to forty percent (40%).

The Internal Revenue Service ("IRS") currently has a special voluntary disclosure initiative, the *Offshore Voluntary Disclosure Program ("OVDP")*, designed to bring offshore money back into the U.S. tax system and help people with undisclosed income from unreported foreign accounts and assets in compliance with their taxes. There are substantial penalties imposed in this process. Taxpayers who enter into the OVDP are required to pay an accuracy related penalty equal to twenty percent (20%) of the total amount of the underpayments of the tax for all years and an offshore penalty of twenty-seven percent (27%) of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the period covered by the voluntary disclosure program.

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When individuals enter into the OVDP they are required to submit original and amended federal income tax returns for all of the years (currently eight) covered by the OVDP. They are required to comply with a set penalty framework for the years at issue. The OVDP framework generally requires individuals to pay a penalty amount on the formerly unreported income, as well as back-taxes, interest, accuracy related and/or delinquency penalties. Taxpayers in the OVDP are required to: submit full payment of the tax liabilities or make good-faith arrangements with the IRS to pay in full their tax liabilities; agree to cooperate with IRS offshore enforcement by providing information about offshore financial institutions, off shore service providers, etc.; and execute a Form 906 *Closing Agreement on Final Determination Covering Specific Matters.*

Following entry into the OVDP, individuals who successfully complete the program are able to become U.S. tax compliant and avoid criminal prosecution. In addition to the general OVDP, the IRS has also recently expanded the OVDP to include a simpler process for individuals with smaller tax compliance issues.

<u>OVDP's Streamlined Procedure</u>

The streamlined procedure, which went into effect September 1, 2012, is available for U.S. taxpayers living abroad, who have not filed U.S. income tax returns since 2008 and that present, what the IRS deems to be, a low compliance risk. Individuals are deemed to present a low compliance risk if they have simple returns with little or no U.S. tax due. In general, returns that show less than $1,500 tax due in each of the years will be considered low compliance risk. However, if for example, any of the returns submitted though this program claim a refund, the taxpayer is under audit or

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investigation by the IRS, a Form TD F 90-22.1 *Reports of Foreign Bank and Financial Accounts* ("FBARs") warning letter or FBAR penalties have been asserted against the taxpayer, there is U.S. source income,[2] there are indications of tax avoidance, the taxpayer has not declared all of his income in his or her country of residence, etc. then the submission may be deemed as a high risk rather than a low risk.

Individuals of low compliance risk can use the OVDP's stream lined procedure and have an expedited review process. This streamlined procedure has been implemented in recognition that some U.S. taxpayers living abroad have failed to timely file U.S. federal income tax returns, or FBARs and are now seeking to come into compliance with U.S. tax law.

The streamlined procedure is available for non-resident U.S. taxpayers who have resided outside of the United States since January 1, 2009 and who have failed to file U.S. tax returns during this time period. All of the returns submitted under the OVDP's streamlined procedure must have a valid Taxpayer Identification Number, which for U.S. citizens is a Social Security Number ("SSN"), and for individuals not eligible for a SSN, an Individual Taxpayer Identification Number ("ITIN").

Under the OVDP's streamlined procedure, the IRS will not assert penalties or pursue follow-up actions.

Taxpayers utilizing this procedure will be required to file delinquent tax returns with the appropriate related informational returns, for example Form 3520 *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*

[2] *See* I.R.C. § 861 for authority on income from sources within the United States.

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or Form 5471 *Information Return of U.S. Persons with Respect to Certain Foreign Corporations* for the past three (3) years and to file delinquent FBARs for the past six (6) years. Additionally, they must submit a complete, accurate and signed questionnaire as well as follow the instructions listed on the IRS's website.

Example:

Jane and John Sample are U.S. citizens who have retired to Canada. They moved to Canada at the end of 2008. They live in their Canadian home and are primarily living off of their savings. They currently have two (2) U.S. bank accounts and one (1) Canadian bank account that are interest bearing. The last U.S. tax return Jane and John Sample filed was their 2008 Form 1040 U.S. Individual Tax Return.

