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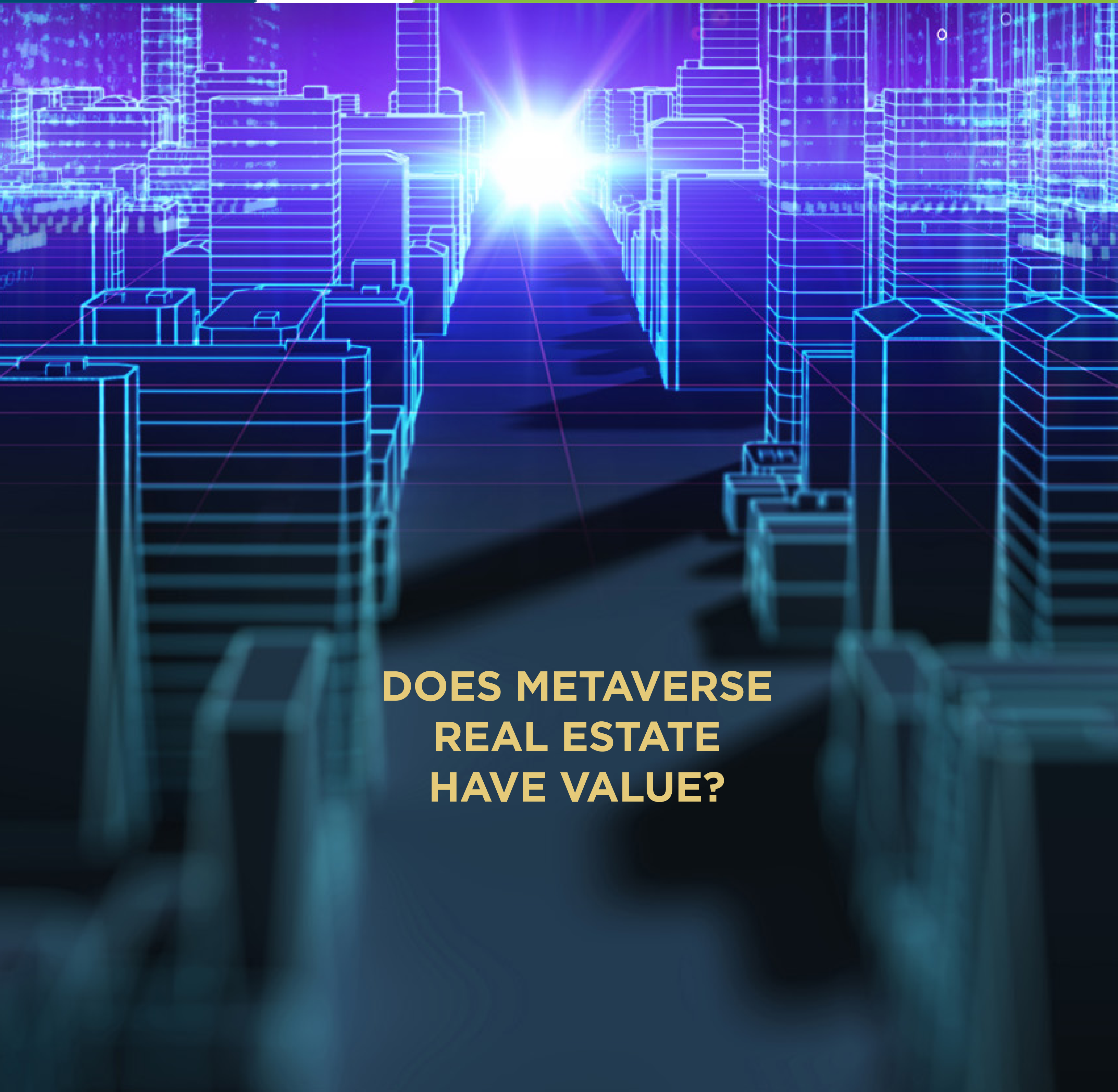

DOES METAVERSE REAL ESTATE HAVE VALUE?

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A QUARTERLY ELECTRONIC PUBLICATION FROM RPTE

DOES METAVERSE REAL ESTATE HAVE VALUE?

By: Phillip N. Coover[1]

This article briefly addresses valuation of metaverse real estate.

Is there really a gold rush on real estate in "the metaverse"? I've been hearing that a lot recently. There are several misconceptions in that question. Initially, there is no one "metaverse." There are several leading platforms which sell metaverse real estate, such as Sandbox and Decentraland. Purchasing a piece of metaverse real estate is essential to buying an NFT (i.e Non-Fungible Token) in a software platform, similar to a video game, which is a series of NFTs. These parcels of real estate exist in a meta world. And companies are gobbling up these parcels. The cheapest parcel on Decentraland was more than $10,000, last time I checked.

The intrinsic value in real world real estate is its' inherent utility by being a tangible physical asset. You could always store something on your real estate, or make a garbage dump, even if it didn't have a better use. You cannot use metaverse real estate in a tangible way. But when you start thinking about meta real estate, the questions and analysis are actually quite similar to real world real estate. Is this a good location where there will be increasing demand? Is there utility in this parcel of real estate? Can I turn this parcel into cash flow, either by leasing, selling goods, advertising on it, or even developing it (yes, you can have software engineers create buildings and other constructs on your virtual parcel).

My gut reaction to all of those questions is "no." There is no utility value in virtual real estate, aside from betting on further demand (like a penny crypto coin). But I also realize that my initial answer may be shortsighted and obtuse. Did people 300 years ago realize that there was value in being on the end of Manhattan where you could build a skyscraper that is leased to hundreds of commercial businesses? It's very possible that I simply do not have the foresight on utility and value in the virtual world. For now, I'll be keeping my ear to the ground for real world real estate, but also have my head in the clouds for the virtual world.

Endnotes

1. Phillip Coover is a partner in Ice Miller's Real Estate Practice, where he helps clients achieve their goals, find strategic solutions and maximize the value of their real property. Phillip is the founder and host of the widely popular "Real Estate for Breakfast" Podcast. On the show, Phillip interviews executives, CEOs, brokers, founders, owners, developers, financiers and other real estate professionals of all types about current real estate trends, issues and developments.

The Top 5 New Environmental Issues for Commercial Property Owners or Managers

By Bernadette M. Rappold, Kerri L. Barsh, Christopher L. Bell, David G. Mandelbaum, and Kaitlyn R. Maxwell[1]

This article discusses certain environmental issues for commercial property owners and managers to consider in light of the pandemic and potential new federal requirements.

The Biden-Harris administration is quickly establishing new federal environment requirements affecting commercial property owners and managers. These requirements, along with changes occasioned by the COVID-19 pandemic, raise a host of new practical and legal considerations for landlords and property managers.

Chief among them are the five issues below:

1. Microbial Contamination Resulting from Property Vacancy and Underutilization

Teleworking has increased dramatically during the pandemic as the result of public health measures to increase social distancing and stem the spread of COVID-19. As a result, many commercial buildings and offices have lain vacant or underutilized.

As workers increasingly return to the workplace, landlords and property managers must be vigilant about the increased possibility of contamination resulting from underuse of key building systems like HVAC and plumbing. Without workers to use these systems, pockets of stagnant water can arise, creating ideal conditions for growth of pathogenic organisms like *Legionella spp*. at levels that may be harmful to the health of occupants and customers alike. *Legionella spp*. cause a severe form of pneumonia that may lead to hospitalization or death.

While most jurisdictions and localities require property owners to conduct regular HVAC inspections and maintenance, few impose analogous requirements for plumbing systems. Even so, landlords and property managers should consider plumbing inspection and maintenance activities prior to workers returning to the office. In carrying out these activities, property owners without specialized expertise in-house should consider engaging consultants that utilize scientifically sound, best practices for monitoring and disinfection.

Failure to properly address residual contamination may result in not only adverse health outcomes but also in loss of income and litigation. Property owners and managers should consult with counsel when developing communications and remediation plans and may want to review their pollution legal liability coverage to ensure it includes contamination with microorganisms.

2. ASTM's Revised Phase 1 Environmental Site Assessment Standard

The American Society for Testing and Materials (ASTM) recently revised its widely used E1527 Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process, now denominated as E1527-21. This standard has long been part of EPA's "all appropriate inquiries" (AAI) rule (40 C.F.R. Part 312) that provides a foundation for parties who may wish to qualify for the bona fide/innocent purchaser defenses to CERCLA/Superfund liability.

The revised standard includes some noteworthy changes in emphasis. For example, "discussions" has been added to key definitions that might increase reliance on the environmental professional's subjective experience or "logic" rather than data in identifying "recognized environmental conditions" (REC), and the new and lengthy "guidance" in an appendix on what constitutes a REC may be mistakenly read as binding mandates. The determination of whether hazardous substances are "likely" to be present on a property should not be transformed into the question of whether one "can exclude the possibility" that hazardous substances "may be present"; doing so could lead to a "prove the negative" approach rather than one based on concrete evidence that contamination is "likely." The revised minimum information source review requirements may also lead to more in-depth assessments. The revised standard also raises the possibility of including materials not yet defined as "hazardous substances" under Federal law, such as per- and polyfluoroalkyl substances (PFAS) in the optional "Non-Scope" portion of a Phase 1.

The bottom line is that the revised ASTM standard may result in more RECs being identified by Phase 1 assessments. Users or consumers of Phase 1 assessments should not hesitate to raise questions about the reports' conclusions, particularly where the conclusions cannot be traced to concrete evidence of releases or contamination.

The existing limitations and cautions about Phase 1 assessments continue to apply, including that typically there is no legal requirement to conduct Phase 1s, and neither the ASTM standard nor EPA's AAI rule require that RECs be corrected or that Phase 2 subsurface investigations be conducted. Phase 1s also have a relatively limited scope, focusing primarily on the risk of soil and groundwater contamination, and are not a comprehensive review of all environmental or related compliance risks. Lastly, there appear relatively few instances where the innocent/bona fide purchaser defenses are actually invoked.

For those interested in the innocent landowner/bona fide purchaser defense, the 2013 version of the ASTM rule (E1527-13) is still the version referred to in EPA's AAI rule. Notwithstanding EPA's direct involved in the ASTM standard's revisions process and that it has the revised standard in-hand, it could be several months, even more, before the revised rule is formally incorporated into the AAI rule. Given that the revised ASTM standard is arguably "more stringent" than the 2013 version, it is unclear whether EPA or a court evaluating an innocent landowner/bona fide purchaser would reject a Phase 1 conducted under the revised standard before EPA updates its rule. Therefore, in the near-term, consulting firms will likely be offering their clients three options: (1) use the 2013 version until EPA updates its rule; (2) use both standards under a blended approach, or (3) use the 2021 version now.

3. EPA Clarifies that the Lead Renovation, Repair, and Painting Rule Applies to Property Managers

With certain exceptions, EPA's Lead Renovation, Repair, and Painting Rule (RRP), 40 C.F.R. §§ 745.80 – 745.92, requires renovation, repair, or painting at residential properties built before 1978 (the year lead was banned in paint) to be carried out only by certified firms. For years, the EPA has maintained a guidance document called *EPA Lead-Based Paint Program Frequent Questions* ("Lead FAQs") (Lead RRP Frequent Questions 7 28 10.doc (epa.gov)). The current iteration of the Lead FAQs includes answers to two questions related to property management companies (PMCs).

The answers suggest that property managers need obtain lead certification only when their own employees are carrying out renovation, repair, and painting of lead surfaces and that the EPA would take enforcement only against the certified renovation firm retained by the PMC – not the PMC itself.

Recently, the EPA published a Federal Register notice stating its plan to withdraw those property manager Q&As. Environmental Protection Agency, *Withdrawal of Two Answers to Frequent Questions About Property Management Companies and the Toxic Substances Control Act Lead-Based Paint Renovation, Repair, and Painting Rule*, 86 Fed. Reg. 60812 (Nov. 4, 2021). Instead, the EPA intends to clarify that it:

> would assess compliance by PMCs with the RRP rule, as it would for any other entity, according to the broadly applicable language of the RRP rule: That no firm may perform, offer, or claim to perform renovations without certification from EPA in target housing or child-occupied facilities

(unless the renovation qualifies for a specified exception). See, e.g., 40 CFR 745.81(a)(2)(ii). Furthermore, the EPA will evaluate compliance and appropriate enforcement actions on the basis of each case's individual facts and circumstances, and the EPA may exercise its enforcement discretion regarding PMC obligations.

Id. at 60813.

While the Lead FAQs are guidance, not regulation, the EPA accepted comments through Dec. 6 on the proposed withdrawals. The handful of received comments was evenly split between those favoring the withdrawals and those against. It is unclear how the EPA will respond to comments, but absent an influx of comments disfavoring the withdrawals on substantive grounds, the withdrawals look likely – especially in light of the Biden-Harris administration's focus on children's health.

This means that PMCs soon may be required to obtain lead certification and to follow all of the RRP regulations, including recordkeeping, particularly where they are subcontracting the lead renovation work. Navigating the RRP can be tricky at first, as is establishing a recordkeeping system that helps to ensure compliance. Routinizing compliance and compliance documentation is critical to avoid winding up in the crosshairs of EPA enforcement.

4. Federal PFAS Regulatory Action May Create New Challenges for Property Owners and Managers

In October 2021, EPA updated its national strategy for addressing certain per- and polyfluoroalkyl substances (PFAS) under a number of federal statutory authorities, including the Safe Drinking Water Act (SDWA), the Toxic Substances Control Act (TSCA), the Resource Conservation and Recovery Act (RCRA), the Clean Water Act (CWA), and the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). There are thousands of PFAS, with different applications, uses, toxicological profiles, and chemical properties. Regulatory action has focused primarily on PFOA (perfluorooctanoic acid) and PFOS (perfluorooctane sulfonic acid), but the list of PFAS under state and federal scrutiny is expanding.

EPA plans to take the following PFAS actions relevant to property owners and managers:

1. Final rulemaking for a federal drinking water standard for PFOA and PFOS by 2023. Some states already have state drinking water standards for PFOS, PFOS, and other types of PFAS.

2. Action under TSCA to increase data collection concerning certain PFAS. Such action includes enhancing reporting obligations under the Toxics Release Inventory (TRI) by proposing rulemaking in 2022 to categorize certain PFAS on the TRI list as "Chemicals of Special Concern" and to remove de minimis eligibility from supplier notifications. Additionally, EPA intends to expand its list of PFAS subject to the TRI.

3. Toxicity assessments for additional PFAS, including hexafluoropropylene oxide dimer acid and its ammonium salt, commonly called "GenX chemicals," as well as PFBA, PFHxA, PFHxS, PFNA, and PFDA. EPA may decide to publish health advisories for GenX and PFBS based on the toxicity assessments.

4. Addressing PFAS discharges from industrial sources through data collection and rulemaking.

5. Plans to designate PFOA and PFOS as hazardous substances under CERCLA. It has been reported that EPA's proposal is with the White House's Office of Management and Budget for final interagency review prior to publication in the Federal Register. Under CERCLA, a site is contaminated if it is the location of a "release" of a "hazardous substance," which causes the incurrence of response costs. As we have explained previously, this hazardous substance designation may expand sites under which a CERCLA cleanup may be conducted.

Accordingly, parties purchasing new property may wish to consider PFOA and PFOS during diligence activities, even before any final designation, depending on the site's prior use, surrounding uses, and future intended use. Parties likewise may wish to consider PFOA and PFOS, as well as other PFAS when drafting environmental indemnification provisions in purchase and sale agreements or commercial leases.

5. Changing Incentives for Heating, Cooling, and Power in Commercial Properties

For decades, various tax and other incentives have sought to induce energy efficiency, fuel choice, or installation of energy systems in commercial buildings. With climate change mitigation now a prominent priority of the Biden-Harris administration, property managers may want to revisit their heating, cooling, and electric power systems.

The Infrastructure Investment and Jobs Act (IIJA), Pub. L. No. 117-70, signed by President Biden Nov. 15, 2021, provides an example and may indicate where other regulatory change is in the works. As of this writing, the companion Build Back Better Act appears stalled.

Title V of the IIJA covers building energy efficiency generally. It authorizes several programs geared to building energy efficiency, for the most part dovetailing with existing measures under the Energy Policy and Conservation Act of 1975, so it is not entirely new. However, looking at what Congress funded may suggest priorities going forward.

IIJA authorizes grants to states to upgrade energy auditing. It also authorizes development of better model building codes to encourage, and in some cases to allow, efficiency and resiliency features in buildings. Then, it authorizes an effort to train tradesman to install those measures. Similarly, it authorizes funding a study of impediments to deployment of heating systems that also generate distributed power. Those sorts of co-generation efforts are not new, but Congress and the Biden administration evidently want to see more and at smaller scale. The statute also contains provisions funding or subsidizing/encouraging various energy efficiency modifications to buildings. Most of these programs run through states, so exact implementation will vary from place to place.

The data may be spotty on exactly how important energy efficiency in commercial buildings will turn out to be. The Energy Information Administration (EIA) only reports data on commercial building energy use through 2003. It has conducted a nationwide Commercial Buildings Energy Consumption Survey, but that was in 2018, and only preliminary results are available. Congress had to authorize information-sharing between the EIA and the EPA on commercial building energy efficiency. So, it is not clear whether the policies and incentives that one sees going forward will be driven by comprehensive data. If not, opportunities may exist to provide the anecdotal information that will lead to favorable incentives for particular projects.

