

Comments on the 2014 Offshore Voluntary Disclosure Program and the Streamlined Procedures

AMERICAN BAR ASSOCIATION SECTION OF TAXATION

May 2, 2018

*The Honorable David Kautter
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20024*

Re: Comments Regarding the OVDP and Streamlined Procedures

Dear Acting Commissioner Kautter:

Enclosed please find our response to the Notice and Request for Comments published in the Federal Register on February 28, 2018 (Collection; Comment Request on Information Collection Tools Relating to the Offshore Voluntary Disclosure Program (OVDP), 83 Fed. Reg. [No.] 40, 8734) which requested comments related to the OVDP and the “Streamlined Filing Compliance Procedures” (“Comments”). These Comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association.

The Section of Taxation will be pleased to discuss the Comments with you or your staff.

*Sincerely,
Karen L. Hawkins
Chair, Section of Taxation*

cc:

*Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
Thomas West, Tax Legislative Counsel, Department of the Treasury
L.G. “Chip” Harter, Deputy Assistant Secretary (International Tax Affairs),
Department of the Treasury
Doug Poms, International Tax Counsel, Office of International Tax Counsel,
Office of Tax Policy, Department of the Treasury
Douglas O’Donnell, Commissioner, LBE&I, Internal Revenue Service*

Nikole C. Flax, Deputy Commissioner (International), LB&I, Internal Revenue Service

John Cardone, Director, Withholding and Individual International Compliance, LB&I, Internal Revenue Service

William M. Paul, Acting Chief Counsel and Deputy Chief Counsel (Technical), Internal Revenue Service

Drita Tonuzi, Deputy Chief Counsel (Operations), Internal Revenue Service

Kathryn Zuba, Associate Chief Counsel (Procedure & Administration), Internal Revenue Service

Marjorie Rollinson, Deputy Associate Chief Counsel (International), Internal Revenue Service

Carolyn Schenck, Senior Counsel (SB/SE), Internal Revenue Service

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (the “Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Caroline D. Ciralo (Vice-Chair, Committee on Civil and Criminal Tax Penalties (“CCTP”)), Niles Elber (Chair, CCTP), Zhanna Ziering (Subcommittee Chair, CCTP), and Michael Sardar (Subcommittee Chair, CCTP). The following individuals provided substantial assistance in drafting these Comments: Arielle Borsos, Arsalan Memon, Benjamin Eisenstat, Benjamin Tompkins, Bruce Zagaris, Carina Federico, David Rice, Deborah J. Jacobs, Fran Obeid, Frank Agostino, Jeffrey Dirmann, Jennifer O’Brien, John Pontius, Kathleen Agbayani, Kathleen Gregor, Kelley Miller, Kevin Packman, Kevin Sweeney, Lawrence Sannicandro, Matthew Kadish, Michael Miller, Michel Stein, Mitch Horowitz, Neil A.J. Sullivan, Parag Patel, Robert Ward, Ross Sharkey, Sahel Assar, Shamik Trivedi, Sharyn Fisk, Susan Berson, Lisa M. Zarlenga, and Valerie Vlasenko.

These Comments were reviewed by John M. Colvin of the Section’s Committee on Government Submissions and by Julian Y. Kim, the Section’s Vice Chair (Government Relations).

Although the members of the Section who participated in preparing these Comments have clients who would be affected by the federal income tax principles addressed by these Comments, or have advised clients on the application of such rules, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

Contacts: Caroline D. Ciraolo Niles A. Elber
cciraolo@kflaw.com nelsber@capdale.com
(202) 790-6991 (202) 862-7827

Date: May 2, 2018

Executive Summary of Comments and Recommendations

These Comments are presented in connection with the effort by the Department of the Treasury and Internal Revenue Service (the “Service” or “IRS”) to collect information on the paperwork and other burdens facing U.S. taxpayers who are participating in one of the Service’s programs to voluntarily disclose previously unreported offshore assets, and specifically in response to the Notice and Request for Comments published in the Federal Register on February 28, 2018 (“Notice and Request”).¹ These Comments address issues related to the Offshore Voluntary Disclosure Program (“OVDP”) and the “Streamlined Filing Compliance Procedures” (“Streamlined procedures”), which consist of the Streamlined Domestic Offshore Procedures (“SDOP”) and the Streamlined Foreign Offshore Procedures (“SFOP”).

