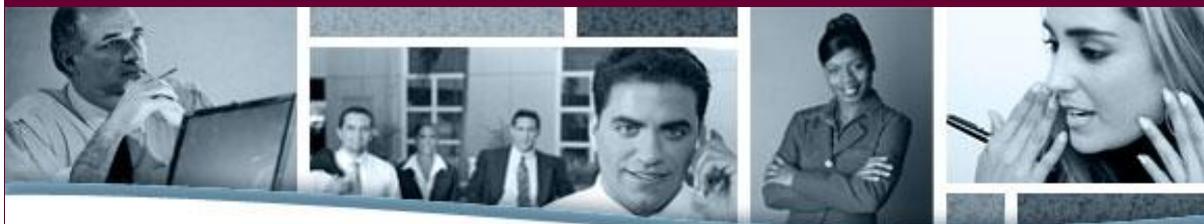


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New Options for Taxpayers Who Failed to File International Information Returns

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Foreign Income & Taxpayers

In June, the IRS made considerable modifications to the Offshore Voluntary Disclosure Program (OVDP), which for years has been used by taxpayers to avoid criminal prosecution by disclosing foreign financial accounts, getting current on taxes owed on income generated by those accounts, and paying a penalty.

In addition to changes to the OVDP, the IRS provided updated guidance addressing the appropriate procedure for taxpayers who have failed to file required international information returns (such as Forms 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, and 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business) or who have failed to file required Fin CEN Forms 114, Report of Foreign Bank and Financial Accounts (FBARs) (previously Treasury Form TD F 90-22.1). The ways a taxpayer can deal with the failure to file these forms are outlined in "Options Available for U.S. Taxpayers with Undisclosed Foreign Financial Assets" (available at www.irs.gov).

Remedial procedures contained in the options may apply to taxpayers in the following situations:

- Failure to report gross income from a foreign financial asset and pay tax as required by U.S. law;
- Failure to timely file FBARs; and

- Failure to timely file international information returns (e.g., Forms 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts; 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner; 5471; 5472; 8938, Statement of Specified Foreign Financial Assets; 926, Return by a U.S. Transferor of Property to a Foreign Corporation; and 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund).

The four options available contain significant distinctions that must be considered by taxpayers and tax advisers. Below is an overview of each option.

Option 1: Offshore Voluntary Disclosure Program (OVDP)

The OVDP is designed for taxpayers with exposure to potential criminal liability and/or substantial civil penalties due to a wilful failure to report foreign financial assets and pay all taxes due on those assets. It provides taxpayers with such exposure (1) protection from criminal liability; and (2) terms for resolving their civil tax and penalty obligations. The decision for a taxpayer to enter into the OVDP is not one to be taken lightly. Indeed, many practitioners regard the decision as one requiring legal consultation, given the risk of potential criminal prosecution.

Option 2: Streamlined Filing Compliance Procedures

The streamlined filing compliance procedures are designed to provide individual taxpayers (including estates) with an efficient way to file amended or delinquent returns and terms for resolving their tax and penalty obligations. This option requires that the taxpayer certify that the failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to nonwillful conduct. Taxpayers residing in the United States filing under this option are required to pay a 5% miscellaneous offshore penalty. Additional criteria may apply depending on whether the taxpayer is residing inside or outside the United States.

Option 3: Delinquent FBAR Submission Procedures

Delinquent FBAR submission procedures will generally be available where a taxpayer does not need to use either Option 1 or Option 2 but has not filed a required FBAR. To be eligible for this option, a taxpayer cannot be under examination by the IRS, or have been contacted by the IRS about the delinquent FBARs. A taxpayer that files FBARs under this option will not be subject to a penalty for failure to file delinquent FBARs if the taxpayer properly reported and paid tax on all income from the foreign financial

accounts reported on the delinquent FBARs and otherwise meets the requirements above. FBARs submitted under this option are not automatically subject to audit, but they may be selected for audit through the existing audit selection process.

Option 4: Delinquent International Information Return Submission Procedures

Delinquent international information return submission procedures will generally be available where a taxpayer does not need to use either Option 1 or Option 2 but has not filed one or more required international information returns (e.g., Forms 5471, 5472, 926, etc.), has reasonable cause for not timely filing the information returns, is not under an IRS civil examination or a criminal investigation, and has not already been contacted by the IRS about the delinquent information returns. These procedures replace the procedures described in FAQ No. 18 in the 2012 OVDP FAQs that were in effect before July 1, 2014.

A taxpayer is eligible to use this option regardless of whether it has unreported income, so long as it meets the other requirements. The taxpayer must provide a statement of facts under penalties of perjury establishing reasonable cause and certify that any entity for which the information returns are being filed was not engaged in tax evasion. Information returns submitted under this option are not automatically subject to audit, but they may be selected for audit through the existing audit selection process. Unlike with Option 3, a taxpayer filing under Option 4 is not guaranteed relief from penalty assessment for delinquent returns filed.

Takeaway

Taxpayers who have not been wilful in their failure to report gross income from foreign financial assets or to meet their reporting obligations, should carefully consider using Option 3 or Option 4. For many taxpayers, these options may provide an expedient and cost-effective way to get current on tax and reporting obligations. However, given the IRS's and the U.S. Department of Justice's vigilance in tracking unreported offshore financial accounts and income, taxpayers should consult with their tax adviser (and potentially legal counsel) before making any disclosures to the IRS.

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