But federal incentives are not the only game in town. States, tribes, and municipalities are increasingly providing incentives for energy efficiency and for the installation of community solar, whereby customers can buy or lease portions of a shared solar system. This is of particular benefit to customers who lack sufficient roof space or land to install solar systems themselves. And it may provide an even bigger benefit to commercial property owners and managers that can transform their rooftops and lands into solar farm locations. Typically, the sites where these solar resources are located can gain significant tax credits and membership fees, while building community goodwill.

Endnotes

1. Bernadette M. Rappold focuses her practice on federal and state regulatory issues related to energy, manufacturing, and the environment. She has substantial litigation experience and advises clients on regulatory compliance as well as the environmental, safety, and health aspects of numerous business and real estate transactions, including water, air, and chemical hazards. Bernadette offers clients perspective gained through years of service at the Environmental Protection Agency. While serving as a director of the Special Litigation and Projects Division in the Office of Civil Enforcement at the EPA's Office of Enforcement and Compliance Assurance, she led complex enforcement actions in response to violations of the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act, and other environmental statutes. She was educated at Temple University (B.A. 1990; J.D. 1994).

Kerri L. Barsh is Co-Chair of the firm's Environmental Practice and represents public and private clients on an array of environmental regulatory, permitting and litigation matters, including transactional support and due diligence, environmental assessment and liability matters, climate change, energy and infrastructure projects, wetlands and coastal permitting, complex land use projects, air quality matters, hazardous materials contamination, and other compliance and enforcement cases. She was educated at the University of Missouri (B.A.) and received her law degree from the University of Miami (J.D.).

Christopher L. Bell represents clients in civil and criminal enforcement and investigations, litigation, compliance counseling, emergency incident response, and legislative and regulatory advocacy (including appellate challenges to rulemakings) under all of the major environmental, health, safety and natural resource laws. Chris also assists buyers, sellers, investors and financial institutions on the environmental aspects of transactions, advises clients on ESG, sustainable development, climate change, and product stewardship, and has worked with clients around the world to design, implement and audit environmental management and compliance systems (including those based on ISO 14001 and the U.S. Sentencing Guidelines). He was educated at Michigan State University (B.A. 1981), received his law degree from the University of Michigan (J.D. 1985), and served as a law clerk to Hon. Philip Pratt (E.D. Mich.) before entering practice.

David G. Mandelbaum represents clients facing problems under environmental laws. He regularly represents clients in lawsuits and also has helped clients achieve satisfactory outcomes through regulatory negotiation or private transactions. A Fellow of the American College of Environmental Lawyers, David teaches Superfund, and Oil and Gas Law in rotation at the Temple University Beasley School of Law as well as an environmental litigation course at Suffolk (Boston) Law School. He was educated at Harvard University (A.B. 1980; J.D. 1983) and served as law clerk to Hon. Louis H. Pollak (E.D. Pa.) before entering practice.

Kaitlyn R. Maxwell focuses her practice on environmental litigation. She advises clients on regulatory compliance issues and represents clients in litigation in state and federal courts. Her work includes litigation of major contamination cases under the hazardous waste and Superfund laws. Kaitlyn also advises clients in transactions involving the sale of contaminated real property. She was educated at Dickinson College (B.A. 2007), received her law degree from Boston University (J.D. 2012), and served as a law clerk for the Hon. Linda K. Caracappa (E.D. Pa.) before entering practice.

Uniform Law Commission RPTE Projects (Real Property) Winter 2022 Update

Benjamin Orzeske, counsel to the Uniform Law Commission, provides an update on current projects of interest to Real Estate practitioners.

The following Uniform Law Commission projects may be of interest to members of the ABA Section on Real Property, Trust and Estate Law.

Drafting Committees:

Tenancy-in-Common Ownership Default Rules. The committee will draft uniform or model state legislation to resolve problems arising under common law tenancy-in-common ownership rules. The committee will attempt to develop default management rules for common real-estate interests (and the proceeds thereof) that balance the protection of individual property rights with the need to make management decisions efficiently. The law may permit less-than-unanimous decisions on at least some issues while also preserving the cotenants' right to contract around those rules.

Mortgage Modifications. A new drafting committee on mortgage modifications will draft a uniform or model act to standardize state laws with respect to whether modifying the terms of a mortgage require recording an instrument to document changes to the pre-recorded mortgage. The act will also clarify when a modified mortgage retains its priority over subsequent creditors to secure repayment of the debt.

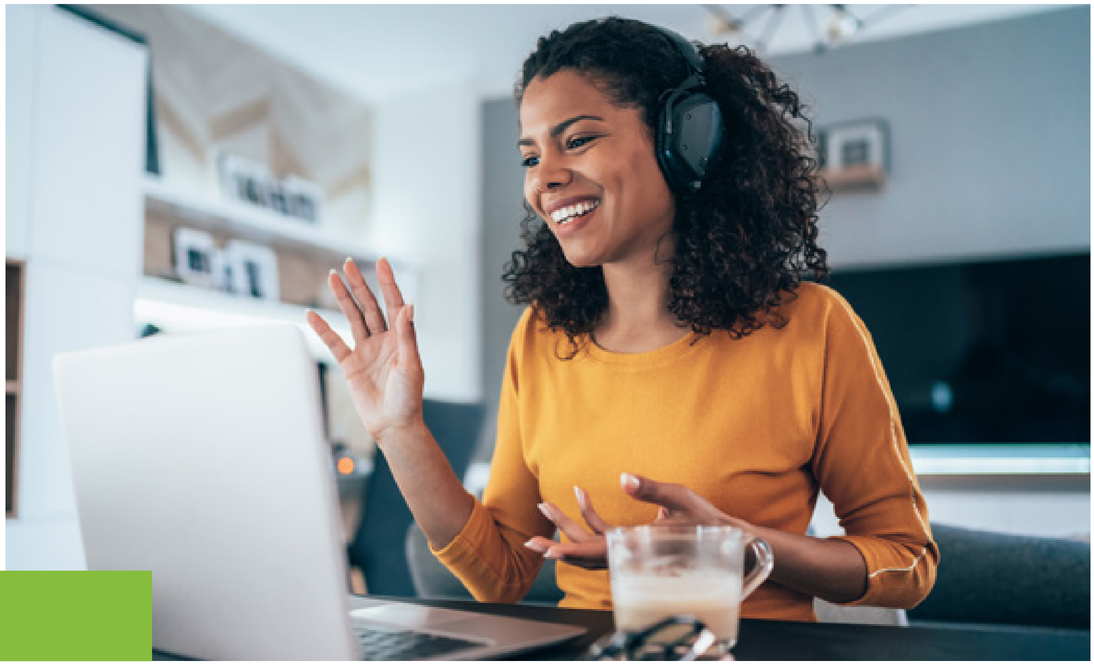
Restrictive Covenants in Deeds. A drafting committee on restrictive covenants will draft a new uniform law governing the removal of discriminatory restrictive covenants from recorded property records. Many older deeds contain restrictions based on race or religion. Though these discriminatory restrictions are unenforceable, some property owners want the offensive provisions expunged entirely. States have begun to accommodate those requests, but without a consistent process. The American Land Title Association proposed this project to draft a uniform state law providing a standard process for removal of discriminatory restrictions without affecting the integrity of a property's chain of title.

Study Committees:

Redaction of Personal Information from Public Records. Last year, a New Jersey federal judge's husband and son were shot at their front door by a disgruntled former litigant who targeted the judge's family by getting her home address from public records. In the wake of this horrific act of violence, states are beginning to pass legislation allowing the redaction of personal information of judges and other public officials from public records. However, there is no consistent approach. A new study committee on redaction of personal information from public records will determine whether a uniform or model act on the subject is feasible, and the scope of any potential drafting project.

Use of Tenant Information in Rental Decisions. This committee will study the need for and feasibility of a uniform or model law addressing landlords' use of tenant screening reports in rental decisions. Such reports may give landlords outdated, inaccurate, or incomplete information about prospective tenants' involvement in prior litigation (e.g., if the report states that the tenant was a party to litigation with a previous landlord but does not disclose that the tenant was the prevailing party). In particular, the committee will focus on identifying how widespread any problems may be and whether any act should be directed primarily at commercial providers of screening reports.

The RPTE Section appoints at least one Advisor to each uniform law commission project involving the law of real property, trusts and estates. All uniform law drafting committees are open to any interested observer and members of the RPTE Section are encouraged to join and contribute their relevant expertise. Visit www.uniformlaws.org to find more information on these committees and on other ULC projects.



FREE MONTHLY GROUP AND COMMITTEE CONFERENCE CALLS

Group and Committee conference calls are a complimentary benefit of Section membership and normally are limited to Section members. However, prospective members are welcome to join a call without charge to learn more about the Section of Real Property, Trust and Estate Law (RPTE) Groups and Committees, and how to become involved upon joining the Section.

https://www.americanbar.org/groups/real_property_trust_estate/committees/committee-calls/

LAND USE ENVIRONMENTAL GROUP
Thursday, March 10, 2pm CT

BUSINESS PLANNING GROUP
Wednesday, March 16, 12pm CT

EMPLOYEE PLANS AND EXECUTIVE COMPENSATION GROUP
Friday, March 18, 12pm CT

LEASING GROUP-NUTS AND BOLTS
Wednesday, March 23, 12pm CT

Financial Regulators Address Discontinuation of LIBOR

By Bryan M. Mull, Gordon Feinblatt LLC[1]

This article highlights rules governing the transition away from LIBOR as an index for interest rates.

Recently, the Consumer Financial Protection Bureau (CFPB), the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Association, the Office of the Comptroller of the Currency and certain state financial regulators issued a Joint Statement on Managing the LIBOR Transition.

In this guidance, the regulators clarified that entering into contracts using the London Interbank Offered Rate (LIBOR) as a reference rate after December 31, 2021 would create safety and soundness risks, including litigation, operational and consumer protection risks. The guidance provides that a new LIBOR contract includes agreements that create additional LIBOR exposure or extends the term of an existing LIBOR contract. The guidance further provides that new contracts entered into before the end of the year should use a reference rate other than LIBOR or contain robust fallback language providing for an alternative reference rate.

On the heels of the joint guidance, the CFPB issued a final rule amending Regulation Z to facilitate the LIBOR transition. The final rule becomes effective on April 1, 2022, though mandatory compliance does not start until October 1, 2022 for revisions to change-in-terms notice requirements. The final rule affords lenders with the flexibility to transition away from LIBOR-based rates before LIBOR becomes unavailable and sets forth factors to consider in establishing a replacement benchmark index. For closed-end loans, the final rule endorses the use of indices based on the Secured Overnight Funds Rate (SOFR) to replace one-month, three-month, and six-month LIBOR rates. The CFPB did not commit to endorsing a SOFR-based rate to replace the one-year USD LIBOR rate until after the CFPB can evaluate the Alternative Reference Rates Committee's replacement proposal. For home equity lines of credit, the final rule sets forth factors for adopting a replacement index such as a SOFR-based index or the *Wall Street Journal* Prime Rate. The replacement index should have substantially similar historical fluctuations and result in a substantially similar APR compared to the outgoing LIBOR-based rate.

Endnote

1. Bryan Mull is a member in Gordon Feinblatt's Financial Services Group, located in Baltimore, Maryland. His practice focuses on the representation of secured and unsecured creditors in collections, bankruptcies, loan workouts, financings, and related matters. Bryan also advises clients in connection with state and federal lending laws, garnishment compliance and legal order processing, mortgage servicing, and debt collection compliance.

Financial Institution Requirements

Concerning Retention of Drivers License Copies

By Christopher Rahl[1]

This article reminds us to take care with diligence gathered to support financing transactions.

A little-known federal law imposes restrictions on federally insured financial institutions in connection with copying and retaining copies of state-issued drivers license and similar identification cards when accounts, products, or services are requested through online applications. The statute, part of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (EGRRCPA)(codified at 12 U.S.C. § 1829c), applies to situations involving online requests by an individual to open an account or obtain any other financial product or service from a federally insured financial institution. The law (called the "Making online banking initiation legal and easy") permits a financial institution to copy and temporarily store an individual's state identification card in an electronic format only for certain purposes.

Under this provision, financial institutions may use the information obtained from copying and storing a state identification card to: (a) verify the authenticity of the identification card; (b) verify the identity of the individual; and (c) comply with legal requirements related to opening an account or obtaining a financial product or service (including customer identification requirements under the Bank Secrecy Act as supplemented by the USA Patriot Act). The law further provides that upon copying and storing a state identification card for the permitted account opening or related product/service request, a financial institution must permanently delete any image of the identification card and any copies of the image; but the law does not specify how quickly a financial institution must delete state identification card images/copies. The law preempts any conflicting state law.

Many financial institutions believe that they are required to retain copies of state identification cards presented for customer identification purposes under the Bank Secrecy Act (codified at 31 U.S.C. §5311, *et seq.*) as supplemented in 2001 by the USA Patriot Act (107 Pub. L. No. 56, 115 Stat. 272) and related implementing regulations. A close reading of the regulations that implement these federal customer identification requirements do not explicitly require financial institutions to retain copies of customer identification (see 31 C.F.R. § 1020.220). Financial institutions are required to maintain "descriptions" of documents and/or methods relied upon to verify a customer's identity for 5 years after the related account is closed, but not an actual copy of customer identification documents. Because of the above EGRRCPA provisions applicable to online account/service offerings, financial institutions should review their online account opening procedures to verify that state identification cards are being destroyed within a reasonable period after an online account or product/service request has been completed.

Endnotes

1. Christopher Rahl is the chair of Gordon Feinblatt's Financial Services Group, located in Baltimore, Maryland. He provides legal advice concerning a broad range of legal issues, including regulatory compliance, transactional matters, corporate governance, and litigation avoidance and management. Chris advises clients in connection with state and federal lending, deposit, debt adjustment, credit service business, money transmission, and privacy statutes and regulations. For more detail regarding Chris and his practice see: Rahl, Christopher R. | Gordon Feinblatt LLC (gfrlaw.com).

COOPERATIVE APARTMENT CORPORATIONS EXEMPTED FROM ONOROUS PROVISIONS OF THE 2019 HOUSING STABILITY TENANT PROTECTION ACT

By Jeffrey Schwartz, Steven Sladkus, and Jeffrey Reich[1]

A new law in New York exempts cooperative corporations from certain provisions of the Housing Stability Tenant Protection Act. These important changes in the statute are summarized by Jeffrey Schwartz, Steven Sladkus, and Jeffrey Reich.

On December 22, 2021, Governor Kathy Hochul signed into law an amendment to the 2019 Housing Stability Tenant Protection Act, that previously imposed a number of restrictions on the operations of cooperative apartment corporations. Pursuant to the amendment (which can be found at https://legislation.ny.senate.gov/pdf/bills/2021/S5105C) cooperatives (other than those that have been established pursuant to the Private Housing Finance Law) are exempt from the provisions of the law which would otherwise:

1. Prevent a cooperative board from collecting a deposit in excess of one month's rent;
2. Prevent a cooperative board from charging application and/or processing fees and credit report and/or background search fees in excess of $20.00;
3. Limit the amount of late fees imposed by a cooperative board at the lesser of $50.00 or 5% of the outstanding payment (although, as noted below, an 8% cap is imposed);
4. Prevent cooperative boards from seeking late fees, charges or penalties in any non-payment action;
5. Require a cooperative board to send certified notices advising shareholders of any delinquent payments before being able to commence any action in connection with the collection of the delinquent payments; and
6. Prevent a cooperative board from seeking legal fees in connection with a default judgement.

These changes mean that cooperative boards may, subject to the terms of the cooperative proprietary lease:

1. Condition their approval of purchase applications upon the posting of a maintenance escrow;
2. Charge application, processing and search fees as determined in the board's discretion;
3. Impose late fees in an amount up to (but not to exceed) eight (8%) percent of a delinquent shareholder's monthly maintenance charge;
4. Seek to collect late fees, legal fees and other expenses related to shareholder defaults in any non-payment action the apartment corporation may bring;
5. Send delinquency notices by any method consistent with the terms of the cooperative proprietary lease; and
6. Seek the reimbursement of legal fees in connection with obtaining a default judgments against delinquent shareholders.

Endnotes

1. Jeffrey Schwartz, Steven Sladkus, and Jeffrey Reich are founding partners of the law firm Schwartz Sladkus Reich Greenberg Atlas LLP in New York City. They are partners in the Real Estate department of the firm. They can be reached at JSchwartz@ssrga.com, SSladkus@ssrga.com, and JReich@ssrga.com, respectively.

Uniform Law Commission RPTE Projects Winter 2022 Update (Trust and Estate)

Benjamin Orzeske, counsel to the Uniform Law Commission, provides an update on current projects of interest to Trust and Estate practitioners.

The following Uniform Law Commission projects may be of interest to members of the ABA Section on Real Property, Trust and Estate Law.

Drafting Committees:

Electronic Estate Planning Documents. The Uniform Electronic Wills Act, approved in 2019, provides rules for the electronic execution of wills. This committee will draft a statute to clarify that other types of estate planning documents, including trusts and powers of attorney, can also be executed electronically. The committee may also draft amendments to various uniform trust and estate acts to ensure the law is consistent and will allow estate planners and their clients to use teleconferencing and electronic signature technology. The committee will attempt to complete its work by summer 2022.