The Service’s voluntary disclosure programs have been remarkably successful with more than 56,000 taxpayers participating in the OVDP since 2009 and more than 65,000 taxpayers taking advantage of the Streamlined procedures. For many taxpayers, these options helped solve a potentially paralyzing problem; namely, the repatriation of foreign assets without fear of unpredictable penalties or criminal prosecution. However, taxpayers who choose to participate do so at considerable cost in terms of time and resources.

While we recognize the Service needs to do a certain amount of due diligence and information gathering to determine the appropriate amount of tax, interest, and penalties taxpayers must pay to resolve their cases, we think there are adjustments the Service could make in its information gathering process to make this process less onerous on taxpayers. Additionally, although taxpayers disclosing noncompliance should expect that they will be subject to a rigorous verification process, we think that all the Service’s programs and procedures should be administered fairly and equitably and should not be unnecessarily punitive.

Our hope is that the Service will take these Comments into consideration in the continued administration of SDOP and SFOP and in crafting any new OVDP that will be effective after the current iteration of the OVDP ends on September 28, 2018.

With the foregoing thoughts in mind, we provide the following Comments for consideration:

¹ Proposed Collection; Comment Request on Information Collection Tools Relating to the Offshore Voluntary Disclosure Program (OVDP), 83 Fed. Reg. [No.] 40, 8734 (February 28, 2018).

I. Comments Provided in Direct Response to the Notice and Request for Comment

A. Whether the Collection of Information is Necessary for the Proper Performance of the Functions of Agency

The forms created to facilitate the collection of data in connection with the SFOP and SDOP are necessary and appropriate to standardize the process and perform an initial risk assessment. However, it would be helpful for the Service to: (1) confirm that the forms are subject to the doctrine of substantial compliance; and (2) provide guidance on the relationship between the forms submitted by spouses filing returns as married filing jointly and the Relief from Joint and Several Liability provisions contained in section 6015.² In addition, Form 15023 (*Offshore Compliance Status Response*), which solicits compliance information from taxpayers who were either rejected or withdrew from the OVDI, has caused substantial confusion with respect to the three compliance options. Additional guidance regarding the look-back period for the second and third options would be very helpful, particularly in cases where a taxpayer has been fully compliant in recent years.

B. Comments on the Agency's Estimate of the Burden of the Collection of Information

We believe the Service's estimate of 8 hours to complete the forms associated with the Streamlined procedures, including Form 14653 (*Certification by U.S. Person Residing Outside of the United States for Streamlined Foreign Offshore Procedures*) or Form 14654 (*Certification by U.S. Person Residing in the United States for Streamlined Domestic Offshore Procedures*), substantially understates the time that taxpayers spend gathering and processing information. Participating taxpayers are required to prepare and file three years of amended income tax returns and six years of Financial Crimes Enforcement Network ("FinCEN") Forms 114 (*Reports of Foreign Bank and Financial Accounts*) ("FBARs"). We are mindful that the burden estimates for the collection of information often do not reflect the actual burden imposed, but make the above observation to respond to the specific request for comment in the Notice and Request. In addition, considerable time is generally needed to gather the information to prepare a complete explanation for the taxpayer's prior non-compliance, particularly because the definition of "willfulness" with respect to failure to file FBARs remains unclear.

²References to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "Code"), unless otherwise indicated.

