

International Tax and Foreign Financial Asset Reporting

Chapter 11

Supp

FINCEN Notice
October 19, 2017

FBAR Extension to
1/1/2018 for California
Wildfire Victims

Bedrosian v. U.S.,
(DC PA 4/13/2017)

Issue of Willful Failure
To File An FBAR Is An
Inherently Factual
Question

3

Facts

- Bedrosian opened two UBS accounts (in Switzerland) 1973.
- Bedrosian did not tell his tax preparer, Handelman, about his foreign bank accounts until "the 1990's"
- No FBARs filed; no Form 1040 admission.

4

- Handleman told Bedrosian that he had been breaking the law for the past 20 years by denying the ownership of a foreign bank account on Schedule B.
- When Bedrosian asked what to do, "Handelman stated that he could not 'unbreak the law,' and should therefore take no action."

5

- When Handleman died in 2007, Bedrosian hired another accountant, Bransky, and Bedrosian for the first time filed an FBAR reporting one UBS account of \$240,000 and admitted to a foreign bank account on Form 1040 Schedule B.
- He failed to report the other account worth about \$2 million on the FBAR.

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- “Bedrosian did not report any of the income that he earned on either Swiss account on his 2007 return.”
- “Sometime after 2008, UBS told Bedrosian that it **would be providing his account information to the United States government.**”

7

Prior to any government investigation, Bedrosian hired an attorney and in Aug. 2010:

- 1) Filed an **amended 2007 Form 1040** and reported the **\$220,000** of income earned from the Swiss accounts.
- 2) Filed an **amended FBAR for 2007** reporting both UBS accounts.

8

Bedrosian also
“engaged an
accounting firm to go
back and amend his
returns from 2004 to
the present.”

9

An IRS investigation began in 2011 and on July 13, 2013 the IRS sent Bedrosian a letter stating that it was imposing a penalty for his willful failure to file the FBAR form, for tax year 2007 and the proposed penalty was \$975,789.17 (50% of the maximum value of the account (\$1,951,578.34))

10

Dist. Ct. Issue

Both parties sought pre-trial summary judgment in their favor.

11

Dist. Ct. Holding

“Whether Bedrosian willfully failed to submit an accurate FBAR for 2007 is an inherently factual question and one that cannot be resolved at this stage.”

Both sides' summary judgement motions denied.¹²

Bedrosian v. U.S.,
(DC PA 9/20/2017)
(Bedrosian II)

Government Failed
to Prove a Willful
FBAR Violation

Background

As noted in *Bedrosian*
and other judicial
decisions, "reckless
disregard satisfies the
willfulness standard."

Contrary to IRS CCA
200603026

The government bears the burden of proving each element of the civil FBAR penalty by a preponderance of the evidence, including the issue of willfulness.

15

Dist. Ct. Holding

"After a careful review of the record...we cannot conclude, based on a comparison of the facts of this case compared with those of cases in which a willful FBAR penalty was imposed, that the government has proved, by a preponderance of the evidence, that Bedrosian's violation of Section 5314 was willful."

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“His error was in failing to list the second account [on the FBAR]”.

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“[H]is actions were at most negligent, which does not satisfy the willfulness standard.”

18

Gubser v. IRS, et al., (CA 5, 3/13/2017)

11-5

Taxpayer Lacked Standing
For Pre-assessment (he is
in IRS appeals)
Declaratory Judgment On
FBAR Penalty

19

Facts

- Gubser received a Letter 3709 from the IRS stating that he had not filed the required FBAR for 2008.
- The IRS proposed a **penalty of \$1,363,336**—half of the undisclosed account balance at the time of the violation—**for Gubser's willful failure to file the FBAR.**

20

IRS Gave Three Options:

- 1) agree to the proposed penalty and make payment;
- 2) disagree and request a conference with the IRS Appeals Office; or
- 3) do nothing and the IRS “will assess the penalty and begin collection procedures.”

21

The IRS Appeals officer purportedly told Gubser that IRS likely could prove **by a preponderance of the evidence**—but **not by clear and convincing evidence**—that he **willfully** failed to report the overseas account.

(Preponderance is all that is needed)

22

5th Circuit Upholds District Court

Grubser lacks standing to question the penalty at this stage.