Conflict of Laws in Trusts and Estates. This committee will attempt to clarify and resolve the many conflicts of existing state laws governing trusts and estates. The scope of the project is broad, and will likely address trusts, wills, will substitutes, intestacy, estate administration, fiduciary powers and duties, powers of appointments, powers of attorneys, jurisdictional claims, and statutes of limitations. The drafting committee is collaborating with the American Law Institute reporters who are drafting the Restatement (Third) of Conflict of Laws.

Revisions to the Uniform Health-Care Decisions Act. The Uniform Health-Care Decisions Act governs living wills and powers of attorney for health care. It was last updated in 1993. The committee will address issues including the determination of capacity; default surrogates (including the priority list of those who can act as surrogate, un-befriended patients, and disagreement among surrogates); and barriers to use and execution (including electronic documents, the statutory form, and oral designations). The committee will also give careful consideration the issue of mental health decisions and whether different rules should apply.

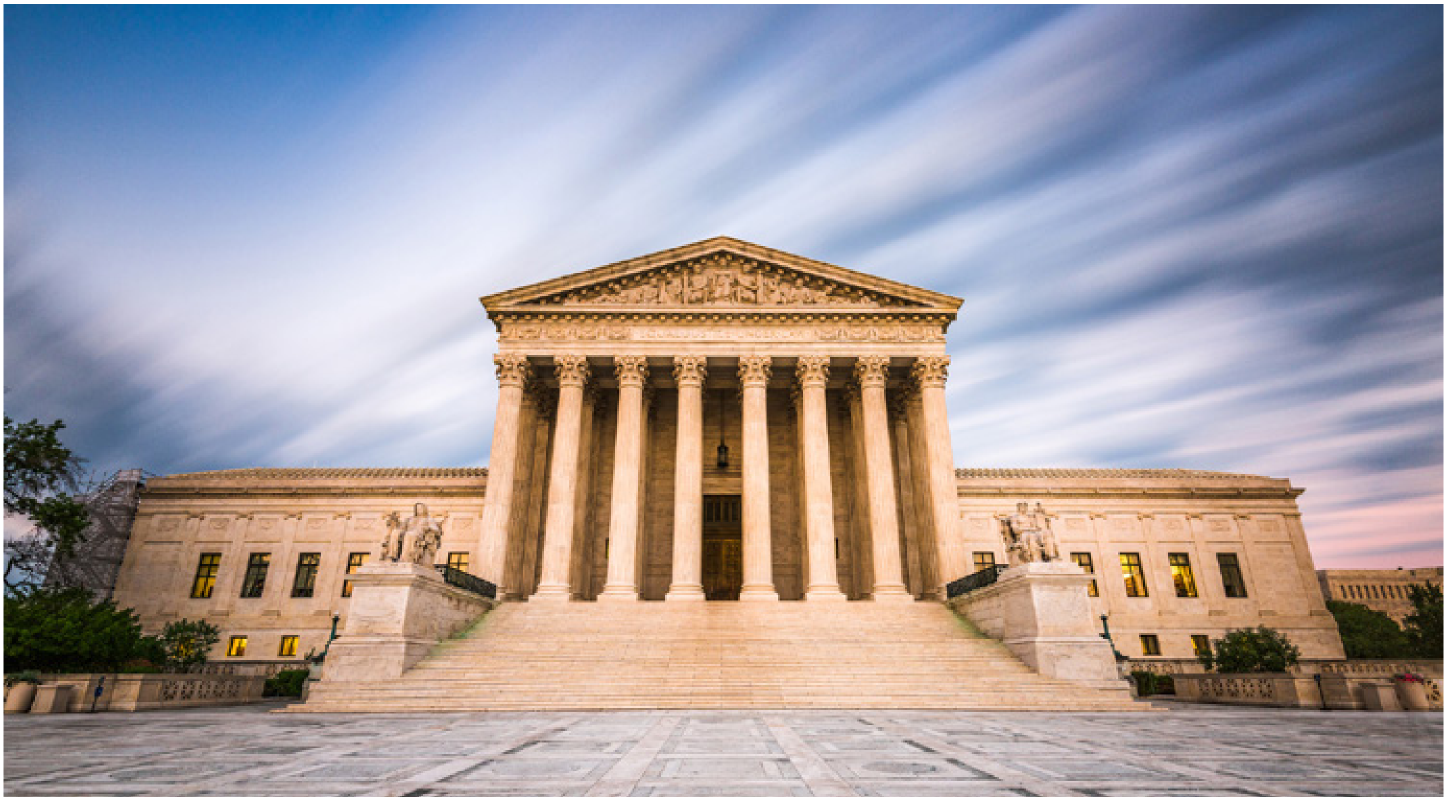
Tenancy-in-Common Ownership Default Rules. The committee will draft uniform or model state legislation to resolve problems arising under common law tenancy-in-common ownership rules. The committee will attempt to develop default management rules for common real-estate interests (and the proceeds thereof) that balance the protection of individual property rights with the need to make management decisions efficiently. The law may permit less-than-unanimous decisions on at least some issues while also preserving the cotenants' right to contract around those rules.

Determination of Death. Another new drafting committee will revise the Uniform Determination of Death Act. This widely adopted act, originally approved in 1980, provides a simple two-prong test to determine when an individual is legally dead. A physician must verify that an individual has sustained either (1) irreversible cessation of circulatory and respiratory functions, or (2) irreversible cessation of all functions of the entire brain, including the brain stem. The second prong that defines brain death needs updating to ensure conformity with recent advances in medical science and evolving standards of practice.

Study Committees:

Transfers to Minors Act. This committee will study the need for and feasibility of updating the Uniform Transfers to Minors Act, last updated in 1986, to address issues including optional extension beyond age 21, successor custodians, minor beneficiaries of qualified retirement accounts, and the relationship between UTMA accounts and other types of investment accounts intended to benefit minors, such as 529 and 529A accounts. This committee was authorized in January 2022.

Redaction of Personal Information from Public Records. Last year, a New Jersey federal judge's husband and son were shot at their front door by a disgruntled former litigant who targeted the judge's family by getting her home address from public records. In the wake of this horrific act of violence, states are beginning to pass legislation allowing the redaction of personal information of judges and other public officials from public records. However, there is no consistent approach. A new study committee on redaction of personal information from public records will determine whether a uniform or model act on the subject is feasible, and the scope of any potential drafting project.



In *Hughes v. Northwestern University*, SCOTUS Nudges Defined Contribution Plans Further into the Fray

By Jose M. Jara and Sheldon S. Miles*
Fox Rothschild LLP
Morristown, NJ

The U.S. Supreme Court ruled on issues involving defined contribution plans under the Employee Retirement Income Security Act (ERISA) in the recent case *Hughes v. Northwestern University*. This article summarizes the case and describes its effect on other cases involving ERISA including excessive fee litigation.

On January 24, 2022, the United States Supreme Court in *Hughes v. Northwestern University*[1] unanimously (8-0, Justice Barret took no part) ruled in favor of participants holding that to state a plausible claim under the Employee Retirement Income Security Act ("ERISA"),[2] a context-specific inquiry is required as to whether fiduciaries continuously monitored the investment options in a defined contribution plan and removed imprudent ones. Since the Seventh Circuit did not use this standard, the Court vacated and remanded its prior decision.[3]

The case garnered significant attention from the employee benefits community who viewed this case as a potential antidote to the wave of excessive fee cases.[4] The Court's decision is disappointing to many plan sponsors and fiduciaries of defined contribution plans, leaving them to navigate ERISA's "Sargasso Sea of obfuscation" [5] without much guidance. It remains unclear as to whether this decision will likely lead to more "excessive fee" litigation across the country. However, within days of the decision, several district courts have denied fiduciaries' motions to dismiss and allowed those cases to proceed to the next stage of litigation.[6]

The Court's short opinion by Justice Sotomayor raises more questions than answers as many prevalent issues remain open, such as:

- Can a participant meet its burden at the pleading stage simply by alleging that record-keepers should be compensated directly, through a flat fee, as opposed to revenue-sharing?

- Is it objectively unreasonable to offer retail class funds when the same investment options can be provided through institutional class shares at a lower share class?

- How many investments are deemed to be too many investments for participants to choose from?

THE HUGHES OPINION

The Plans

In *Hughes*, current and former employees of Northwestern University brought suit against the fiduciaries of two defined contribution plans – (i) the Northwestern University Retirement Plan; and (ii) the Northwestern University Voluntary Savings Plan. In a nutshell, the participants alleged in their Complaint that the fiduciaries of both plans violated their fiduciary duty of prudence imposed under the ERISA, which lead to significant losses for the participants and the plans as a whole. The prudent person standard, in part, requires fiduciaries to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[7]

Both plans at issue are 403(b) plans that allow for its participants to save for their personal retirement by deferring a percentage of their annual compensation into these plans for the purpose of investing contributions into one or more of the investment options assembled by the plans' fiduciaries. These investment options included: target-date mutual funds; index funds; actively managed funds; and a self-directed brokerage account.[8] Prior to October of 2016, over 400 investments were offered between these two plans. At all times, participants had full discretion in selecting plan investments. Contributions were subject to gains and losses from investments as well as costs associated with investment management and plan administrative fees, such as record-keeping costs. Here, the plans had two record-keepers: Fidelity and Teachers Insurance and Annuity Association of America (TIAA).[9] These record-keepers were paid through the funds' expense ratios, which is commonly known as revenue-sharing. Participants in their amended complaint alleged that they paid substantially more for record-keeping than they otherwise would have if record-keeping costs were charged at an annual flat rate, such as $35 per participant instead of through revenue-sharing.

How We Got Here

In 2018, the district court granted Northwestern's motion to dismiss. Deciding that the plans had an array of different investments for participants to choose from and therefore the participants were not required to invest in those funds that they allege to be too expensive and underperforming. [10] On appeal, the Seventh Circuit affirmed the district court's decision, and held that the investments that were preferred by the participants were in fact offered under both plans and that the participants were not forced to stomach an unappetizing menu of investments. Put another way, if the plaintiffs wanted to pay less in recordkeeping fees, they could have done so by choosing the investments in the plans with the lowest expense ratios. Likewise, if the plaintiffs wanted low-cost index funds, they could have invested in them since the plans had several index funds. The Seventh Circuit found support for their holding in *Hecker v. Deere & Co.*,[11] where there was no fiduciary breach of prudence since participants could invest in over 20 different investment funds and had access to over 2,500 mutual funds through a brokerage window.

The Decision

At issue before the Supreme Court is whether the participants in the Northwestern plans sufficiently pled a claim that Northwestern violated the fiduciary duty of prudence by:

(a) Failing to monitor and control recordkeeping fees, resulting in unreasonably high costs to plan participants;

(b) Offering investments in the form of "retail share classes" that charged higher investment fees than those otherwise charged by identical share classes of the same investments; and,

(c) Providing too many investment choices for participants.[12]

In their opinion, the Court did not directly address any of these questions but instead focused on its previous ruling in *Tibble v. Edison Int'l*,[13] to reach its decision. The Court found that the Seventh Circuit solely concentrated on one component of the duty of prudence to compile a diverse menu of investment options[14] and ignored that the duty of prudence also requires fiduciaries to continuously review plan investments and remove imprudent ones.[15]

This duty is derived from the Court's decision in *Tibble*, where the participants argued that the fiduciary duty of prudence was breached because the 401(k) fiduciaries offered six high cost retail mutual funds when the same investments were available as lower priced institutional class mutual funds,[16] and thus the participants would have had higher investment returns if they did not pay so much for administrative costs. In *Tibble*, the Court noted "[a] trustee must 'systemaic[ally] conside[r] all the investment of the trust at regular intervals' to ensure that they are appropriate."[17] The Court noted in their opinion, as in *Tibble*, that ERISA is derived from the common law of trust and under trust law a trustee has a continuing duty to monitor investments and to remove imprudent ones.[18] However, the Court, in *Tibble*, stated that it expresses no view on the scope of a fiduciary's duty, that is "just what kind of review [is] required?"[19] Similarly, the Court, in *Hughes*, was silent on the scope.

The Court vacated and remanded the Seventh Circuit's decision back to the Seventh Circuit to determine if the participants plausibly alleged, as a whole, a violation of the duty of prudence based on the standards set forth in *Tibble* and in accordance with the pleading standard set forth in *Ashcroft v. Iqbal*,[20] and *Bell Atlantic Corp. v. Twombly.*[21] The Court noted that this inquiry is context-specific,[22] which means that the prudent person test under 29 U.S.C. § 1104(a)(1)(B) is judged under the circumstances then prevailing. More importantly, the Court acknowledged that fiduciaries have to make difficult tradeoffs at times and "courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise."[23]

TAKEAWAYS

Class action lawsuits continue to be filed against ERISA fiduciaries for damages for excessive investment fees and/or recordkeeping and administrative service fees. The Supreme Court decision provides not much guidance or bright-line rules for ERISA fiduciaries to follow, and the lower courts are continuing to wrestle with claims that are often cookie-cutter complaints filed across the country.

Congress has not taken a position on this issue. The Congressional Research Service recently suggested that Congress could "consider further defining the scope of these obligations in legislation, including with respect to how fiduciaries should evaluate the level of fees associated with a particular investment. Alternatively, Congress could explore legislation that addresses a plan participant's burden of proof for bringing a viable claim against a plan fiduciary relating to alleged excessive fees." [24] Any future decision made by Congress will need to address the competing interests of protecting participants while also continuing to incentivize employers to voluntarily establish retirement plans for future employees by not making it so administratively cumbersome.[25]

So what's a fiduciary supposed to do? Invest in the cheapest passive investment. Not so fast and not necessarily so. According to the U.S. Department of Labor, fees should not be considered in a vacuum. Fees are only a "part of the bigger picture, including investment risks and returns[,] the extent and quality of services provided [, and diversification]."[26] Furthermore, "higher investment management fees do not necessarily mean better performance [and] ... cheaper [is not] necessarily better."[27] Fiduciaries have to also consider investment options with a long-term horizon of providing participants with sufficient investment returns for retirement.

For now, fiduciaries can issue request for proposals (RFPs) from service providers, such as recordkeepers and trustees. When conducting an RFP, fiduciaries need to compare the costs with the quality of the services being proposed. Typically, RFPs should be made every three to five years, and fiduciaries should document all decisions related to this process. Next, fiduciaries should evaluate and monitor the performance, costs, and diversification of the assets in their plans on a periodic basis. To monitor the investment fees and their performance, fiduciaries should select comparable industry benchmarks. Similar to the RFP process, all decisions should be documented.

Fiduciaries may also want to adopt an investment policy statement that sets forth appropriate guidelines for selecting and monitoring investments and procedures for reviewing and removing imprudent investment options. Further, fiduciaries should review their fiduciary insurance coverage and should work with their insurer to increase coverage if it is below industry standards.

Lastly, fiduciaries may want to review their plan document and consult with ERISA counsel to consider whether to add an arbitration provision. Arbitration has certain benefits of being less costly than litigation and may provide a quicker resolution than litigating in the court room. On the other hand, decisions made through arbitration, generally, cannot be appealed and the pool of arbitrators to choose from may have less expertise and/or knowledge of ERISA than a federal judge. As with a variety of ERISA issues, courts around the country differ and have inconsistently applied mandatory arbitration clauses to ERISA cases. But a recent district court decision has granted defendant's motion to compel arbitration. [28]

Endnotes

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This article may be cited as Jose M. Jara and Sheldon S. Miles*, In Hughes v. Northwestern University, SCOTUS Nudges Defined Contribution Plans Further into the Fray,* 50 Tax Mgmt. Comp. Plan. J. No. 2 (Feb. 4, 2022).