C. *Ways to Enhance the Quality, Utility, and Clarity of Information to be Collected*

Form 14452 (*Foreign Account or Asset Statement*) could be eliminated or modified to either be more useful to the Service or to prevent duplicative requests for the same data, and, thus, be less burdensome on taxpayers.

II. **Additional Comments Provided with Respect to the OVDP**

A. *Whether a New OVDP Should be Announced and if so, on What Terms*

The various iterations of the OVDP were very successful, bringing nearly 60,000 taxpayers into compliance and generating more than \$11.1 billion in taxes, interest and penalties. The programs also provided the taxpayers and their representatives with a level of certainty and transparency and established guidelines for IRS internal processing of the submissions. Finally, under the terms of the programs, taxpayers came to the Service with full disclosure, supporting documents, and, when possible, full payment of the amounts due, thereby saving the Service from expending limited resources initiating audits and enforcement action. For all these reasons and based on the uncertainty that prevailed between the end of the 2009 OVDP and the start of the 2011 Offshore Voluntary Disclosure Initiative (“2011 OVDI”), the Service should announce a new offshore voluntary disclosure program to take effect after September 28, 2018, the scheduled conclusion of the 2014 OVDP, and should take steps to expedite the pre-clearance process, which has become unduly delayed.

B. *Guidance on Treatment of Undisclosed Cryptocurrencies*

Taxpayers lack guidance on the proper tax treatment of cryptocurrency transactions held in exchanges or wallets formed outside of the United States. We recommend that the Service issue guidance addressing whether an FBAR or Form 8938 (*Statement of Specified Foreign Financial Assets*) needs to be filed for such transactions and if so, how the information should be reported. We further recommend that the Service announce an 18-month period in which taxpayers who bought, sold, sent, or received cryptocurrency, including cryptocurrency obtained through Coinbase, Inc. or any other domestic or foreign exchange, may file qualified amended returns pursuant to Treasury Regulation section 1.6664-2(c).

C. *50% OVDP Super Penalty*

In light of the guidance issued in 2015 that set the maximum civil willful FBAR penalty at 50% of the high value of a taxpayer’s undisclosed foreign accounts,³ we recommend that the Service: eliminate or substantially reduce the increased penalty imposed on taxpayers with accounts associated with

³ IRS Interim Guidance for FBAR Penalties, SBSE-04-0515-0025, dated May 13, 2015.

a blacklisted foreign financial institution or facilitator; limit any increased penalty to those specific accounts associated with the identified institutions or facilitators; and establish a *de minimis* exception to any increased penalty with respect to taxpayers with less than \$25,000 in these accounts.

D. *Breadth of the OVDP Penalty Base*

To incentivize taxpayers to participate in any future voluntary disclosure program, the miscellaneous penalty should be limited to foreign assets that are reportable on the FBAR or Form 8938. Alternatively, we suggest that the Service adopt a *de minimis* income exception with respect to non-reportable assets so that such assets with minimal income tax noncompliance are not included in the penalty base.

E. *Eliminating the Use of Substantive Information Required on Pre-Clearance Requests*

The 2014 OVDP pre-clearance procedures require that pre-clearance requests disclose the names of the banks and entities associated with the taxpayers' offshore noncompliance. This information may incriminate a taxpayer before the Service confirms that the taxpayer is eligible to participate in the voluntary disclosure program. As a result, taxpayers are reluctant to come forward. We recommend that the Service issue clear guidance stating that information provided for purposes of a pre-clearance request will not be treated as an admission by the taxpayer in the event of a criminal referral.

F. *Request for a Settlement Program to Accelerate the Efficient Conclusion of Ongoing Audits*

Offshore compliance examinations require the Service to dedicate significant time and resources to reach resolution of taxpayer cases. Such cases move from exam, to the IRS Office of Appeals, and ultimately to litigation, using up the Service's limited resources at every step. We recommend that the Service institute a settlement program to resolve offshore compliance audits in a simplified manner.