"[I]t was 'highly speculative' and 'far from likely' that Gubser's requested declaration would prevent the IRS from assessing a penalty."

23

Pomerantz
(DC WA 10/3/2017)

11-9

Court Rejects
Taxpayer's
Arguments To Stop
FBAR Civil Penalties

24

*IRS News Release
2017-43 (02/23/2017)*

11-10

*IRS Explains Filing
Requirements For
Certain non-U.S.
citizens*

25

Most individuals in F-1, J-1, M-1, Q-1 and Q-2 non-immigrant status are eligible to be employed in the U.S. and are eligible to apply for a Social Security number if they are actually employed in the United States.

26

Those not eligible for an SSN but who have a tax filing requirement may request an Individual **Taxpayer Identification Number** from the IRS.

27

*CCA 201719026
(5/12/2017)*

11-12

Offshore Compliance
Program Amended
Returns Claiming Refunds
Must Meet Timely Filing
Rules

28

Maze v. IRS
(CA DC 7/14/2017)

11-14

Anti-Injunction Act
Blocked Efforts To
Enter More Lenient
Offshore Disclosure
Program

29

2012 OVDP Requires
Taxpayers to (in part):

- File 8 Years of Form 1040s and FBARS.
- Pay tax and interest for 8 years.
- Pay accuracy-related penalties for 8 years.
- Pay a misc. Title 26 penalty of 27.5% of foreign asset value.

30

In 2014, IRS introduced the 2014 Streamlined Filing Compliance Program (SFCP) for **non-willful** taxpayers:

- File 3 years of Form 1040s and 6 years of FBARs;
- Pay tax and interest for three years.
- Pay misc. Title 26 penalty of 5% of value of foreign assets.

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The SFCP offers no protection against:

- Criminal prosecution.
- Income tax fraud.
- Willful FBAR penalties.

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Generally, if a taxpayer enters the OVDP, they are barred from the SFCP

33

The IRS offered eligible taxpayers who entered the OVDP shortly after the SFCPs were put in place in 2014, and before July 1, 2014, "Transition Treatment" to receive the more lenient 5% v. 27.5% SFCP penalty but otherwise remain in OVDP (8 years of tax returns and accuracy penalties)

34

- A taxpayer that enters an OVDP after July 1, 2014 is categorically barred from the SFCP
- The plaintiffs all entered the OVDP prior to July 1, 2014.

35

The plaintiffs sought to be allowed to “directly enter” the SFCP and be treated like any other SFCP applicant.

(and not be forced to accept the “transition treatment”)

36

Appellate Court Holding

Affirming the District Court, the Appellate Court agreed with the IRS that the Anti-Injunction Act (AIA) **deprives the Court "of jurisdiction over this action in its entirety by those statutes."**

37

Alternative Remedies:

[IRS identifies] "two alternative remedies that Plaintiffs can pursue: specifically, to pursue a settlement with the IRS independent of the established voluntary disclosure programs and, if those settlement talks fail, **to pay the full assessed liabilities and seek a refund through a refund suit [and challenge the Transition Rules]"**

38

McManus

11-14

(Ct Fed Cl 3/3/2017)

Irish Citizen Wins 17.4 million at Backgammon But Loses Tax Fight in U.S. Court of Federal Claims.

39

- McManus **won \$17,400,000** in a three-day backgammon match in the U.S.
- He sought a refund of the \$5,220,000 withheld U.S. federal income tax based upon the U.S./Ireland Tax Treaty.

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“It is not disputed that if Mr. McManus was a ‘resident’ of Ireland in 2012 for the purposes of the Tax Treaty he would be entitled to a refund.”

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McManus is a
citizen of
Ireland who
lives in
Switzerland.

42

Ct. Fed. Claims Holding

McManus was **not a resident of Ireland in 2012 under the Tax Treaty** despite his payment of a "domicile levy" to Ireland.

No Refund!

43

Too Late Argument

- During oral arguments McManus argued that the United States tax violates the Tax Treaty's **nondiscrimination provisions.**
- The judge dismissed the argument as too late.

44

Pei Fang Guo 11-15

149 TC No. 14
(Oct. 2, 2017)

Unemployment
Compensation Taxable
Under U.S. - Canada
Treaty
(Tax Court First Impression)

45

Issue

Is U.S.-source unemployment compensation received by a citizen of Canada (not residing in the U.S. in the year at issue--2012) exempt from Federal income tax under the U.S./Canada Tax Treaty?