1. No. 19-1401, 2022 BL 22257 (U.S. Jan. 24, 2022).
2. Pub. L. No. 93-406.
3. *Divane v. Northwestern Univ.,* 953 F.3d 980 (7th Cir. 2020).
4. Jose M. Jara, *In ERISA Excessive Fee Cases, Will the Supreme Court*

Issue Guidance for Dividing the Plausible Sheep From the Meritless Goats? 49 Tax Mgmt. Comp. Plan. J. No. 11 (Nov. 5, 2011); Jose M. Jara, Richard Lynn, and Sheldon S. Miles, *Oral Arguments in the Hughes v. Northwestern ERISA Excessive Fee Case*, 50 Tax Mgmt. Comp. Plan. J. No 1. (Jan. 7, 2022).
5. *Travelers Ins. Co. v. Cuomo*, 14 F.3d 708, 717 (2d Cir. 1993("[T]he Supreme Court has described ... ERISA ... as 'not a model of legislative drafting.' In truth, it is a veritable Sargasso Sea of obfuscation:").
6. *Turpin and Johnson v. Duke Energy Corporation, et al.,* No. 320CV00528KDBDSC, 2022 BL 32672, at *4 (W.D.N.C. Jan. 31, 2022)("While the ultimate truth of Plaintiff's allegations will be determined through discovery and further proceedings, Plaintiffs have alleged that Plan participants paid excessive record keeping and account management fees ... and failed to adequately monitor the expenses charged to Plan participants. Therefore, Plaintiffs are entitled at this earliest stage of the case to an opportunity to pursue their claims."); *Shaw v. Quad/Graphics, Inc.,* No. 20-CV-1645-PP, 2022 BL 26119, at *1 (E.D. Wis. Jan. 26, 2022)("Given the defendants' extensive reliance on *Divane* and other cases that applied similar categorical rules, the court will deny the defendants' motion without prejudice."); *Bangalore v. Froedtert Health Inc.,* No. 20-CV-893-PP, 2022 BL 26147, at *1-2 (E.D. Wis. Jan. 26, 2022)("Given the defendants' extensive reliance on *Divane* and other Seventh Circuit cases that applied similar categorical rules, the court will deny the defendants' motion without prejudice.); *Goodman v. Columbus Reg'l Healthcare Sys., Inc.,* No. 4:21-CV-15 (CDL), 2022 BL 24373, at *3-4 (M.D. Ga. Jan. 25, 2022)("The fact that Plaintiffs in this action had some lower cost index fund options is not dispositive of whether[Defendant] satisfied its duty of prudence as a matter of law. Dismissing this claim would not comport with recent Supreme Court precedent." In addition, ... [p]laintiffs allege that [Defendant]'s recordkeeper received fees that were nearly double what a reasonable recordkeeping fee would have been for a [comparable]plan and that [Defendant]'s recordkeeper received additional indirect compensation that was excessive .... Taking these allegations as true and drawing all reasonable inferences in Plaintiffs' favor, the Court finds that the complaint adequately alleges that [Defendant] breached its duty to prudently manage administrative costs.").
7. ERISA 404 (a)(1)(B).
8. *Divane v. Northwestern Univ.,* 953 F.3d 980, 983 (7th Cir. 2020).
9. *Divane* at 990.
10. *Divane v. Northwestern Univ.,* No. 16-C-8157, 2018 BL 186065, *8 (N.D. Ill. May 25, 2018).
11. 556 F.3d 575, 586 (7th Cir. 2009).
12. *Hughes v. Northwestern University,* No. 19-1401, 2022 BL 22257 (U.S. Jan. 24, 2022).
13. *575 U.S. 523 (2015).*
14. The purpose of the broad range of alternatives, according to the U.S. Department of Labor, "is to enable participants ... to achieve various levels on the risk and return spectrum while at the same time minimizing the risk presented by their portfolio ...." 57 Fed. Reg. 46,906, 46,920 (Oct. 13, 1992).
15. *Hughes,* 2022 BL 22257.
16. *Tibble,* 575 U.S. 523.
17. *Tibble,* 575 U.S. at 529.
18. *Hughes,* 2022 BL 22257 at *4.
19. *Tibble,* 575 U.S. at 530.
20. 556 U. S. 662 (2009).
21. 550 U. S. 544 (2007).
22. *Fifth Third Bancorp v. Dudenhoeffer,* 573 U.S. 409, 425 (2014)(in an ESOP case, the Supreme Court eliminated the presumption of prudence courts gave fiduciaries for investing in employer stock and finding that "[s]uch a rule does not readily divide the plausible sheep from the meritless goats. That important task can be better accomplished through careful, context-sensitive scrutiny of a complaint's allegations.").
23. *Hughes, 2022 BL 22257 at *5.*
24. Jennifer Staman*, Supreme Court Rules on Retirement Plan Fiduciary Duty in Hughes v. Northwestern University.* Congressional Research Service. Jan. 31. 2022.
25. *Varity Corp. v. Howe,* 516 U.S. 489, 497 (1996)([C]ourts may have to take account of competing congressional purposes, such as Congress' desire to offer employees enhanced protection for their benefits, on the one hand, and, on the other, its desire not to create a system that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering ... benefit plans in the first place").
26. https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/publications/a-look-at-401k-plan-fees.pdf, at p. 11.
27. See Note 26, above.
28. *Holmes v. Baptist Health South Florida, Inc.,* 1:21-cv-22986-Civ-Scola, 2022 BL 19784 (S.D. Fl. Jan. 20, 2022) (the plan was a so-called 403(b) that allegedly did not monitor the performance or the fees of its investments).

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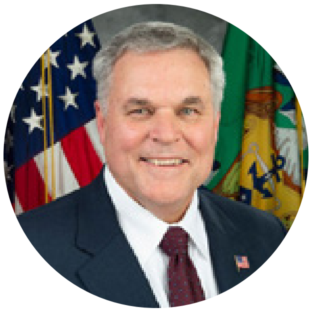

CHARLES P. RETTIG
United States Commissioner of Internal Revenue

KEYNOTE SPEAKER

Charles P. Rettig is the 49th U.S. Commissioner of Internal Revenue. As Commissioner, Mr. Rettig presides over the nation's tax system, which collects more than $3.5 trillion in tax revenue each year representing about 96% of the total gross receipts of the United States. In this regard, the continued success of our country depends upon a successful IRS because this revenue funds most government operations and public services. Mr. Rettig manages an agency of about 80,000 employees and a budget of more than $11 billion.

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Offshore Tax Evasion is an IRS Enforcement Priority 2022

Sean M. Golding

International tax lawyer Sean M. Golding provides several articles on a variety of tax and reporting issues involving offshore assets and foreign transactions.

Offshore Tax Evasion

With the increased US Government enforcement of evasion of overseas income, assets, investments, and accounts — offshore tax evasion is a key priority. In fact, there are few international tax crimes more serious than Tax Evasion. That is because unlike other types of international violations — Tax Evasion is a crime and not a civil violation (such as Fraud, which the US Government can pursue as both a civil and criminal violation). With Tax Evasion, the Taxpayer has willfully committed a proactive act — usually requires more than just not filing a tax return, which technically is an "omission" and not an "affirmative act." For decades, the IRS has been actively pursuing matters involving *offshore non-compliance*. But in the past few years, the number of offshore criminal investigations has been steadily rising, including FATCA criminal indictments and FBAR criminal indictments — traditionally these were civil violations. When it comes to offshore and international tax-related matters, evasion typically involves money laundering and/or structuring in addition to foreign account, asset, and investment reporting non-compliance — and not just missing the FBAR filing requirement. When a person is willful, neither the Streamlined, Delinquency nor Reasonable Cause options are available. Rather, the person submits to the traditional Voluntary Disclosure to try to avoid an offshore tax evasion investigation.

Is Offshore Tax Evasion a Crime?

Yes. Unlike other violations, offshore tax evasion is a crime that is codified under *26 USC 7201*.

26 USC 7201

- "Any person who **willfully** attempts in any manner to evade or **defeat any tax imposed** by this title or the payment thereof shall, in addition to other penalties provided by law, be **guilty of a felony** and, upon conviction thereof**, shall be fined not more than $100,000** ($500,000 in the case of a corporation), or **imprisoned not more than 5 years, or both**, together with the costs of prosecution."

What is Tax Evasion (26 USC 7201)

The statute for tax evasion (technically, attempt to evade or defeat tax) is founded in 26 USC section 7201.

26 USC 7201

The code provides the following definition of tax evasion:

- Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.

How is Tax Evasion Defined?

As provided in the Criminal Tax Manual (located on the Justice.gov website):

- "Tax evasion" is a shorthand phrase that many people use for all manner of tax fraud.

- But the charge of tax evasion, in violation of 26 U.S.C. § 7201, is not necessarily the best one to bring against individuals defrauding the IRS.

- Defendants frequently seek to exploit the fact that, in order to establish the crime of tax evasion, the government must prove the existence of a tax due and owing and willfulness. Prosecutors therefore should consider other charges, such as conspiring to defraud the United States, 18 U.S.C. § 371; filing false returns, 26 U.S.C. § 7206; or endeavoring to obstruct the IRS, 26 U.S.C. § 7212(a), as alternatives or supplements to the charge of tax evasion.

What does this Mean?

It means that while there is a general concept of the word tax evasion — that tends to encompass several different types of actual tax violations beyond just actual tax evasion — the actual code section for tax evasion is 26 USC 7201 — and not all tax crimes amount to tax evasion. Depending on the facts and circumstances, the US Government may want to consider alternatives to a tax evasion charge.

Willful Attempt to Evade or Defeat the Assessment of Tax

There are many different ways a Taxpayer may attempt to evade or defeat the assessment of tax. But, is the idea that there must be an *affirmative act* — therefore, merely not filing a tax return without any other action would generally not meet the requirement to pursue an offshore tax evasion case.

As provided by the Criminal Tax Manual:

- The means by which defendants can attempt to evade are virtually unlimited.

- As noted above, Section 7201 expressly prohibits attempts to evade tax "in any manner." In order to violate Section 7201, the taxpayer generally must take some **affirmative action with an intent to evade tax**.

- The general rule is that **omissions to act will not satisfy the affirmative act requiremen**t.

- For example, a mere failure to file a return, standing alone, cannot constitute an attempt to evade taxes. See Spies v. United States, 317 U.S. 492, 499 (1943); United States v. Hoskins, 654 F.3d 1086, 1091 (10th Cir. 2011) ("To be liable under § 7201, a defendant must do more than passively fail to file a tax return"); United States v. Nelson, 791 F.2d 336, 338 (5th Cir. 1986).

Thus, in order for the government to prove Taxpayer willfully attempted to evade or defeat the assessment tax, there must be an affirmative act. The most common form of evasion is typically filing a false tax return and/or keeping a double set of books — the latter which can take the Taxpayer down the path of a S*pies evasion investigation* — which makes it easier for the government to bring a criminal indictment/complaint involving tax evasion.

Examples of a Willful Attempt to Evade or Defeat the Assessment of Tax:

- **Establishing stock accounts for his children** into which [the defendant] had his investment banking income redirected). United States v. Beall, 970 F.2d 343, 346-47 (7th Cir. 1992)

- **Using a warehouse bank** and instructing an employer to pay one's income to a warehouse bank constitutes an affirmative act of evasion);6 United States v. Carlson, 235 F.3d 466, 469 (9th Cir. 2000)

- **Opening and using bank accounts with false social security numbers** and incorrect dates and places of birth could easily have misled or concealed information from the IRS); United States v. Valenti, 121 F.3d 327, 333 (7th Cir. 1997)

- **Use of cash, not keeping business records, paying employees in cash** and not reporting their wages to the IRS, advising employees they did not have to pay taxes); United States v. Jungles, 903 F.2d 468, 472- 74 (7th Cir. 1990) (employee's use of "independent contractor" agreement to eliminate withholding and warehouse bank to evade income tax were affirmative acts).

Attempt To Defeat or Evade Payment is Also Tax Evasion

Unlike a Taxpayer's attempt to evade the *Assessment* of Tax, the attempt to evade *Payment of Tax* is different. Many cases have held that merely not paying taxes is insufficient to carry a charge for tax evasion. But, since the government typically only has to show a single affirmative act per count of offshore tax evasion, Taxpayers need to be careful not to commit any affirmative act if they have already been assessed tax and are simply seeking to evade payment.

Examples of Willful Attempt to Evade or Defeat the Assessment of Tax

- Examples of affirmative acts of evasion of payment include:
  - **[P]lacing assets in the names of others**, dealing in currency, using nominees to conduct business, buy and sell assets, or conduct other financial transactions, or providing false information about assets or income to the IRS. See Cohen v. United States, 297 F.2d 760, 762, 770 (9th Cir. 1962); see also United States v. Carlson, 235 F.3d 466, 469 (9th Cir. 2000)
  - **Opening and using bank accounts with false social security numbers**, incorrect places of birth, and incorrect dates of birth could easily have misled or concealed information from the IRS); United States v. Gonzalez, 58 F.3d 506, 509 (10th Cir. 1995) (signing and submitting false financial statements to the IRS); United States v. Pollen, 978 F.2d 78, 88 (3d Cir. 1992);
  - Defendant placed assets out of the reach of the United States Government by **maintaining more than $350,000.00 in gold bars and coins, platinum, jewelry, and gems in safety deposit boxes at bank**, in a fictitious name); United States v. Beall, 970 F.2d 343, 345-47 (7th Cir. 1992)
  - Defendant **instructed employer to pay income to a tax protest organization**; United States v. McGill, 964 F.2d 222, 227-29, 232-33 (3d Cir. 1992)
  - Defendant concealed assets by **using bank accounts in names of family members and coworkers**; United States v. Brimberry, 961 F.2d 1286, 1291 (7th Cir. 1992)
  - **Defendant falsely told IRS agent that she did not own real estate and that she had no other assets** with which to pay tax); United States v. Daniel, 956 F.2d 540, 542-43 (6th Cir. 1992)
  - **Defendant used other persons' credit cards, used cash extensively**, placed assets in other persons' names); United States v. Conley, 826 F.2d 551, 553 (7th Cir. 1987)
  - **Defendant concealed "nature, extent, and ownership of his assets** by placing his assets, funds, and other property in the names of others and by transacting his personal business in cash to avoid creating a financial record"); United States v. Shorter, 809 F.2d 54, 57 (D.C. Cir. 1987)

Proving an Intent to Evade Tax For Income Offshore

When it comes to the US government seeking to pursue an offshore tax evasion case, the quintessential requirement is that the government can show that there was an **affirmative act** — and that that act was made with the intent to evade tax.

As provided by the Criminal Tax Manual:

- It is crucial that the affirmative act be committed with an intent to evade tax. The mere fact that there was a non-payment or understatement of taxes is insufficient; the government must prove that the defendant committed an affirmative act with the specific intent to evade tax. See United States v. Slutsky, 487 F.2d 832, 844 (2d Cir. 1973); United States v. Coblentz, 453 F.2d 503, 505 (2d Cir. 1972).
- That said, "[i]f the tax evasion motive plays any part in such conduct the offense may be made out even though the conduct may also serve other purposes such as concealment of other crime." Spies v. United States, 317 U.S. 492, 499 (1943); United States v. Voigt, 89 F.3d 1050, 1090 (3d Cir. 1996); United States v. Nolen, 472 F.3d 362, 379 (5th Cir. 2006); United States v. King, 126 F.3d 987, 989-90 (7th Cir. 1997).
- Evidence proving that a defendant has engaged in "any conduct, the likely effect of which would be to mislead or to conceal," including "keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind" (Spies, 317 U.S. at 499), can establish intent to evade assessment or payment of tax.

Offshore Tax Crimes

Offshore tax crimes come in all different flavors. It is important to note that not all tax violations are criminal. Oftentimes taxpayers contact us after being fear-mongered into believing that every violation of FBAR, FATCA, etc. will land them behind in prison —

Standard of Proof

It is important to remember that since offshore tax evasion is a crime, the U.S. government must prove their case by beyond a reasonable doubt, and not merely preponderance of the evidence (Civil FBAR) or clear and convincing evidence (Tax Fraud).

Examples of Offshore Tax Evasion

Here are some of the more common (potential) offshore tax evasion scenarios:

- David earns significant money from selling and exchanging cryptocurrency held overseas. David knows he is supposed to report the income, but he knowingly and intentionally does not include it on his U.S. tax return.

- Michelle opened several investment accounts in her name in different countries to escape detection (pre-FATCA). Michelle is a U.S. Person and is aware that she is required to include the income on her tax return, but she knowingly and intentionally excludes it from her tax return.

- Scott operates a business overseas. He has significant profits, but instead of distributing the income, he has the company pay all of his (lavish) personal expenses and writes them off as business expenses. He knows they are not proper deductions, but thinks he will not get caught.

Examples of Non-Offshore Tax Evasion

- David was unaware he had to report his foreign accounts or the income associated with it. His CPA never asked him about it, and he only recently learned of the reporting and tax requirements.

- Michelle never reported her foreign income, because she was unaware that her tax exempt interest in Taiwan was reportable and taxable in the U.S.

- Scott never disclosed his foreign pension income from a non-treaty country on his tax return, because he sincerely misunderstood the reporting requirements and sincerely believed it was not reportable in the U.S.

Offshore Tax Amnesty: We All Have 20/20 Hindsight

One of the most important aspects of determining whether a person is guilty of offshore tax evasion or fraud is the intent of the individual. And, whether a person is willful (criminal vs civil) or non-willful will impact which IRS Disclosure program they should submit to.

Here are a few things to keep in mind:

Are You Very Risk Averse?

Some individuals are by nature, very risk-averse.

They would never do *anything* to put themselves in harm's way.

For these individuals, the moment they even read about IRS international tax penalties, they are convinced they will be heading to prison, even when it is clearly not the case based on their own specific facts and circumstances.

Do You Like to Walk the Line?

Other individuals tend to like to walk the line, for better or worse.

Since these types of individuals are inherent risk-takers, they may believe they could sneak by the IRS by entering the Streamlined Program (even though they are willful) or even riskier (and illegal) by submitting a Quiet Disclosure.

Analyze YOUR Facts, Not Someone Else's Facts

Be sure to take a step back and make sure you are assessing the situation using your own fact pattern, and not one you may have read online.

Foreign Banks ARE Reporting

These days, with more than 110 countries and hundreds of thousands of foreign financial institutions entering into inter-governmental agreements (IGAs) with the United States for the enforcement and reporting of U.S. account holders, it is a much riskier move to try to hide your money offshore.

Whistleblowers & Informants are Everywhere

Unfortunately, this a fact of life. Now more than ever, the U.S. government is able to track taxpayers through social media and other media outlets. Once a person gets caught, it is not uncommon for them to turn on anyone they can, to save their own hide.

Offshore Tax Evasion is a Serious Tax Crime

Unlike other types of tax violations, the crime of offshore tax evasion is a very serious tax crime that may result in significant incarceration and monetary fines. Tax evasion is a felony and when charges are brought against the Defendant, the Government must show as it all crimes that they are guilty — **beyond a reasonable doubt**. But, it is also important for Taxpayers who may have violated the Tax Code to take stock of the situation — and realize that oftentimes merely being out of compliance with the IRS is not tax evasion.