G. *Collection Alternatives for Taxpayers Unable to Fully Pay OVDP Liability*

Taxpayers participating in the OVDP face uncertainty if they are unable to pay the tax, interest and penalties due. We recommend that the Service establish clear guidance that taxpayers participating in an offshore voluntary disclosure program may pursue available collection alternatives.

H. *Clarification as to When an OVDP Disclosure is Deemed Timely*

The current lack of clarity as to the timeliness of a voluntary disclosure discourages some taxpayers from coming forward. We recommend that eligibility be measured as of the date a taxpayer submits a pre-clearance application.

I. *Request for Additional Safeguards for the OVDP Removal Process*

Some revenue agents have inappropriately used removal or the threat of removal against taxpayers participating in the OVDP when taxpayers are unable to obtain foreign account records or wish to pursue a good faith challenge to a position taken by the Service. We recommend that clear guidance be issued protecting taxpayers from unwarranted removal in such cases.

III. **Additional Comments Provided with Respect to Streamlined Procedures**

A. *Guidance for U.S. Citizens, including Accidental Americans, Without Social Security Numbers*

The Streamlined procedures require U.S. citizens, U.S. residents, and certain other individuals to have a valid Social Security Number (“SSN”). The SSN application process can be onerous and protracted, and while waiting for an SSN, taxpayers risk a triggering event that could make them ineligible for any voluntary disclosure. We recommend that the Service accept Streamlined submissions from taxpayers who have applied for an SSN and are waiting for the application to be processed and approved. These taxpayers can provide an alternative identification number (*e.g.*, foreign passport number or foreign tax ID number) and the Service could assign a temporary control number that will be replaced with the taxpayer’s SSN when issued. We also recommend the Service seek [“seeks” in original comment] ways to work with the Social Security Administration to expedite the processing of requests for SSNs.

B. *Equity of Including Tax Compliant Assets in the Penalty Base*

The SDOP requires taxpayers to pay a penalty equal to five percent of the highest aggregate end of year balance/value of the taxpayer’s foreign financial assets that should have been, but were not, reported on the taxpayer’s FBARs and Forms 8938 during the covered period, regardless of whether the asset is tax compliant. In other words, even if a foreign financial asset generated no income, or income with respect to the asset was fully reported, the asset will be included in the SDOP penalty base if the asset was not reported on the FBAR or Form 8938. Under the OVDP, if there is no unreported income, the asset is not included in the offshore penalty base, even if that asset was not reported on the FBAR or Form 8938. The SDOP should not result in a penalty base that exceeds the OVDP penalty base. We recommend that the Service expand SDOP Frequently Asked Questions (“FAQ”) 1 to provide that assets that did not generate reportable income, or for which gross income was accurately reported, are excluded from the five percent penalty base.

C. *Expanding the Streamlined Procedures to Non-willful Domestic Non-filers*

The SDOP categorically excludes without exception any taxpayer who did not file a required original return (*i.e.*, non-filers), resulting in the exclusion from the program of all domestic non-willful non-filers. This runs afoul of

the intent of the SDOP because it penalizes non-willful taxpayers, including Accidental Americans who do not meet the SFOP residency requirement, students and children who may not be aware of their U.S. filing obligations, and other taxpayers whose facts and circumstances clearly dictate a Streamlined resolution. We recommend that the Streamlined procedures be expanded to include all residents and nonresidents whose failure to report foreign financial assets did not result from willful conduct, regardless of whether original U.S. tax returns were filed. If the Service does not want to expand SDOP to include those individuals who have not filed an original return that should have included other U.S. source income, it could limit any revision to those original returns that are filed to report foreign income and assets.