46

Tax Court Holding

The Tax Treaty **does not exempt the Canadian citizen** from U.S. tax on U.S. unemployment compensation.

47

*Klubo-Gwiedzdzinska,
TC Summary Opinion
2017-45 11-16
(June 28, 2017)*

Hospital's Payments To
Research Fellow Were
Taxable Under
U.S.-Poland Treaty

48

Treaty Background

Article 17 of the U.S./Poland Treaty exempts personal service income performed for “teaching or research” by a U.S. resident in Poland if at a “university or other recognized educational institution” for 2 years.

49

Tax Court Holding

The taxpayer’s services performed at a Polish University Hospital (focused on patient care, not teaching), were not done at a “university or recognized educational institution” so no Article 17 exemption.

50

Treaty Background

Article 18 of the U.S./Poland Treaty exempts payments to a recipient of a Studying “grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational organization” for studying or research.

51

Tax Court Holding

- The taxpayer also fails to meet the Article 18 exemption.
- She simply performed services for the University Hospital and was not the recipient of a “grant, allowance or award....”

52

Dewees

11-17

(DC Dist Col 8/8/2017)

Canada Offsetting
Canadian Tax Refund With
U.S. Tax Deficiency Is
Constitutional

53

Facts

Dewees is a U.S. citizen living in Canada, where he operates a consulting business. For over a decade he failed to file IRS Form 5471 for the foreign corporation.

54

- IRS imposed a penalty on Dewees of \$120,000 (\$10K per year of noncompliance).
- Dewees unsuccessfully fought the penalty, but refused to pay it.

55

Per the U.S.-Canada tax treaty (collection assistance provisions), the Canadian tax authority held Dewees' Canadian tax refund in abeyance until the IRS penalty was paid in full.

56

Deweese paid the [U.S.] penalty of \$134,116.34 (penalty plus interest) to the Canadian Revenue Agency and filed suit in U.S. District Court.

57

District Court Holding

“Deweese has failed to state a claim for relief on his Eighth Amendment and due process claims, and lacks standing to bring his equal protection claim, the Court will grant the Government's motion and dismiss the case.”

58

Liljeberg, et al,
148 TC No. 6
(March 16, 2017)

Foreign Work-Travel
Exchange Students
Denied Deduction For
Travel Costs

Background

Comm'r v. Janss, 260 F.2d
99 (8th Cir. 1958) **disallowed**
an Iowa college student's
deduction for travel
expenses while employed
as a construction worker in
Alaska on the grounds that
no business exigencies
required his travel there.

Facts

- Taxpayers are foreign nationals (nonresident aliens U.S. tax purposes)
- The cases arise out of their participation in the Summer Work Travel Program (SWTP).

61

- They are present in the U.S. on temporary "J Visas"
- "They came to the United States for no more than four months over the summer to participate in cultural exchange, travel domestically, and work in temporary or seasonal jobs."

62

Issue

- Can the SWTP students deduct as unreimbursed employee business expenses, their travel, living expenses, and meals and entertainment (travel away from home expenses)?

63

Tax Court's Holding

The SWTP students fail the "away from home requirement" so no deduction for travel expenses.

64

"[A] taxpayer who pursues temporary employment away from the location of his usual residence, **but has no business connection with that location**, is not **"away from home"** for purposes of section 162(a)(2)." *Hantzis v. Comm'r*, 638 F.2d at 255 (8th Circuit)

65

Sotiropoulos II,
TC Memo 2017-75
(May 1, 2017)

11-18

Foreign Tax
Overpayments Were
"Refunds" For Purposes Of
Foreign Tax Credit

66

Facts

- Taxpayer is a U.S. citizen who lived and worked for **Goldman Sachs** in the United Kingdom.
- On her Federal income tax returns for 2003-2005, she **claimed foreign tax credits** based on the amounts of U.K. **income tax withheld** from her wages by her employer.

67

- Her U.K. income tax returns for the relevant periods, showed large overpayments and the UK government “duly rebated to her **substantially all of the tax** that had been withheld from her wages.”
- She failed to file amended returns to reduce the FTCs.