What Do FATCA Reporting Rules Require US Taxpayers to File?

FATCA Reporting

FATCA Reporting: FATCA refers to Foreign Account Tax Compliance Act and was developed in or about 2010 in conjunction with Internal Revenue Code section 6038D. FATCA is the newest addition to the US Government's arsenal and leads the charge against offshore tax evasion and reporting noncompliance. The Government developed this international asset reporting regulation to ensure US Taxpayers located across the globe are actively reporting their foreign assets, accounts, investments, and income. Unlike other international information reporting forms, FATCA Reporting (generally submitted to the IRS on a Form 8938) is a part of the US Tax Return — and noncompliance may lead to fines and penalties. The Internal Revenue Service aggressively pursues Foreign Accounts Compliance for US Persons across the globe. The IRS continues its aggressive enforcement of FATCA reporting. With more than 110 countries entering into FATCA Agreements and 300,000 (Foreign Financial Institutions (FFIs) on board, FATCA reporting is here to stay.

Let's review the basics of FATCA reporting:

FATCA Reporting Basics

The FATCA reporting form 8938 was introduced on the U.S. tax return in 2011. Unlike the FBAR, which has been around for nearly 50-years, FATCA is relatively new. The Foreign Account tax Compliance Act was introduced as part of the HIRE Act.

As provided by the IRS:

- "The HIRE act generally requires that foreign financial Institutions and certain other non-financial foreign entities report on the foreign assets held by their U.S. account holders or be subject to withholding on withholdable payments. The HIRE Act also contained legislation requiring U.S. persons to report, depending on the value, their foreign financial accounts and foreign assets."
- The purpose of FATCA Reporting is to reduce offshore tax evasion and dissuade people from trying to hide money offshore in overseas accounts. The rules require U.S. persons to disclose foreign financial accounts and foreign assets.
- FATCA has become a harsh reality for millions of people. FATCA reporting impacts millions of U.S. account holders, who now must report foreign assets to the IRS each year on Form 8938.

10 Important FATCA Reporting Facts

FATCA Reporting is a complex area of law.

We tried to simplify the key components that impact U.S. person with an "individual" filing requirement

Deadline to Disclose

The FATCA Reporting Deadline is the same day a person's tax returns are due to be filed, including extensions.

In other words, if a filer receives an extension to file their tax returns, the FATCA filing requirements for Form 8938 also go on extension.

Worldwide Income

The United States is one of only a handful of countries on the planet that taxes individuals on their worldwide income.

What does that mean?

It means that whether or not you reside in the United States or in a foreign country, you are required to report all of your US income as well as foreign source income on your U.S. Tax Return. It also does not matter if the income you earn is tax-exempt in a foreign country (PPF or Passive Income earned in many countries), or whether the income you earn in a foreign country was already taxed (although a Foreign Tax Credit or Foreign Earned Income Exclusion may apply, see below). While you may be able to obtain a credit or exemption for the taxes you paid or income you earned in a foreign country – you are still required to report the income on your US tax return. Moreover, it should be noted that the foreign passive income you earned is also required to be identified on the FATCA Form 8938 (thresholds vary based on their U.S. Residency Status and/or marital and filing status).

You Must Have An *Interest* in the Account

Another similar form is called an FBAR (Report of Foreign Bank and Financial Account Form).

It is a form that is required to be filed by any US person who has ownership, joint ownership, or signature authority over a foreign account or group of accounts that in aggregate had more than $10,000 on any day of the year. With FATCA Form 8938 (required to be filed by certain taxpayers), the person must have an *interest* in the account. Therefore, if you merely have signature authority over an account, chances are you may not need to file the form. Moreover, if your name is on the account but you do not have any interest in the account — that is something you should discuss with an experienced international tax attorney before completing the form.

Filing Thresholds Vary

With the FBAR, the $10,000 threshold requirement does not vary. In other words, whether or not you are single, married filing jointly, or reside outside of the United States — the $10,000 threshold is still the same. FATCA reporting requirements are different. Not only must you have an interest in the account, but the threshold requirements vary — depending on whether you reside in the United States or in a foreign country, and whether you are married or single.

For example, if you are single or married filing separate and reside in the United States, then the minimum threshold requirement is $50,000 on the last day of the year or $75,000 on any day of the year (if you have less than $50,000 on the last day of the year). In sharp contrast, a person filing married filing jointly and residing overseas may have a minimum threshold requirement of $400,000.

Not All Assets are Reported

Unlike the FBAR, which is mainly focused on items such as accounts and insurance policies, FATCA Form 8938 is more comprehensive. It requires reporting for ownership of certain assets, such as an interest in a business or foreign corporation. The level of ownership of the foreign business, partnership, or corporation is important — because you don't want to duplicate file the Form 8938 and other forms (such as 8938 and 5471 or 8621).

Foreign Real Estate can get Complicated

If a person owns foreign real estate, whether or not they report the real estate will generally be determined by whether it earns any foreign income and/or whether the person is making interest or tax payments that they would like to deduct on their US tax return. Foreign real estate is not directly reported on a FATCA Form 8938. If a person owns an interest in a foreign corporation or business *that owns real estate*, the ownership interest in the foreign business or corporation is subject to FATCA reporting — but the real estate is not separately identified on its own 8938.

You Have to Report the Income as well

A form 8938 has multiple parts to it, but the introductory part asks the taxpayer to identify whether the accounts or assets listed in the 8938 (or 8938 continuation form) generate any income. If it does, the individual is required to identify whether the income is capital gains, interest income, dividend income, or any other type of income and how much was earned from those accounts. (This information will also be included on other forms such as his or her Schedule B, Schedule D, Schedule E, or other tax schedules).

Form 3520 & 3520-A

When a person receives a foreign gift or foreign trust distribution, they may be required to report it on a form 3520/3520-A There may be an overlap with Form 8938.

Foreign Corporation & Partnerships (5471 & 8865)

The rules are somewhat different for these two forms, but essentially the same (with the 5471 being much more commonplace for U.S. investors). Both of these forms require comprehensive disclosure requirements, involving balance statements, liabilities, assets, etc. Moreover, the forms need to be filed annually, even if a person does not have to otherwise file a tax return

FATCA & PFIC Reporting

One of the most vilified types of financial assets/investments (from the U.S. Government's perspective) is the infamous PFIC. A PFIC is a Passive Foreign Investment Company. The reason the United States penalized this type of investment is that it cannot oversee the growth of the investment, and/or the income it generates. In other words, if a U.S. person invests overseas in a Foreign Mutual Fund or Foreign Holding Company — the assets grow and generate income outside of IRS and U.S. Government income rules and regulations. As a result, the IRS requires annual disclosure of anyone with even a fractional interest in a PFIC (unless you meet very strict exclusionary rules).

The Form 3520 Reporting Requirements Explained 2022

Form 3520

The IRS Form *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts* in accordance with Internal Revenue Code Section 6039F is a deceptive international information reporting form. While the form itself is not as complicated as other forms, such as Form 5471 — the penalties for non-compliance are simply outlandish. When a U.S. person receives a gift from a foreign person, the IRS may require the U.S. person to file a Form 3520 to report the transactions. There are certain filing threshold requirements that the gift(s) must meet before the U.S. person is required to file the form, and the related party rules apply. The threshold for reporting foreign gifts on form 3520 varies depending on whether the gift is received from an individual or entity. The reporting threshold for gifts received from a foreign individual is significantly higher than the reporting threshold for a gift from a foreign entity. The form is due to be filed at the same time a person files their tax return. If a person files an extension for their tax return, then the time to file Form 3520 also goes on extension. The failure to properly report the form may result in 3520 penalties, which may culminate with the Taxpayer receiving a CP15 penalty notice. Let's review the basics of Form 3520:

Form 3520 Filing Requirements

Form 3520 is technically referred to as the A*nnual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts.* Not everyone who is a US person and receives a gift from a foreign person will have to file Form 3520. The filing requirements depend on the **value** of the gift(s) was, and whether the gift was given by a foreign individual, entity, or trust.

*Even if a U.S. person is not required to file a tax return, they may *still* have to file the form if the gift size exceeds the reporting threshold.

Reporting Foreign Gifts & Inheritance on Form 3520

The reporting of a foreign gift or inheritance is the main catalyst for having to file the form.

<u>US Persons may be required to file this form if they received either</u>:

A large gift

- A series of gifts from the same person
- A gift from a foreign business
- A foreign trust distribution
- Ownership of a foreign trust
- Other foreign trust transactions

Type of Foreign Gift

A gift is not limited to money. In other words, whether a person receives cash from overseas or other items that have cash value — they may be subject to the reporting rules.

Therefore, before filing Form 3520, the first step is to evaluate the value of the gifts received.

How to Value a Gift from Foreign Person

Typically, individuals can use any reasonable exchange rate that was published during that tax year. Both the Internal Revenue Service and the Department of Treasury publish different exchange rates.

There is nothing wrong with picking one rate over the other if the rate is more beneficial to the filer.

What is the Source of the Gift?

The source of the gift will determine the proper reporting requirements. More specifically, whether or not the transaction was with a foreign individual, entity or trust will determine the US Person reporting requirements.

Who is a Considered a Foreign Person for Form 3520?

There are three categories of foreign persons for determining the Form 3520 reporting:

- Foreign Individual
- Foreign Entity
- Foreign Trust

<u>**Foreign Individual**</u>

For example, when a person receives a gift from a foreign person individual, the reporting kicks in when the value of the gift (or series of gifts) exceeds $100,000. In other words, if a person receives a single gift from an individual who is a foreign person and the gift amount was $99,000 USD, then they would not have to report to the gift. Alternatively, if they received two gifts from the same person each valued at $55,000 USD each, then they would have to report the total amount of $110,000 in foreign gifts.

Why?

Because even though each gift was under $100,000 the total value of the gift from the individual during the year is over $100,000.

<u>**Foreign Corporation or Foreign Partnership**</u>

The threshold requirements for having to file a gift received from a foreign corporation or foreign partnership is significantly lower than it is for a foreign person. If the value of the foreign gift(s) received from a foreign corporation or partnership exceeds $16,388, then the U.S. person is required to report the gift on Form 3520.

*Unlike receiving a gift from a foreign person in which they do not have to identify the name of the donor, if the gift came from a foreign *business* then the IRS wants to know the name of the foreign business.

<u>**Foreign Trust**</u>

Foreign trust reporting is very complex.

Having ownership in a foreign trust and/or receiving a distribution from a foreign trust may require that the U.S. person file form 3520. There may be additional filing requirements as well, including Form 3520-A.

The New Streamlined Domestic Offshore Procedures 2022

Streamlined Domestic Offshore Procedures

In 2014, the Internal Revenue Service developed a stand-alone International Tax Amnesty Program for non-willful US Taxpayers who have not timely disclosed offshore assets, investments, accounts, and income. The program is referred to as the **Streamlines Domestic Offshore Procedures** — or SDOP for short. Each year, US Taxpayers are required to report their overseas money on a variety of different international information reporting forms — such as FBAR and FATCA — in order to comply with US tax and reporting rules — and remain in Foreign Accounts Compliance with the US Government. The Streamlined Domestic Offshore Procedures Program is designed to help noncompliant Taxpayers safely get into compliance. It is important to note that SDOP is reserved for non-willful, noncompliant US Residents only — willful taxpayers are still eligible to submit to the VDP (Voluntary Disclosure Program) instead of the Streamlined Procedures. With the US Government's aggressive enforcement of foreign accounts and asset compliance — and the recent increase in international audits — it is important to consider SDOP as a proactive means of offshore compliance. Once a Taxpayer is under audit they lose the right to use the Streamlined Domestic Offshore Procedures.

Benefits of the Streamlined Procedures

With the Streamlined Procedures for US Residents, non-willful Taxpayers can get caught up with International Reporting Forms, including (but not limited to):

- FinCEN Form 114 (FBAR)
- Form 8938 (FATCA)
- Form 5471 (Foreign Corporations)
- Form 8621 (PFIC)
- Form 8865 (Foreign Partnerships)
- Form 3520-A Foreign Trusts

The Streamlined Procedures for US Residents has been a very successful program for the US Government — and a **safe** way for Taxpayers to get into offshore tax compliance for international information form reporting — and avoid offshore penalties. Since the IRS both closed OVDP (2018) and ended DIIRSP (2020), the big question is whether Streamlined may be next up on the chopping block. The Board-Certified Tax and legal team at **Golding & Golding** have successfully handled streamlined filing submissions (Streamlined Domestic and Streamlined Foreign) for clients located all over the world. We have developed an innovative, all-inclusive flat-fee, full-service **tax and legal** model which has been adopted by international tax lawyers across the globe.

Purpose of IRS Streamlined Domestic Offshore Program

The purpose of the Streamlined Domestic Program is to leverage a smaller penalty now, against a potentially larger penalty later — noting that in recent years, the IRS has become much more aggressive in enforcing FBAR and offshore penalties. By way of brief background In 2014, the IRS developed the "stand-alone" domestic streamlined offshore program for U.S. resident taxpayers who are delinquent with offshore account and income reporting. Eligibility for the domestic version (SDOP) is for non-foreign residents with previously unreported foreign accounts, assets, income, and investments. These Taxpayers can use the Streamlined Domestic Offshore Procedures to get back into compliance with FATCA, FBAR, and other international information reporting forms.

<u>The three (3) main requirements necessary to qualify for SDOP are</u>:

- **non-willful**
- **filed U.S. tax returns timely for three (3) years); and**
- **not be under audit**

The goal of the program is to proactively bring non-willful taxpayers into offshore compliance. In exchange for making the submission, the Internal Revenue Service agrees to reduce all the offshore penalties to a single Title 26 miscellaneous offshore penalty of 5%. In recent years, the IRS has significantly increased the number of international tax and FBAR audits. If the Internal Revenue Service initiates an audit before the taxpayer makes a submission, the taxpayer becomes ineligible for submission.

Streamlined Domestic Offshore Eligibility Criteria

In order to be eligible for the domestic version of the procedure, there are four (4) main requirements. Within these elements, there are various requirements, nuances, exclusions, exceptions, and limitations — but these are the four (4) main components.

<u>A. Were You Non-Willful?</u>

Generally, if a person was unaware that there was a foreign account, foreign income, or foreign asset reporting requirement, the applicant may qualify as non-willful. Unfortunately, there is no bright-line test, and a more complex "totality of the circumstances" analysis is required.

<u>Non-Willful vs. Lower Standards of Willfulness</u>

Willfulness does not mean intent.

There can be "lower" forms of willfulness, which do not require willful or intent — these additional willful standards are referred to as:

- Reckless Disregard
- Willful Blindness

Even if a person was only non-willful for a small amount of time, or was willful but only had relatively small amounts of unreported income they do not qualify.

Learn what happens if you are willful and try to enter the program.

<u>B. Did You Previously File "Timely" Tax Returns?</u>

In order to qualify for the streamlined domestic offshore procedures (SDOP) a person must have filed original tax returns and those returns had to be filed timely. In other words, you cannot file original tax returns as part of the streamlined domestic offshore procedures

*The "timely return" requirement does not apply to the Streamlined Foreign Offshore Procedures.

<u>C. Are You Currently Under Audit or Examination</u>

As provided by the IRS:

- "If the IRS has initiated a civil examination of taxpayer's returns for any taxable year, regardless of whether the examination relates to undisclosed foreign financial assets, the taxpayer will not be eligible to use the streamlined procedures.
- Taxpayers under examination may consult with their agent. Similarly, a taxpayer under criminal investigation by IRS Criminal Investigation is also ineligible to use the streamlined procedures."

<u>D. Are you a Non-Foreign Resident?</u>

If a person is a foreign resident, then they will qualify for the Streamlined Foreign Offshore Procedures aka SFOP (presuming they are non-willful). When a person qualifies for SFOP, the 5% penalty is waived and the applicant can file original tax returns under the program.

Treatment & Scope of IRS Streamlined Domestic Procedures

A common question we receive about Streamlined Domestic Offshore Procedures (SDOP), is what type of general treatment an applicant will receive from the IRS under this program.

Here is a brief summary:

<u>A. Unpaid Taxes Due in Prior Years</u>

When a person submits to the streamlined domestic offshore procedures, they are responsible for paying what their tax liability w*ould have been*, had they initially paid their taxes timely. Unlike the voluntary disclosure program, there is no penalty on the amount of tax due — although interest continues to accrue.

<u>B. Title 26 Miscellaneous Offshore Penalty</u>

The penalties are relatively straightforward. The applicant will pay a one-time 5% penalty for the 6-year compliance period (summarized below). Under the Streamlined Domestic version of the program, a person pays a single, 5% penalty in lieu of all the other penalties the applicant could be hit with: The calculation for the penalty can be deceivingly complicated. This is primarily due to the fact that some assets are not penalized — such as individually owned real estate. In addition, other penalties are exempt, such as the value of Canadian RRSP and RRIF. We have prepared a detailed step-by-step summary about how to calculate the SDOP 5% Title 26 Miscellaneous Offshore Penalty.