D. *Allowing Submission of Treaty Tie-breaker Returns*

Under the SFOP, eligible taxpayers do not include those individuals who are U.S. residents but file their returns on Form 1040NR under tie-breaker treaty provisions. These individuals are not taxed on their offshore income, are among the least likely to have been willful in their noncompliance and are among the most deserving of the full or partial penalty relief afforded under the Streamlined procedures. We recommend that the Service modify the Streamlined procedures to allow tie-breaker individuals filing Form 1040NR to participate.

IV. Other

A. *Delinquent International Information Return Submission Procedures (“DSP”)*

The DSP is available to taxpayers who do not need to use the OVDP or Streamlined procedures to file delinquent or amended tax returns to report and pay additional tax, but who have not filed one or more international information returns, such as Form 5471 (*Information Return of U.S. Persons With Respect To Certain Foreign Corporations*) or Form 5472 (*Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*), have reasonable cause for not filing the information returns, are not under civil examination or criminal investigation, and have not already been contacted by the Service about the delinquent information returns. Under DSP, taxpayers file delinquent international forms, such as Forms 5471 or 5472, with an *amended* income tax return, such as a Form 1120X or 1065X. DSP does not apply to taxpayers who have not filed the original income tax returns, and the Service is automatically assessing penalties under sections 6038 and 6038A on late-filed Forms 1120 and 1065 that include Forms 5471 or 5472 regardless of whether the taxpayer’s income tax return reflects any tax due. We recommend that the Service eliminate the process of automatically assessing penalties for delinquent international forms attached to late-filed original income tax returns with no tax due when the evidence establishes benign, non-volitional, and innocent errors. We also recommend that the Service consider expanding the

First Time Abate procedures for administrative penalty waivers to include late-filed international forms, including, but not limited to, Forms 5471 and 5472, and issue clear guidance that taxpayers who have unreported income or unpaid tax are not precluded from using the DSP.

B. *Inbound Voluntary Disclosure*

Failure of a foreign taxpayer to file a required U.S. income tax return by a specified deadline can result in the loss of otherwise permissible deductions and penalties, often grossly disproportionate to the amount of tax owed. Many foreign taxpayers want to come into compliance but opt not to do so because of the substantial financial costs imposed, despite facts and circumstances that support inadvertence or mistake. We recommend either an expansion of the Streamlined procedures, or a new voluntary disclosure program, to allow foreign taxpayers to submit delinquent federal income tax returns, along with all applicable information returns, for a specified period in exchange for a waiver of the deduction disallowance rule and any penalties for failure to file, failure to pay, and failure to file information returns, such as Forms 5471 and 5472. For foreign taxpayers whose returns for the Streamlined submission period reflect no tax due, we recommend zero penalties, and for those taxpayers with tax due, a miscellaneous penalty equal to a specified percentage of that liability. We also recommend foregoing any requirement that the foreign taxpayer certify non-willful conduct.

Introduction

The Service has long had a practice, under which taxpayers who come forward with a complete, accurate, and timely voluntary disclosure can avoid a referral for criminal investigation and prosecution for violations of the internal revenue laws. Taxpayers who make a voluntary disclosure are required to pay tax, penalties and statutory interest for the years at issue. The nature and amounts of any penalties assessed depend on the facts and circumstances of each case.

Unlike most industrialized countries, the United States taxes its citizens and residents on their worldwide income, though it typically provides credits or deductions with respect to taxes paid in other jurisdictions. To implement this worldwide taxation system, there are a series of statutory rules that require U.S. taxpayers to disclose foreign business and financial information on their tax returns, as well as a requirement to report information about foreign bank accounts to FinCEN. Failure to satisfy these reporting requirements can result in substantial penalties; for example, the penalty for willfully failing to file a FBAR is the greater of \$100,000 or 50% of the balance in the account. Even if the failure to report a foreign financial account was negligent rather than willful, the penalty is \$10,000. Taxpayers who willfully evade their tax and reporting obligations face potential criminal prosecution.