The issue here is whether or not Jane and John Sample qualify for the streamlined OVDP.

Jane and John Sample may qualify for the OVDP's streamlined procedure. Jane and John have resided outside of the United States since January 1, 2009, and have not filed a U.S. tax return during the same period; therefore some of the basic requirements have been satisfied for qualifying for the program. There are two issues, however, which there may be with Jane and John Sample's satisfaction of the requirements for the OVDP's streamlined procedure. First, Jane and John Sample have interest bearing bank accounts. Evaluation of these bank accounts will be dependent on the amount of income they generate. If these bank accounts generate an income such that more than $1,500 of taxes is due on these accounts, then it is likely that this will not qualify for the OVDP's streamlined procedure. If however, the income from these bank accounts did not generate more than $1,500 in taxes due, it is possible for Jane and John Sample to qualify for the OVDP's streamlined approach. It must be

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emphasized that it is imperative that the surrounding facts and circumstances be analyzed and evaluatesd in order to accurately determine whether or not Jane and John Sample qualify for the OVDP's streamlined procedure. The other risk factors must be evaluated in order for proper determination to be made. It is strongly recommended that professional advice be obtained in order to evaluate eligibility to this program.

Registered Retirement Savings Plans

Registered Retirement Savings Plans ("RRSPs") are the Canadian version of U.S. IRAs. Under Article XVIII (7) of the U.S. – Canada income tax treaty, Canadian taxpayers who are required to file U.S. income tax returns can receive a tax deduction for amounts they put in the accounts and pay tax when they start drawing down the funds during retirement. However, in order for the accrued income (but not distributed) earned in an RRSP not to be taxable to a U.S. taxpayer, s/he must make an election to defer the tax until distributions are made from the RRSP, by filing a Form 8891 *U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans*, with his/her timely U.S. tax return. Absent an election, accrued earnings of the plan would be taxable. Individuals who failed to timely file a timely Form 8891 can come into compliance by filing (1) a statement requesting an extension of time to make an election to defer income tax, (2) Form 8891 for each of the tax years and type of plan covered under the voluntary disclosure, and (3) a statement signed by the taxpayer under penalties of perjury describing the events that led to the failure to make the election and the events that led to the discovery of the failure.

Example:

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Mary Sample is a Canadian national. In 2008, she was relocated by her Canadian employer to their New York office. Prior to leaving Canada, Mary Sample contributed regularly to her Canadian RRSP. When she moved from Canada to the United States she continued contributing to her RRSP. She has not made any withdrawals from her RRSP nor has she received any distributions from it. Since being relocated to the U.S., Mary has not filed any U.S. tax forms other than a Form 1040 U.S. Individual Income Tax Return. She has not filed informational forms regarding the RRSP with her U.S. income tax returns.

The primary issue here is how Mary Sample could come into tax compliance.

Mary Sample could enter into the OVDP. In doing so she would be required to follow all of the filing requirements for the regular OVDP. She would need to amend her U.S. returns from 2008 to the present with Form 8891. Mary Sample would not need to file FBARs. Following filing of these forms and successful completion of the OVDP, Mary could come into U.S. tax compliance. Going forward Mary should file Form 8891 with her annual U.S. tax return in order to maintain compliance with U.S. tax laws.

The IRS Offshore Voluntary Disclosure Program and Initiative demonstrated the value of a uniform penalty structure for taxpayers who came forward voluntarily and reported their previously undisclosed foreign accounts and assets. The current program is ongoing and is still open for taxpayers. However, the terms of this program could change at any time going forward.

The IRS remains actively engaged in ferreting out the identities of those with undisclosed foreign accounts. Moreover, increasingly this information is available to the IRS under tax treaties, through submissions by whistleblowers, and will become more available under the Foreign Account Tax Compliance Act (FATCA) and foreign financial asset reporting requirements.

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