<u>Other Offshore Penalties you can Avoid</u>

By submitting the 5% penalty, you can avoid other penalties, including:

- FBAR Penalties
- 3520 Penalties
- 3520-A Penalties
- Form 5471 Penalties
- Form 5472 Penalties
- Form 8621 Penalties
- Form 8938 Penalties

- Form 8865 Penalties

IRS Form 14654 Streamlined Domestic Non-Willful Certification

In order to qualify for the Streamlined Domestic Program, you must be able to certify (under penalty of perjury) that you were non-willful on Form 14654.

Here are a few pointers:

You Cannot Be Even a *Little* Willful

If you are willful, you do not qualify for the streamlined program. Even if you are willful but sorry and regretful, in the eyes of the IRS — you are still willful. You are signing the form under penalty of perjury. Your only option for formalized offshore disclosure is the traditional VDP.

Do Not Write a Novel

While the certification statement asks for significant facts to substantiate your non-willfulness, the goal is to be accurate and succinct. Even though each person's facts and circumstances are different, most submissions do not require a 10-page summary.

Be Clear and Concise

The IRS agents are overworked and underpaid. If you could find a way to say the same sentence using seven (7) words instead of 15 words, then you should do it. You should do your best to write and rewrite the statement as many times as necessary to get it as succinct (and concise) as possible — while still including all of the necessary information.

Be Respectful

The IRS agents are only doing their job; it is not as if the agents have it out for you. Whether you want to believe that or not, we've been doing this for *many* years, and we can tell you most agents are not gunning to become the head IRS person in charge. They have a job, and they have certain protocols for accepting or rejecting a submission. There is no need to be rude to the agents; be respectful and you will find that being respectful will go a long way in your streamlined submission (and in life).

Review the IRS Form Instructions Before Submitting

The IRS periodically updates the program requirements and updates the version of the forms. It is important that you have met all the necessary requirements, both substantively and administratively — so that your submission does not get kick-backed unnecessarily.

First Try Streamlined Domestic, then go (New) VDP?

No, but you're thinking smart — and that's always a good thing.

Why can't you try Streamlined first?

Because if the IRS would let you dip your toe in the Streamlined Pool first, before taking the plunge into OVDP, then everyone would do it — even if the applicant was clearly willful.

As provided by the IRS:

- "Once a taxpayer makes a submission under either the Streamlined Foreign Offshore Procedures or the Streamlined Domestic Offshore Procedures, the taxpayer may not participate in OVDP.

- Similarly, a taxpayer who submits to an OVDP voluntary disclosure letter pursuant to OVDP FAQ 24 on or after July 1, 2014, is not eligible to participate in the streamlined procedures."

What are the Fees for Hiring a Streamlined Domestic Offshore Attorney?

Learn why *experienced* Streamlined Offshore Disclosure Lawyers always charge flat-fee for tax **and** legal representation — and avoid using Kovel Letters.

Permanent Resident (Green Card Holders) US Tax & Foreign Reporting

How Permanent Resident Income is Taxed

Some of the most complicated IRS tax rules involve lawful permanent residents — otherwise referred to as Green Card Holders and the US tax implications of being a permanent resident. What makes tax law involving green card holders so complex, is that even though green card holders are not US citizens of the United States — they are still considered a US Person for tax purposes (aka a Legal Tax Resident). Technically, a Green Card Holder is a Citizen of a foreign country — but maintains the right to permanently reside in the United States (as long as they meet the annual physical residency requirements). And, once a foreign person becomes a Green Card Holder (absent a Form 8833 election if it is a treaty country), the permanent resident becomes subject to US tax on their worldwide income similar to a US citizen. That is the case whether or not they reside in the United States. Let's review the basics about how Green Card Holders are subject to

US tax and have to file US tax returns.

US Tax Systems Basics & Green Card Holders

The United States follows a Citizen-Based Taxation *(CBT) Tax Model. Right off the bat, this is a misnomer — because in actuality the US follows a *US Person-based* tax system. As a result, all US persons are subject to US tax on their **worldwide income**. It does not matter if the US Person resides outside the United States — and it does not matter if the income is generated from sources within the United States or sources outside of the United States — they are still subject to US Tax. For example, Drew is a permanent resident who resides outside of the United States in a foreign country. In addition, all of his income is foreign-sourced. Nevertheless, Drew must file a US tax return to report his worldwide income — because he is considered a US person.

Foreign Tax-exempt Income is Usually Taxable

Especially in Asian countries, it is very common for Passive Income (such as dividends, interest, capital gains or royalties) to be non-taxable in that country. For example, a foreign non-resident alien who earns all of their foreign passive income from an Asian Foreign Financial Institution is not (usually) taxed on the interest, dividends, or capital gains (exceptions apply). But if that same person is actually a lawful permanent resident who resides overseas (not taking into consideration the Green Card 6-month residence requirement), then they are subject to US tax on that income — making matters worse, is that since they did not pay any tax abroad — they will not have any foreign tax credits to apply, to reduce their US tax liability.

Expired Green Card & US Tax

This is where it gets a bit more complicated. The green card is actually just a *representation of permanent resident status*. Therefore, until the taxpayer formally relinquishes their green card (usually by filing a Form I-407) they are still considered a US person for tax purposes — they just lose their travel rights to the US — which is usually the primary purpose for many foreign nationals to obtain permanent residence in the United States in the first place — a double-whammy.

Foreign Account & Asset Reporting for Green Card Holders

In addition to having to report worldwide income, Green Card Holders also have to report their global assets on a broad range of different IRS international information reporting forms. Some of these forms include the FBAR (FinCEN Form 114), FATCA Form 8938, Form 5471, and Form 8865

Green Card Holder Treaty Position

If the person is a Lawful Permanent Resident/Green Card Holder and resides abroad, they may be able to make a treaty position that they should be treated as a foreign resident for that tax year. This may minimize any tax liability to the US government.

Relinquish and Become a Visa-Holder

For some Taxpayers who are Lawful Permanent Residents and residing abroad (unless they obtained approval to reside outside of the United States for more than six months (aka re-entry permit)) — chances are at some point the Green Card will be confiscated at a checkpoint at the airport. Green Card Holders in this situation may want to consider relinquishing their green card and instead try to acquire Tourist (B1/B2) or Investment (EB-5) status.

Offshore Amnesty Program Summary

The Offshore Amnesty Programs are programs developed by the Internal Revenue Service to assist Taxpayers who are already out of compliance for non-reporting, including Green Card Holders worldwide.

Some of the more common programs include:

- Voluntary Disclosure Program (VDP or "New" OVDP)
- Streamlined Domestic Offshore Procedures
- Streamlined Foreign Offshore Procedures
- Delinquency Procedures
- Reasonable Cause

Can I Just Start Filing This Year Instead?

No, unless the current year is the first year you had a reporting requirement. If you had a prior year reporting requirement, but only begin to start filing in the current year (Filing Forward) it is illegal. In the world of offshore disclosure, this is referred to as a Quiet Disclosure. The IRS has warned taxpayers that if they get caught in a Quiet Disclosure situation, it may lead to willful penalties and even a criminal investigation by the IRS Special Agents.

Can You Voluntarily Disclose Foreign Accounts if You are Willful?

Should You Voluntarily Disclose Foreign Accounts if You are Willful?

How IRS Voluntary Disclosure Program Practice Has Changed: At the end of 2018, the Internal Revenue Service discontinued the Offshore Voluntary Disclosure Program (OVDP). Then, at the end of 2018 and early 2019, the traditional Voluntary Disclosure Program (VDP) was updated due to the closure of the Offshore Voluntary Disclosure Program (OVDP) and other recent changes to the enforcement protocols of domestic tax compliance. A common question tax attorneys receive from potential applicants regarding Voluntary Disclosure is whether or not the program is good for taxpayers? The answer will depend on what the taxpayer is seeking to achieve from submitting to the program. Here are three common benefits to the program to consider:

Criminal Tax Liability

Typically (but not always), taxpayers seek to enter the Voluntary Disclosure Program (VDP) because they are willful and seeking to avoid criminal enforcement. The IRS only pursues a few thousand criminal tax cases each year and so, the overall likelihood that a taxpayer is going to be investigated for a tax crime is relatively small. Still, that statistic does little to calm the mind of a taxpayer who believes that they might have crossed the line from a civil tax violation to a criminal tax violation. While the new version of VDP has very specific requirements in terms of what the taxpayer must provide regarding the noncompliance, the IRS still stands by the position that if a taxpayer is honest and makes a full disclosure, then they will almost always avoid criminal enforcement. Thus, if the goal of the taxpayer is to avoid criminal enforcement, then the new VDP is still a good option.

Mitigating FBAR Penalties

For many taxpayers, the FBAR penalties are the biggest cause for concern. Under the new version of the program, the penalties nearly doubled from what they were at the tail end of the OVDP (27.5%) — presuming that there were no bad banks involved under OVDP, which automatically brought the whole penalty up to 50%. With OVDP, the penalty amount was firm, unless the taxpayer opted out and shot to reduce the penalty — which may very well result in an increased penalty amount. Under the new version of the program, the IRS goes by the code and the Internal Revenue manual as to the issuance of FBAR penalties. For the most part, taxpayers are going to get hit with a 50% penalty on the highest year's non-compliance. But, the taxpayer has the opportunity to try to mitigate the penalties in accordance with IRS guidelines. In addition, some examiners are willing to negotiate the penalty, especially if the 50% penalty is below the $100,000 minimum penalty (adjusted for inflation).

Audit vs. Opt-Out

One drawback from the prior OVDP is that taxpayers typically have to undergo an audit as part of the VDP process. Even though the taxpayer is going to face an audit, depending on the facts and circumstances of this situation and how thorough this submission is, oftentimes the audit may be resolved by correspondence only and/or the audit is very limited in scope. The taxpayer is essentially acknowledging that they are "not non-willful" when they submit to VDP, so there is no issue of the taxpayer claiming to be non-willful when they submit to the Voluntary Disclosure Program. If a taxpayer is non-willful, then they would not submit to the Voluntary Disclosure Program (this is different than OVDP, in which many non-willful taxpayers preferred to submit to OVDP in order to receive the closing letter and avoid audit).

New Offshore VDP Is a Good Deal for Some Taxpayers

The Voluntary Disclosure Program is designed for taxpayers who cannot certify under penalty of perjury that they are non-willful. While the parameters of the program were different than they were under the prior OVDP, depending on the facts and circumstances of the taxpayer, they may find themselves in a better position than they would have fared under OVDP.

Sean M. Golding is a founder of Golding & Golding, APLC, an international tax law firm located in Irvine, CA.

CALLING ALL LAW STUDENTS!

The Section of Real Property, Trust and Estate Law is now accepting entries for the 2022 Law Student Writing Contest. This contest is open to all J.D. and LL.M students currently attending an ABA-accredited law school. It is designed to encourage and reward law student writing on real property or trust and estate law subjects of general and current interest.

1st Place	2nd Place	3rd Place
$2,500 award	$1,500 award	$1,000 award

- Free round-trip economy-class airfare and accommodations to attend the RPTE Fall Leadership meeting. This is an excellent meeting at which to network with RPTE leadership! (First place only.)
- A full-tuition scholarship to the University of Miami School of Law's Heckerling Graduate Program in Estate Planning OR Robert Traurig-Greenberg Traurig Graduate Program in Real Property Development for the 2022–2023 or 2023-2024 academic year.* (First place only.)
- Consideration for publication in *The Real Property, Trust and Estate Law Journal*, the Section's law review journal.
- One-year free RPTE membership.
- Name and essay title will be published in the *eReport*, the Section's electronic newsletter, and *Probate & Property*, the Section's flagship magazine.

Contest deadline: **May 31, 2022**

Visit the RPTE Law School Writing Competition webpage at **ambar.org/rptewriting**.

*Students must apply and be admitted to the graduate program of their choice to be considered for the scholarship. Applicants to the Heckerling Graduate Program in Estate Planning must hold a J.D. degree from an ABA accredited law school and must have completed the equivalent of both a J.D. trusts and estates and federal income tax course. Applicants to the Robert Traurig-Greenberg Traurig Graduate Program in Real Property Development must hold a degree from an ABA accredited law school or a foreign equivalent non-US school.

Key U.S. Tax Considerations for International Private Clients

Basil Zirinis, Elizabeth Kubanik and Rebecca Szocs[1]

Basil Zirinis, Elizabeth Kubanik, and Rebecca Szocs provide an overview of the US tax system for individuals -- including income tax, transfer taxes, and reporting requirements -- for offshore assets.
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I. INTRODUCTION

This article provides an overview of the US tax system for individuals, including income tax, transfer taxes and reporting requirements for offshore assets.

2021 saw the inauguration of a new president, marking a change in political party and legislative policy. In September 2021, Democrats in the House of Representatives, with the support of the Biden administration, proposed significant changes to the tax structure to pay for the "Build Back Better Plan," which would have included funding for expanded social welfare services, infrastructure and jobs plans, and to combat climate change. The initial budget proposals would have increased the ordinary income and capital gains rates, the corporate tax rate, and enacted substantial changes to the taxation of grantor trusts. However, the initial tax proposals did not earn sufficient support in the Senate and were removed in a later version of the budget reconciliation package for the Build Back Better plan, which, as of February 2022, has not been passed by the Senate.

Additionally, separate from these recent legislative proposals, a number of developments aimed at increasing transparency have had significant implications for wealthy families and their advisers. A well-known example is the enactment of the Foreign Account Tax Compliance Act (FATCA) in 2010, which increased transparency by requiring the cross-border exchange of tax-related information. Another example is the 2016 IRS regulation that imposes additional disclosure requirements for a US disregarded entity wholly owned, directly or indirectly, by a non-resident alien. The disclosure rules are particularly relevant for non-resident aliens who wish to purchase real estate through a disregarded entity for privacy reasons. Such non-resident aliens should also be aware of the US Department of the Treasury Financial Crimes Enforcement Network's (FinCEN) Geographic Targeting Order (GTO) that requires the disclosure of identifying information by any title company involved in a qualifying real property transaction.

New reporting requirements are also set to go into effect. On January 1, 2021, the Corporate Transparency Act (CTA) was enacted as part of the Anti-Money Laundering Act of 2020 (AML). Under the CTA, corporations, limited liability companies, and similar entities must disclose to FinCEN information relating to the beneficial ownership of the entity. FinCEN is tasked with maintaining such ownership information in a non-public and secure database. In December 2021, FinCEN released proposed regulations seeking to implement the "beneficial ownership information" reporting requirement of the CTA. Final regulations should be published sometime this year.

II. TAX

i. Income tax

US citizens (regardless of where they reside) and residents (collectively, US persons) are subject to US income tax on worldwide income.[2] On the other hand, individuals who are neither citizens nor residents of the United States (non-resident aliens) are subject to US income tax only on certain types of US-sourced income, income effectively connected with a US trade or business and gains on the sale of US *situs* real property.[3]

A non-citizen of the United States is considered a resident of the United States for income tax purposes if the individual:

1. is admitted for permanent residence (i.e., holds a 'green card');
2. elects to be treated as such; or
3. has a 'substantial presence' in the United States in a given calendar year.[4]

An individual satisfies the substantial presence test and is deemed a resident if he or she has been present in the United States for at least 31 days in the current year and for at least 183 days during a three-year period that includes the current year, determined based upon a weighted three-year average.[5]

The use of this 'weighted average' can become a trap for individuals who focus only on the total day count and who believe that they can spend up to 182 days each year in the United States without having a 'substantial presence' that will cause them to be considered a US resident for income tax purposes. Under the weighted average test, a person may spend, on average, up to 120 days in the United States each year without being treated as a US income tax resident under the substantial presence test. An individual who meets the substantial presence test but spends less than 183 days in the United States in a year can still avoid being treated as a US income tax resident if he or she can establish that the individual maintains his or her tax home in another jurisdiction and maintains a 'closer connection' to such foreign tax home by filing a Form 8840 (Closer Connection Exception Statement for Aliens) with the IRS.[6] It is also important to consider whether a non-US citizen may be entitled to protection under a tax treaty between the United States and the jurisdiction the individual considers to be his or her home.

ii. Gift, estate and GST tax

There are three types of US federal transfer taxes: estate tax, gift tax and generation-skipping transfer (GST) tax (collectively referred to as transfer taxes). US citizens and US residents are subject to transfer taxes on worldwide assets.[7] The test to determine whether an individual is a US resident for transfer tax purposes is different from the test to determine whether an individual is a US resident for income tax purposes. Whereas the residence test for income tax purposes, as discussed above, is an objective test, residence for the purpose of transfer taxes is determined by a subjective domicile test, turning on the individual's intentions. A person is a US resident for transfer tax purposes if he or she is domiciled in the United States at the time of the transfer.[8] A person can acquire domicile in a place by living there, for even a short period of time, with the intention of remaining there indefinitely.[9]

Subject to provisions of an applicable treaty, a non-US citizen who is not domiciled in the United States is subject to US transfer taxes only on property deemed situated in the United States (US situs assets), including US real estate (which includes condominium apartments) and tangible personal property located in the United States. Shares in US corporations, debt obligations of US persons (subject to important exceptions for certain portfolio debt and bank deposits), and certain intangible property rights issued by or enforceable against US persons are subject to US estate tax but not US gift tax.

Current income and transfer tax rates

The TCJA passed under the Trump administration modified the income limits and respective rates of the seven individual income tax brackets, mostly with the effect of decreasing the tax rate for each bracket. The top marginal rate was decreased from 39.6 per cent to 37 per cent and in 2022 applies to single filers with income in excess of US$539,900, and married couples with income in excess of US$647,850. The TCJA also nearly doubled the standard deduction, which is adjusted annually for inflation and in 2022 is US$12,950 for single filers and US$25,900 for married couples.