In January 2003, the Service announced the Offshore Voluntary Compliance Initiative (“2003 OVCI”), which was designed to allow taxpayers

to voluntarily amend their tax returns to include offshore income in return for a waiver of certain civil penalties and an assurance of no criminal prosecution. To participate, a taxpayer was required to:

1. Send a written request to the Service with specific information *before* the Service initiated a civil or criminal investigation or notified the taxpayer that it intended to commence an examination or investigation or otherwise obtained information about the taxpayer from third parties directly related to the taxpayer's underlying specific tax liability;
2. Confirm that the taxpayer had not (i) promoted, solicited, or otherwise facilitated tax avoidance arrangements; (ii) derived income from illegal sources, such as income from drug trafficking; or (iii) facilitated illegal activities not related to taxes; and
3. Provide accurate, amended, or delinquent information returns and complete FBARs for the relevant years.

In March 2009, the Service announced the Offshore Voluntary Disclosure Program ("2009 OVDP") for taxpayers who failed to report foreign accounts and other income-generating foreign assets. The 2009 OVDP was available until October 2009 and required taxpayers to file amended income tax returns and FBARs for the preceding six years (2003-2008). The 2009 OVDP differed from the long-standing voluntary disclosure practice in that taxpayers could pay a miscellaneous civil tax penalty equal to 20% of the value of their income-generating foreign assets in lieu of a host of other international penalties which, in combination, could easily exceed the value of the taxpayer's foreign assets. In addition, under the 2009 OVDP, taxpayers were required to pay all tax, accuracy related and any applicable delinquency penalties, and interest at the time the returns were filed, and pay the miscellaneous penalty with the execution of a closing agreement.

After the 2009 OVDP ended, taxpayers and their representatives were left without any guidance from the Service regarding the disclosure of (and penalty exposure arising from) unreported offshore accounts. After more than a year, in February 2011, the Service announced the Offshore Voluntary Disclosure Initiative ("2011 OVDI"). Like the 2009 OVDP, the 2011 OVDI was also only available to taxpayers who elected to participate during a limited time frame, until September 2011, but expanded the compliance period to 8 years of amended tax returns and FBARs and increased the miscellaneous penalty to 25%.

The 2011 OVDI introduced a special election for foreign mutual funds and similar investments subject to the Passive Foreign Investment Company ("PFIC") rules of sections 1291-1298. This election reduced both the PFIC tax rate and the associated interest component under a special alternative mark-to-market ("MTM") methodology, which substantially reduced the administrative and financial burden on taxpayers. Notwithstanding this

option, determining whether an investment is a PFIC and whether to make the MTM election remains an extremely expensive and time-consuming task.

After the close of the 2011 OVDI, the Service waited less than four months before announcing an open-ended Offshore Voluntary Disclosure Program in January 2012 (“2012 OVDP”). The most notable difference between the 2011 OVDI and the 2012 OVDP was an increased miscellaneous penalty to 27.5%. The 2012 year also saw the establishment of limited Streamlined procedures through which non-willful foreign taxpayers who met relatively strict eligibility requirements could come into compliance by filing three years of tax returns and six years of FBARs and paying tax and interest.

In June 2014, the Service modified the 2012 OVDP program, requiring full payment of all amounts due when the returns were filed, and expanded the Streamlined procedures by including non-willful taxpayers residing in the United States and removing the other eligibility restrictions. Taxpayers taking advantage of the Streamlined procedures are required to certify under penalties of perjury that the failure to report their foreign income and submit all required information returns, including FBARs, was due to non-willful conduct. According to guidance from the Service, non-willful conduct is “conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.”⁴

The SFOP allows taxpayers living outside the United States to file three years of delinquent or amended tax returns, pay the tax liabilities and interest on those three years, and file six years of FBARs. To participate in the SFOP, a taxpayer must certify that during at least one of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed, the taxpayer did not have a U.S. abode and was physically outside the United States for at least 330 calendar days. Eligible taxpayers who satisfy the SFOP requirements will not be subject to any penalties (including failure-to-file and failure-to-pay penalties, accuracy-related penalties, information return penalties, and FBAR penalties).