68

- In the audit, IRS recomputed her foreign tax credits and imposed an accuracy-related penalty.
- The taxpayer argued that the refunded UK taxes were “under investigation”.

69

<u>Year</u>	<u>Tax Deficiency</u>	<u>Penalty</u>
2003	\$135,250	\$27,050
2004	127,366	25,473
2005	140,848	28,170

70

Tax Court's Holding

"We accept petitioner's averments as true [that her UK refunds were under investigation], but they are irrelevant in determining whether the repayments of U.K. tax she received were 'refunds'."

71

- "For U.S. tax purposes, the term 'refund' does not connote finality or the final determination of a tax liability."
- In other words, her U.S. FTC is reduced by the UK refunds whether or not the UK is investigating the refunds.

72

“As a cash basis taxpayer, petitioner is entitled to claim a credit for foreign income taxes when paid”

73

“If her predictions prove correct and [the UK] later collects additional 2002-2006 U.K. tax from her, she will be entitled to claim a [U.S. FTC] for those taxes for the year in which she pays them.”

74

"[W]e conclude that the repayments of U.K. income tax that petitioner received during 2003-2005 represented previously paid foreign tax that was "refunded in whole or in part" within the meaning of section 905(c)(1)(C)."
(partial summary judgment granted)

75

*Trusted Media Brands
Inc. v. U.S.* 11-19
(DC SDNY 9/27/2017)

Ten-Year Refund S of L
Period for Foreign Tax
Credit Does Not Apply To
Deductions

76

The district court concludes that the 10-year statute of limitations period for taxpayer refund claims in section 6511(d)(3) is not available to a taxpayer that claimed a foreign tax credit and later (beyond 3 years) amended its return to claim a deduction (instead of a credit) for its foreign taxes paid.

77

Acone, TC Memo 2017-162 (Aug. 22, 2017)

11-20

Commercial Airline Pilot Based In South Korea Failed to Qualify For Foreign Earned Income Exclusion

78

Background

Under section 911(d)(1) the foreign earned income exclusion (FEIE) requires that the taxpayer's tax home is in a foreign country', and the taxpayer's "abode" cannot be in the U.S. (section 911(d)(3))

79

The taxpayer must **also**:

(1) ~~Meet the physical presence test in the foreign country (330 days),~~ **or**

(2) Be a **bona fide resident of a foreign country.**

80

Tax Court's Holding #1

- The U.S. is his tax home (abode)
- He always stayed, at no charge, at an Incheon Airport, South Korea, hotel owned by his employer (KAL); in different rooms.

81

- 80% of time on days off were in the U.S.
- Flights to and from the U.S. were free.
- He received per diem payments from KAL to cover meals and incidental expenses in South Korea.

82

- Never obtained a driver's license or car in South Korea.
- His wife and children lived in New Hampshire.
- He was in New Hampshire enough to **mow the lawn**.

83

Tax Court's Holding #2

Mr. Acone was not a bona fide resident of South Korea applying the eleven "*Sochurek factors*":

- 1) intention of the taxpayer;
- 2) establishment of his home temporarily in the foreign country for an indefinite period;

84

- 3) participation in the activities of his chosen community on social and cultural levels, identification with the daily lives of the people and, in general, assimilation into the foreign environment;
- 4) physical presence in the foreign country consistent with his employment;

85

- 5) nature, extent and reasons for temporary absences from his temporary foreign home;
- 6) assumption of economic burdens and payment of taxes to the foreign country;
- 7) status of resident contrasted to that of transient or sojourner;

86

- 8) treatment accorded his income tax status by his employer;
- 9) marital status and residence of his family;
- 10) nature and duration of his employment; whether his assignment abroad could be promptly accomplished within a definite or specified time;

87

- 11) good faith in making his trip abroad; whether for purpose of tax evasion.

88

Linde

TC Memo 2017-180

(9/18/2017) 11-24

Helicopter Pilot In Iraq
Qualified For Foreign
Earned Income Exclusion

89

- Compare Acone.
- “Mr. Linde resided in Iraq for 248 days in 2010, 240 days in 2011, and 249 days in 2012. During these years Mr. Linde's primary responsibility was to fly ‘[a]ll over Iraq’, transporting Government officials to various locations in direct support of the U.S. Ambassador to Iraq.”