While the aforementioned changes implemented by the TCJA may reduce the federal tax liability of many taxpayers, other changes, such as the elimination of deductions previously available to taxpayers who itemise deductions, may increase federal taxes, especially for taxpayers who live in states and cities that have their own income taxes. For example, the TCJA limits the mortgage interest deduction for mortgages incurred after 15 December 2017, such that the deduction is now allowed only for the interest on up to US$750,000 of the principal, including a home equity loan used to buy or improve a qualified residence.[10] In addition, whereas individual taxpayers were previously able to take a deduction against their federal income tax liability for state and local taxes paid (including property taxes), the TCJA limits the allowable deduction for such taxes to US$10,000 for both single filers and married couples.

The TCJA increased the deductions for some charitable giving to public charities. Charitable contributions of cash to a public charity may be deducted up to 60 per cent of the donor's adjusted gross income. Non-cash contributions to a public charity may be deducted up to 50 per cent of the donor's adjusted gross income, with the exception that contributions of capital gain property, such as appreciated stock, are subject to a 30 per cent limit. Special rules apply when a donor makes both cash and non-cash contributions to a public charity in the same year.[11]

The lifetime exemption from US gift, estate and GST taxes for US citizens and residents was doubled by the TCJA to US$10 million (US$20 million for a married couple), indexed for inflation (for 2022, the indexed exemption is US$12.06 million for an individual and US$24.12 million for a married couple). The exemption reverts back to US$5 million (US$10 million for a married couple), indexed for inflation, after 2025. The top transfer tax rate remains at 40 per cent.

US citizens and residents for transfer tax purposes may also take advantage of 'portability', which permits such persons to use the unused transfer tax exemption amount of the taxpayer's deceased spouse (if he or she died after 31 December 2010).[12] If a taxpayer is predeceased by more than one spouse, the taxpayer may use the unused transfer tax exemption of the last deceased spouse only. The executor of the deceased spouse's estate must make an election on the deceased spouse's estate tax return to allow the surviving spouse to use the deceased spouse's unused transfer tax exemption. The estate of an individual who was a non-resident alien of the United States for transfer tax purposes at the time of such individual's death is not eligible to make a portability election, and thus such individual's lifetime exemption from US transfer taxes (which is only US$60,000) cannot be passed on to his or her surviving spouse. More significantly, a non-resident alien surviving spouse may not acquire his or her deceased US spouse's unused lifetime exemption (except to the extent allowed under a US treaty).[13] However, a surviving spouse who becomes a US citizen after the death of the deceased spouse may elect to use the unused transfer exemption of the deceased spouse.[14]

iii. Medicare surcharge

The net investment income tax (NIIT) is part of the funding of the Patient Protection and Affordable Care Act enacted in 2010 and provides that citizens and residents of the United States (i.e., any individual other than a non-resident alien)[15] must pay an additional 3.8 per cent Medicare tax on the lesser of the taxpayer's 'net investment income', and the excess of the taxpayer's modified adjusted gross income (as calculated for income tax purposes) for the taxable year over a certain threshold amount. Likewise, trusts and estates must pay an additional 3.8 per cent tax on the lesser of the trust's 'net investment income', and the excess of adjusted gross income (as calculated by a trust or estate for other income tax purposes) over the dollar amount of the highest tax bracket for a trust or estate for the applicable tax year.[16]

In general, net investment income includes three broad categories of income:

1. gross income from certain interest, dividends, annuities (including annuities received from a charitable remainder trust), royalties and rents;

2. gross income derived from a business in which the taxpayer does not materially participate (income from a trade or business that is a passive activity is subject to the NIIT) or from trading in financial instruments or commodities; and

3. net gains attributable to the disposition of property, other than property held in a trade or business not described in (a).

iv. Retirement plans

The Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed into law on 20 December 2019, making significant changes to retirement planning. With respect to individual retirement accounts (IRAs), the age at which required minimum distributions must start was increased from age 70 ½ years to 72 years, and the restriction on making contributions after age 70 ½ years has been eliminated.[17] Under the SECURE Act, if the original owner of an IRA dies after 31 December 2019, a beneficiary of the inherited IRA who is not an 'eligible designated beneficiary' (i.e., a beneficiary who is not the surviving spouse or a minor child of the original owner, who is not disabled or chronically ill or who is more than 10 years younger than the original owner) must withdraw all the funds in the inherited IRA within 10 years from the original owner's death, reducing the amount of tax-deferred growth.[18] Before the SECURE Act, beneficiaries of such inherited IRAs could stretch out disbursements over their lifetimes, allowing the funds in such inherited IRAs to grow tax-deferred potentially for decades. Legislative proposals to make additional changes to retirement savings recently have been advanced. However, a detailed discussion of the SECURE Act and potential future changes is beyond the scope of this article.

v. Investment in non-US corporate entities

US citizens and income tax residents are subject to an anti-deferral tax regime if they invest (directly or indirectly) in non-US companies that are treated as controlled foreign corporations (CFCs) or passive foreign investment companies (PFICs).

Controlled foreign corporation

A foreign corporation is a CFC if, at any time during the tax year, more than 50 per cent of its stock (by vote or value) is held by US persons who directly, indirectly or by attribution hold 10 per cent or more of the voting power or value of the CFC. A CFC owned by a non-US trust is treated as owned by the trust's respective beneficiaries, or, in the case of a grantor trust, by the trust's grantor.

The TCJA modified the rules regarding who is considered a

US shareholder of a CFC. Prior to the implementation of the TCJA, the rules only looked at voting power (as opposed to voting power or value) to determine if a taxpayer held a 10 per cent interest in the corporation. The TCJA also expanded the 'downward attribution' rules that must now be considered in determining if an entity is owned 50 per cent or more by US taxpayers. These new rules may make 'accidental' CFCs more common.

Significant US shareholders (i.e., US shareholders who own 10 per cent or more of the vote or value) of a CFC are required to include in their gross income each year as ordinary income their pro rata share of the CFC's passive income (generally, dividends, interest, royalties, gains from the sale of certain types of property), regardless of whether such US shareholders actually receive any distributions.

In addition, under the pre-TCJA rules, a CFC had to be considered a CFC for at least a 30-day period for significant US shareholders to be subject to the special tax charge described above. The TCJA eliminated this provision, which has had significant impact on cross-border CFC planning.

The TCJA also introduced the concept of global intangible low-taxed income (GILTI). Very generally, the GILTI regime imposes a 10.5 percent minimum tax on substantial shareholders of CFCs.

Passive foreign investment company

A foreign corporation is a passive foreign investment company (PFIC) if either 75 per cent of more of the gross income of such corporation for the taxable year is passive income (the 'income test'), or the average percentage of the assets held by such corporation during the taxable year that produces passive income or is held for the production of passive income is at least 50 per cent (the 'asset test'). For this purpose, passive income generally includes interest, dividends, rents and royalties, and similar income and net gains from the sale of property producing such income. For example, an investment in a non-US private equity fund could be treated as an investment in a PFIC.

When US shareholders of a PFIC dispose of their PFIC shares or receive an 'excess' distribution[19] from the PFIC, any gain realised and any 'excess' distribution received is treated as ordinary income and apportioned retroactively over the shareholder's holding period; and an interest charge is imposed with respect to tax payable on any gain attributed to prior years. Importantly, this tax applies even where a US taxpayer holds his or her interest in a PFIC indirectly (e.g., through a US or non-US flow-through entity). For example, stock in a PFIC owned by a non-US non-grantor trust will be considered as owned proportionately by its beneficiaries.

vi. Reporting requirements and penalties

This section discusses a few of the US disclosure and reporting requirements that are of particular interest to individuals with both US and international interests, but is not an exhaustive list.

IRS Forms 3520 and 3520-A

A US person (including a US trust) who engages in certain transactions with a foreign trust, including creating a foreign trust (whether or not the trust has US beneficiaries) or transferring money or property, directly or indirectly, to a foreign trust; receiving a distribution (including a loan) of any amount from a non-US grantor or non-grantor trust; or receiving more than US$100,000 in gifts or bequests from a non-US person or a foreign estate or more than a specified amount (in 2021, US$16,815) from foreign corporations or foreign partnerships in any year, must report such amounts on IRS Form 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts).[20] Such US person must file a Form 3520 for the year in which any such transfer, distribution, gift or bequest is made by the due date of such person's federal income tax return for that year, even if the individual is not subject to US income tax on the amount.[21] An individual who fails to file a required Form 3520 may be subject to very significant penalties.

In addition, the trustee of a foreign trust with a US owner must file Form 3520-A (Annual Information Return of Foreign Trust with a US Owner) for the US owner to satisfy its annual information reporting requirements.

FBAR

If a US person has a financial interest in or signature or other authority over any bank, securities, or other type of financial account outside of the United States, and if the aggregate value of all such accounts exceeds US$10,000 at any time during the calendar year, that person must report such interest for such calendar year. Such report is made on FinCEN Form 114 (referred to as an FBAR form) on or before 15 April of the succeeding year, subject to an automatic six-month filing extension. For purposes of the FBAR rules, a US person is considered to have a financial interest in an account where title to the account is held by a grantor trust and such US person is the grantor of such trust. A US person is also deemed to have a financial interest in an account owned by a trust in which such US person has a present beneficial interest in more than 50 per cent of the assets or current income of the trust. Such beneficiary is, however, not required to report the trust's foreign financial accounts on an FBAR form if the trust, trustee of the trust, or agent of the trust is a US person and files an FBAR disclosing the trust's foreign financial accounts.

A beneficiary of a discretionary trust generally should not be considered as having a financial interest in such trust requiring an FBAR filing merely because of such person's status as a discretionary beneficiary.

FATCA

FATCA helped accelerate the global drive towards greater transparency and scrutiny of offshore assets. Under FATCA, enacted in 2010 as part of the Hiring Incentives to Restore Employment Act, foreign financial institutions (FFIs) are required to either enter into an agreement with the IRS under which they agree to report to the IRS certain details about their accounts directly or indirectly held by US persons (US accounts)[22] or become 'deemed compliant' under the regulations. Non-financial foreign entities (NFFEs) that are publicly traded or engaged in active trading are not required to enter into or comply with an FFI agreement. However, FATCA does require certain 'passive NFFEs' (generally, NFFEs earning mostly passive income that are not publicly traded) to report to withholding agents and participating FFIs with which the NFFE holds accounts, information on their 'substantial US owners' (described in footnote 26), or to certify annually that they have no substantial US owners.[23] Because the United States does not have direct jurisdiction over most FFIs, FATCA compels compliance by imposing a 30 per cent withholding tax on US-sourced income and proceeds from the sale of US property on FFIs that do not agree to provide the IRS with the required information.[24]

The definition of an FFI is broad, including any entity that 'accepts deposits in the ordinary course of a banking or similar business', holds financial assets for the account of others 'as a substantial part of its business', or is engaged primarily in the business of investing, reinvesting or trading in securities, partnership interests, commodities or any interests therein[25] and would include most investment vehicles unless a specific exception applies. Under this definition, foreign trusts with corporate trustees acting for different customers (including, in most cases, a private trust company that retains outside investment advisers or receives fees for its services) will be FFIs if, in general, 50 per cent or more of the trust's gross income is attributable to investing in financial assets.[26] A foreign trust that is not an FFI (for instance, a trust managed by an individual trustee) will generally be an NFFE.

Since the implementation of FATCA began, the Treasury Department has entered into many intergovernmental agreements (IGAs) to facilitate the implementation of FATCA. The purpose of IGAs is to remove domestic legal impediments to compliance with FATCA requirements and to reduce burdens on FFIs located in jurisdictions that enter into IGAs (partner jurisdictions).

Despite early opposition to FATCA in many cases, FATCA has expanded and become increasingly accepted in the international sphere, with partner jurisdictions entering into bilateral IGAs whereby they agree to provide information to the United States in exchange for an agreement from the United States to provide such partner jurisdiction with FATCA-like information regarding financial accounts held by the citizens of such partner jurisdiction in the United States.

Form 8938

In addition to the reporting and withholding requirements discussed above, FATCA also requires certain individual taxpayers, including US citizens or green card holders permanently residing abroad, with interests in certain foreign financial assets with an aggregate value greater than US$50,000 on the last day of the tax year, or greater than US$75,000 at any time during the tax year, to file Form 8938 (Statement of Specified Foreign Financial Assets), reporting the interest with such individual's federal income tax return. The obligation to file Form 8938 is in addition to, not in replacement of, any filing obligation such individual may have under the FBAR rules. Whether a US person beneficiary of a discretionary non-US trust will be required to report his or her interest in the trust on a Form 8938 will depend on many factors, including whether such individual received a distribution from the trust in a given tax year and the value of the individual's interest in other foreign financial assets.

Form 5472

Generally, except in the case of corporations (or entities that elect to be treated as corporations), a US entity that has a single owner is disregarded as separate from its owner. However, in late 2016, the IRS finalised regulations that treat a US disregarded entity wholly owned, directly or indirectly, by a non-resident alien as a domestic corporation separate from its owner for Internal Revenue Code Section 6038A disclosure purposes.[27] Such entities are now required to make additional disclosures when participating in certain transactions.

Under the current rule, these entities must file IRS Form 5472 (which requires an employer identification number) when reportable transactions occur during the tax year and must maintain records of reportable transactions involving the entities' non-resident alien owners or other foreign parties. The regulation classifies transactions such as any sale, lease or other transfer of any interest in or a right to use any property as reportable transactions. To acquire an employer identification number, the owner may have to obtain an individual taxpayer identification number (as they also would when buying property individually), which many non-resident aliens hope to avoid. These disclosure rules are particularly relevant for non-resident aliens who wish to purchase real estate through a disregarded entity for privacy reasons.

Non-resident aliens should also be aware of a revised FinCEN GTO that requires the disclosure by the title company involved in the transaction of identifying information on a FinCEN Currency Transaction Report, filed within 30 days of a qualifying transaction.[28] The GTO's disclosure requirements are applicable to all residential real estate purchases by certain legal entities that are paid for, in whole or in part, by cash, cheque, money order, funds transfer or virtual currency (and without a bank loan or other similar form of financing) of US$300,000 or more in:

1. Bexar, Tarrant or Dallas counties in Texas;
2. Miami-Dade, Broward or Palm Beach counties in Florida;
3. the boroughs of Brooklyn, Queens, Bronx, Staten Island or Manhattan in New York City, New York;
4. San Diego, Los Angeles, San Francisco, San Mateo or Santa Clara counties in California;
5. Clark county in Nevada;
6. King county in Washington;
7. Suffolk or Middlesex counties in Massachusetts;
8. Cook county in Illinois; and
9. the city and county of Honolulu in Hawaii.

A currency transaction report must include information about the identity of the purchaser, the purchaser's representative, and the beneficial owners, as well as information about the transaction itself, including the closing date, payment amount, payment method, purchase price and address of the real property involved in the transaction. In addition, the form requires disclosures about the entity used to purchase the property, including the names, addresses and taxpayer identification numbers for all members. The reporter must obtain copies of driver's licences, passports or similar documents from the purchaser, the purchaser's representative and the beneficial owners.[29]

The purpose of the GTO is to provide law enforcement with data to improve efforts to address money laundering in the real estate sector. The GTO is a temporary measure that is effective for only 180 days, but has been extended several times, and the most recent extension will expire on 29 April 2022.

Form 5471

Form 5471, Information Return of US Persons with Respect to Certain Foreign Corporations, must be filed by, among others, US persons who own or acquire certain interests in foreign corporations, including CFCs.

Form 8621

A US shareholder who directly or indirectly owns shares in a PFIC at any time during such person's taxable year must file a Form 8621. The filing requirement is imposed on the first US person in the chain of ownership (i.e., the lowest-tier US person) that is a PFIC shareholder (including an indirect shareholder).

III. CONCLUSION

It remains to be seen whether any tax proposals will be enacted during the Biden administration. Moreover, as many economies worldwide struggle to emerge from the global pandemic, all indicators point to an increasingly global system of information sharing and enforcement.

Appendix 1

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Endnotes

1. Basil Zirinis is a partner and Elizabeth Kubanik is European Counsel in the London office of Sullivan & Cromwell LLP. Rebecca Szocs is an Associate in the New York City office of Sullivan & Cromwell LLP.
2. IRC Section 61. The top federal individual income tax rate for ordinary income in 2022 is 37 per cent, with a lower 20 per cent rate applied to long-term capital gains and qualified dividends. Net investment income may also be subject to an additional 3.8 per cent Medicare surtax.
3. IRC Sections 871, 897.
4. IRC Section 7701(b)(1)(A).
5. The weighted average test takes into account all of the days of presence in the United States in the current calendar year, a third of the days in the first preceding calendar year and a sixth of the days in the second preceding calendar year. Treas. Reg. Sections 301.7701(b)–1(c)(1), (4).
6. Treas. Reg. Section 301.7701(d)-1.
7. IRC Sections 2031(a), 2511(a), 2612.
8. Treas. Reg. Sections 20.0-1(b)(1), 25.2501-1(b), 26.2663-2(a).
9. Treas. Reg. Section 20.0-1(b)(1).
10. Prior to the TCJA, the mortgage interest deduction was limited to the interest on up to US$1 million in mortgages to acquire or improve a qualified residence, in addition to the interest of up to US$100,000

on any home equity loan. Outstanding indebtedness may not be grandfathered for a home equity loan used for a purpose other than acquiring or improving a qualified residence.
11. The deductibility limit on the non-cash contribution is reduced by the amount of the cash contribution. The non-cash contribution may be deducted up to 50 per cent of the donor's adjusted gross income (or 30 per cent in the case of appreciated stock), less the cash contribution subject to the 60 per cent limit. IRS Pub. No. 526 (12 March 2019).
12. The current portability regulations provide that the deceased spouse's unused exemption amount is based on the exemption amount in effect at the time of the first spouse's death, such that, if the first spouse died prior to 2025, the higher exemption amount would be available to the surviving spouse even after the exemption amount has been reduced. Treas. Reg. Section 20.2010-2(c)(1). However, IRC Section 2010(c)(4) applies the exemption amount of the surviving spouse. Further clarification is needed to resolve this ambiguity.
13. See Fed. Estate and Gift Tax Reporter Section 1450.08; Treas. Reg. Section 20.2010-3.
14. Treas. Reg. Section 20.2010-3.
15. A dual-resident US citizen (per IRC Section 301.7701(b)-&(a)(1)), who declares resident status in a foreign country for tax purposes pursuant to an income tax treaty between the United States and that country and claims benefits of the treaty as a non-resident of the United States, is considered a non-resident alien with respect to the NIIT.
16. US$13,450 for tax year 2022.
17. Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, Pub. L. No. 116–94, Sections 107, 114.
18. id., Section 401.
19. Generally, any distributions received by a US shareholder on PFIC stock in a taxable year that are greater than 125 per cent of the average annual distributions received by the US shareholder on the shares in the three preceding taxable years (or, if shorter, the US shareholder's holding period in the shares) are excess distributions.
20. If the trust owns an interest in a CFC or a PFIC, a US beneficiary may have additional reporting requirements.
21. US law requires a US beneficiary of a non-US trust to obtain from the trustee of a non-US trust a detailed statement of distributions made from the trust to enable the US beneficiary to complete the Form 3520. If such a statement is not filed with the IRS, the distribution could be treated for US income tax purposes as being a distribution of undistributed net income.
22. US accounts include accounts held by US-owned entities. IRC Section 1471(d)(1). A US-owned entity is an entity with 'Substantial US Owners'. IRC Section 1471(d)(3). Generally, an entity has Substantial US Owners if a US person owns more than a 10 per cent interest in the entity. IRC Section 1473(2)(A). However, in the case of investment entities, any US ownership will cause it to be a US-owned foreign entity. IRC Section 1473(2)(B). A foreign non-grantor trust would be a US-owned entity if any specified US person holds, directly or indirectly, more than 10 per cent of the beneficial interest in the trust. IRC Section 1473(2)(A)(iii).
23. IRC Section 1473(2)(A); Treas. Reg. Section 1.1471-4(d)(iii)(B)(3). As an alternative, the regulations permit an NFFE to report directly to the IRS certain information about its direct or indirect substantial US owners, rather than to a withholding agent, by electing to become a 'direct reporting NFFE'.
24. IRC Section 1471(a)–(b). Withholding on the gross proceeds from the sale or other disposition of property of a type that can produce interest or dividends or dividends that are US-source fixed, determinable, annual or periodical income will begin for sales occurring after 31 December 2018. Although FATCA imposes significant compliance and administrative burdens on trustees of non-US trusts, there should be no additional tax burden imposed if trustees comply with all reporting requirements.
25. IRC Section 1471(d)(4)–(5).
26. Treas. Reg. Section 1.1471-5(e)(4).
27. Treatment of Certain Domestic Entities Disregarded as Separate from Their Owners as Corporations for Purposes of Section 6038A, 81 Fed. Reg. 89,849 (13 December 2016) (to be codified at 26 C.F.R. pt. 1, 301).
28. United States Department of the Treasury Financial Crimes Enforcement Network, Geographic Targeting Order (8 May 2020), avail-able at www.fincen.gov/sites/default/files/shared/Generic%20Real%20Estate%20GTO%20Order%20FINAL%20508_2.pdf.
29. Businesses are also required to report identifying information relating to transactions that involve cash payments over US$10,000 by filing an IRS Form 8300.

FELLOWS

The ABA Section of Real Property, Trust and Estate Law Fellows Program encourages the active involvement and participation of young lawyers in Section activities. The goal of the program is to give young lawyers an opportunity to become involved in the substantive work of the RPTE Section while developing into future leaders.

Each RPTE Fellow is assigned to work with a substantive committee chair, who serves as a mentor and helps expose the Fellow to all aspects of committee membership. Fellows get involved in substantive projects, which can include writing for an RPTE publication, becoming Section liaisons to the ABA Young Lawyers Division or local bar associations, becoming active members of the Membership Committee, and attending important Section leadership meetings.

Applications due June 10, 2022.

https://www.americanbar.org/groups/real_property_trust_estate/fellowships-and-awards/

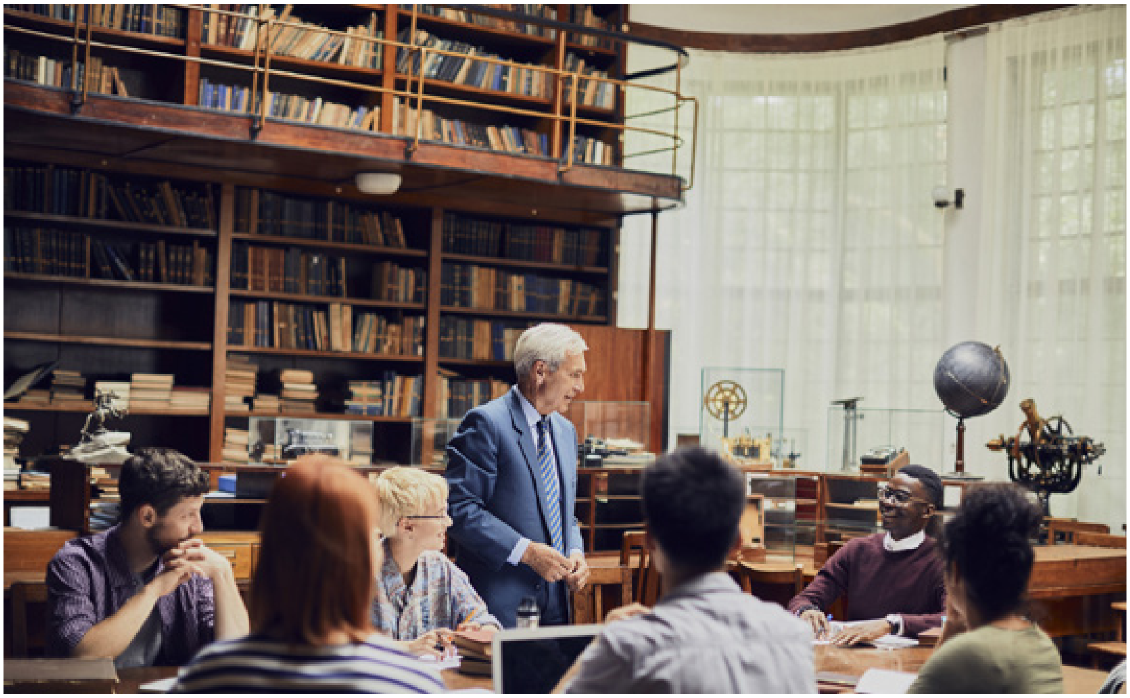
ABA AMERICAN BAR ASSOCIATION
Real Property, Trust and Estate Law Section

THE BUSINESS PLANNING GROUP (BPG)

The Business Planning Group (BPG) addresses trust and estate planning and administration for closely held entity owners via its three committees. The Investment Entities Committee focuses on investment vehicles, including family limited partnerships and LLCs and private investment funds—such as hedge funds, private equity and venture capital. The Farmers, Ranchers and Natural Resources Committee focuses on the planning and administration issues specifically associated with those asset classes. The Operating Businesses Committee focuses on the challenges that are unique to business owners including business succession planning, liquidity planning, and entity taxation. Related topics BPG has covered this year have included charitable planning with business interests and review of qualified plan options for businesses.

BPG members are scheduled to present compelling topics at the virtual 34th Annual RPTE National CLE Conference April 26-29, 2022. BPG members also will also contribute to eCLEs and publications in the coming year. BPG continues to monitor proposed legislation, regulations, and guidance, and offers comments on changes that may affect entity owners. In addition, BPG hosts monthly open Zoom meetings to generate lively discussion and provide information and context for fellow lawyers representing clients with closely held business interests. Join the Business Planning Group to receive calendar invitations for monthly calls and other outreach from the group!

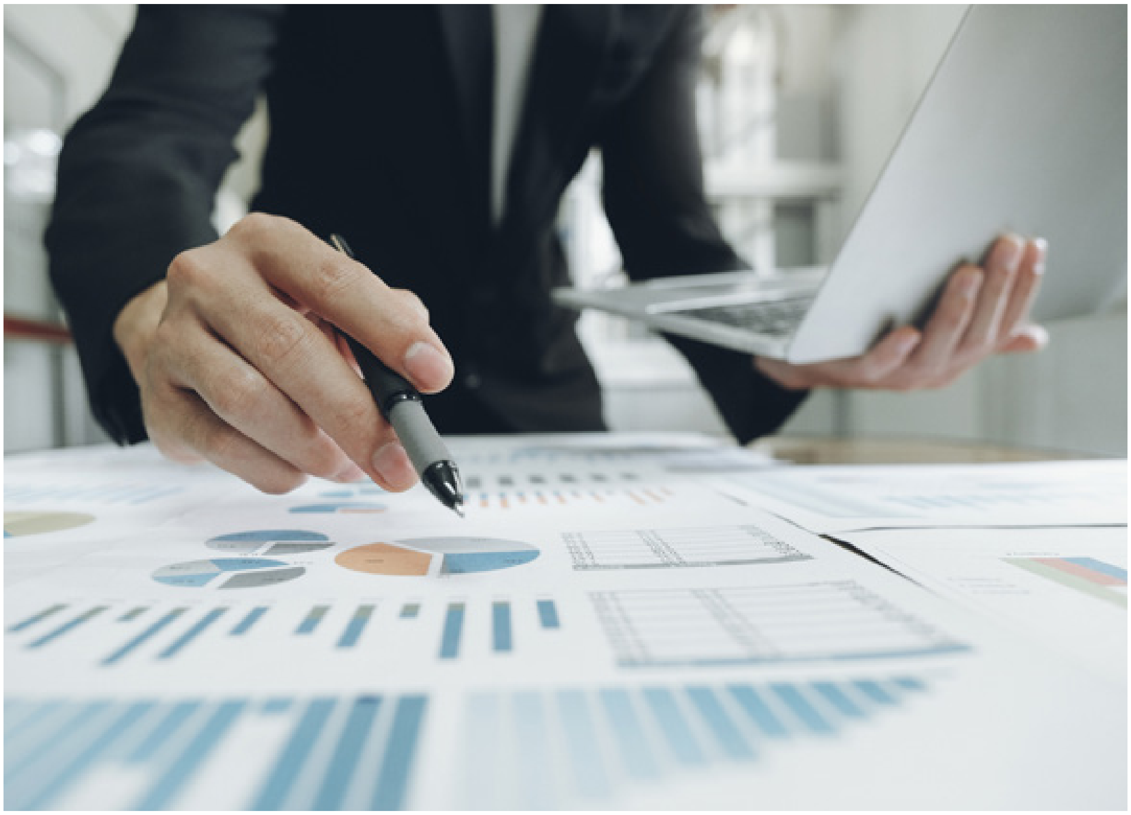
JOINT LEGAL EDUCATION AND UNIFORM LAWS GROUP



The Joint Legal Education and Uniform Laws Group monitors the activities of the National Conference of Commissioners for Uniform State Laws (the Uniform Law Commission) with respect to a host of its TE and real property projects. We also keep abreast of trends in legal education, particularly focusing on ways to increase student interest in RPTE practice areas and to connect members of the academic with relevant expertise to those practicing in the TE and RP arena. One of our more well-known programs is the Professors' Corner webinar, which covers a host of interesting topics. Faculty also traditionally host a recent developments CLE program at the annual meeting.

AMERICAN BAR ASSOCIATION
Real Property, Trust and Estate Law Section

THE REAL ESTATE FINANCING GROUP



The Real Estate Financing Group is devoted to assisting attorneys in financing techniques involving real estate as collateral. To this end, this group presents educational programs and produces written materials to educate lawyers in all aspects of real estate finance. Separate committees within this group are dedicated to mortgage lending, construction lending, securitizations and legal opinions issued in connection with these financings, as well as legal issues and developments in real estate workouts, foreclosures and bankruptcies.

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THE CHARITABLE PLANNING AND ORGANIZATIONS GROUP

The Charitable Planning and Organizations Group hosted a quarterly call on January 5th. Andrew S. Katzenberg, Of Counsel at DLA Piper, presented on "The Five Special Excise Taxes for Private Foundations". The Group is looking forward to the ABA 34th Annual National CLE Meeting and is presenting a program on April 27 called "What's a Donor to Do: A Case Study". An esteemed panel will cover hot topics in charitable giving as well as donor best practices and pitfalls. The Group holds regular calls and welcomes your participation in our substantive discussions and planning meetings.

AMERICAN BAR ASSOCIATION
Real Property, Trust and Estate Law Section

Learn about Section of Real Property, Trust and Estate Law's eReport

The *eReport* is the quarterly electronic publication of the American Bar Association Real Property, Trust and Estate Law Section. It includes practical information for lawyers working in the real property and estate planning fields, together with news on Section activities and upcoming events. The *eReport* also provides resources for seasoned and young lawyers and law students to succeed in the practice of law.

For further information on the *eReport* or to submit an article for publication, please contact Robert Steele(Editor), Cheryl Kelly (Real Property Editor), Raymond Prather (Trust and Estate Editor), or RPTE staff members Bryan Lambert or Monica Larys. Are you interested in reading FAQs on how to get published in the *eReport*? Download the FAQs here. We welcome your suggestions and submissions!

FREQUENTLY ASKED QUESTIONS BY PROSPECTIVE AUTHORS RTPE eReport

What makes eReport different from the other Section publications? The most important distinction is that eReport is electronic. It is delivered by email only (see below) and consists of links to electronic versions of articles and other items of interest. Since eReport is electronic, it is flexible in many ways.

How is eReport delivered and to whom?

eReport is delivered quarterly via email to all Section members with valid email addresses. At the ABA website, www.americanbar.org, click myABA and then navigate to Email, Lists and Subscriptions. You have the option of receiving eReport. Currently almost 17,000 Section members receive eReport.

What kind of articles are you looking for?

We are looking for timely articles on almost any topic of interest to real estate or trust and estate lawyers. This covers anything from recent case decisions, whether federal or state, if of general interest, administrative rulings, statutory changes, new techniques with practical tips, etc.

How long should my article be?

Since *eReport* is electronic and therefore very flexible, we can publish a two page case or ruling summary, and we can publish a 150 page article. eReport is able to do this since the main page consists of links to the underlying article, therefore imposing no page restraints. This is a unique feature of eReport.

How do I submit an article for consideration?

Email either a paragraph on a potential topic or a polished draft – the choice is yours – to the Editor, Robert Steele, at rsteele@ssrga.com, and either our Real Estate Editor, Cheryl Kelly, at ckelly@thompsoncoburn.com, or our Trust and Estate Editor, Raymond Prather, at ray@pratherebner.com.

Do I need to have my topic pre-approved before I write my submission?

Not required, but the choice is yours. We welcome topic suggestions and can give guidance at that stage, or you may submit a detailed outline or even a full draft. You may even submit an article previously published (discussed below) for our consideration.

Do citations need to be in formal Bluebook style?

eReport is the most informal publication of the Section. We do not publish with heavy footnotes and all references are in endnotes. If there are citations, however, whether to the case you are writing about, or in endnotes, they should be in proper Bluebook format to allow the reader to find the material. Certainly you may include hyperlinks to materials as well.

Can I revise my article after it is accepted for publication?

While we do not encourage last minute changes, it is possible to make changes since we work on Word documents until right before publication when all articles are converted to pdf format for publication.

What is your editing process?

Our Editor and either the Trust and Estate Editor or the Real Estate Editor work together to finalize your article. The article and the style are yours, however, and you are solely responsible for the content and accuracy. We will just help to polish the article, not re-write it. Our authors have a huge variety of styles and we embrace all variety in our publication.

Do I get to provide feedback on any changes that you make to my article?

Yes. We will email a final draft to you unless we have only made very minor typographical or grammatical changes.

Will you accept an article for publication if I previously published it elsewhere?

YES! This is another unique feature of eReport. We bring almost 17,000 new readers to your material. Therefore, something substantive published on your firm's or company's website or elsewhere may be accepted for publication if we believe that our readers will benefit from your analysis and insight. In some cases, articles are updated or refreshed for eReport. In other cases, we re-publish essentially unchanged, but logos and biographical information is either eliminated or moved to the end of the article.

How quickly can you publish my article?

Since we publish quarterly, the lead time is rarely more than two months. If you have a submission on a very timely topic, we can publish in under a month and present your insights on a new topic in a matter of weeks.