90

Like Acone, Linde could not meet the physical presence test:

(1) ~~Meet the physical presence test in the foreign country (330 days),~~ or

(2) Be a **bona fide resident of a foreign country.**

91

Tax Court's Holding #1

- Iraq was his tax home (abode)
- "Mr. Linde's economic and social life was centered in Iraq."

92

“Were it not for his son-in-law's disability, Mr. Linde would have arranged for Mrs. Linde and their children to join him in Europe for some of his break periods.”

93

“Mr. Linde did not work in any other country besides Iraq, and he spent two-thirds of each year in issue there.”

94

“Mr. Linde's use of his free time in Iraq-socializing with other contractors and Iraqi interpreters, making physical improvements to his CHU [containerized housing unit], and visiting local markets and restaurants-evidences an effort to create a domestic and personal life for himself there.”

95

Tax Court's Holding #2

Mr. Linde was a bona fide resident of Iraq based upon the “*Sochurek factors*”.

96

Lock

11-26

TC Summary Opinion
2017-10
(March 6, 2017)

No Foreign Earned Income
Exclusion But Innocent
Spouse Relief Granted to
Former Spouse

97

Again, as in the two prior cases, the issue is whether the taxpayer, working in a foreign country and claiming the FEIE **retained his abode in the U.S.** (so his tax home was not in the foreign country and thus no FEIE).

98

- Compare Linde.
- “During most of 2010 and 2011 and for six months in 2012 Mr. Lock [a deputy sheriff in Florida] lived and worked primarily in the International Zone (IZ) (formerly known as the Green Zone) and neighboring areas in Baghdad [Iraq].”

99

- “[His employer] required Mr. Lock to maintain a valid U.S. tourist passport, a valid U.S. driver's license, and a bank account to facilitate electronic deposits of his paychecks.”
- Mr. Lock's wife and son were not permitted to accompany him to Iraq.

100

Tax Court's Holding

- His abode was in the U.S.
- "Throughout the period in question Mr. Lock maintained extensive familial, economic, and personal ties to the United States, while his ties to Iraq were quite limited.****"

101

Redfield

11-28

TC Memo 2017-71
(April 26, 2017)

Failure To Timely Elect
the Section 911 Foreign
Income Exclusion

102

“Petitioner served for 12 years in the U.S. Marine Corps, including several tours of duty in Afghanistan. Sometime before 2010 he left the Marines as a disabled veteran suffering from memory loss and post-traumatic stress disorder.”

103

- He failed to file Form 1040 in 2010 and IRS prepared a substitute for return (SFR) on May 27, 2014 with a tax deficiency of \$55,217.

104

October 7, 2014, he submitted to the IRS a delinquent return for 2010 on which he reported total income of \$241,140 and excluded \$49,136 under the FEIE.

105

If a taxpayer files late and owes tax after the FEIE, then the taxpayer must file Form 1040 and attach Form 2555 BEFORE the IRS discovers the failure to claim the FEIE.

(Reg. 1.911-7(a)(2)(i)(D))₁₀₆

Tax Court's Holding

- FEIE denied.
- “By preparing SFR [substitute for return] the IRS evidenced its ‘discovery’ that taxpayer had failed to elect the FEIE...”

107

Schaeffler, et al v. U.S. (DC TX 4/25/17)

11-30

Refund was attributed to minimum tax credit carryforward NOT Foreign Tax Credits So 3-Year Limitations Period Applied

108

Notice 2017-21 11-30
(3/13/2017)

Housing Cost Allowances
Issued For Those Working
Abroad In High-Cost Areas
In 2017

109

Highest Limit on Daily
Housing Expenses
(base amount = \$83.91)

Hong Kong -- \$323.15

Moscow -- \$295.89

110

FS-2017-3 11-31
(Feb. 23, 2017)

IRS Clarifies Form 1042-S
Requirements for
Withholding Agents;
Outlines Common Errors

111

11-34

*Link to IRS Website
Comparison of Form
8938 and FBAR
Requirements*

112

International Practice Units Training Aids

09-14-2017	Categorization of Income and Taxes Into Proper Basket	(PDF 179KB)
09-14-2017	Creditable Foreign Taxes	(PDF 117KB)
09-14-2017	Sourcing of Income	(PDF 253KB)