In contrast, taxpayers who fail the non-residency requirement can use the SDOP if:

1. They previously filed a U.S. tax return (if required) for each of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed;
2. They failed to report gross income from a foreign financial asset and pay tax as required and may have failed to file an FBAR and/or one or more international information returns with respect to the foreign financial asset; and

⁴ See *U.S. Taxpayers Residing in the United States: Eligibility for the Streamlined Domestic Offshore Procedures*, IRS, last accessed Apr. 23, 2018, <https://www.irs.gov/individuals/International-taxpayers/U-S-Taxpayers-Residing-in-the-United-States> [“a” absent from quote in original comment].

3. Such failures resulted from non-willful conduct.

To participate in the SDOP, taxpayers must file three years of amended returns (along with all required information returns), pay the tax liabilities and interest on those amended returns, and file six years of FBARs. Unlike the SFOP, eligible taxpayers who satisfy the SDOP requirements will be subject to a five percent miscellaneous offshore penalty charge.

On March 13, 2018, the Service announced that it will end the 2014 OVDP on September 28, 2018,⁵ leaving open the possibility of a future voluntary disclosure program.⁶ The SFOP and SDOP are not scheduled to end at this time.

Comments

I. Comments Provided in Direct Response to Notice and Request for Comment

A. *Whether the Collection of Information is Necessary for the Proper Performance of the Functions of the Agency*

In August 2014, the Service released Form 14653.⁷ In January 2015, a parallel Form 14654 applicable to persons participating in the SDOP was released. The 2015 Notice and Request for Comments⁸ requested input on the extent to which the collection of information through Forms 14653 and 14654 is necessary for the proper performance of the functions of the Service. In response, the ABA Tax Section submitted detailed comments (the “2015 ABA Comments”).⁹

As noted in the 2015 ABA Comments, Forms 14653 and 14654 are appropriate to facilitate and standardize processing of Streamlined submissions by the Service. These forms assist taxpayers in making, and the Service in processing, Streamlined submissions by ensuring the use of standard jurat language and by reminding taxpayers of the eligibility requirements for the Streamlined procedures. As outlined in the 2015 ABA Comments, we recommend that:

⁵ IR-News Rel. 2018-52, 19 Stand. Fed. Tax Rep. (CCH) ¶ 46,250.

⁶ See *Closing the 2014 Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, IRS, last accessed Apr. 23, 2018, <https://www.irs.gov/individuals/international-taxpayers/closing-the-2014-offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers>.

⁷ IRS Form 14653 (*Certification by U.S. Person Residing Outside of the United States for Streamlined Foreign Offshore Procedures*) replaced Form 14438 (*Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer Taxpayers*) to reflect an expansion of the Streamlined Procedures to allow for participation by taxpayers who needed to file amended U.S. income tax returns.

⁸ Proposed Collection; Comment Request on Information Collection Tools Relating to the Offshore Voluntary Disclosure Program (OVDP), 80 Fed. Reg. 47,998 (Aug. 10, 2015).

⁹ <https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/101415comments.authcheckdam.pdf>.

1. Forms 14653 and 14654 should be subject to the doctrine of substantial compliance, which will discourage revenue agents from focusing on procedural foot faults and encourage more taxpayers to make Streamlined submissions, thereby reducing the burden of compliance on taxpayers and the Service; and
2. The Service should provide guidance on the relationship between Forms 14653 and 14654 submitted by spouses filing returns as married filing jointly and the Relief from Joint and Several Liability provisions contained in section 6015. For example, signing and submitting a Form 14653 or 14654 should not preclude a spouse from later seeking relief from liability reflected on a jointly filed tax return.

On January 31, 2017, the Service announced a Campaign to address the OVDP applicants who applied for pre-clearance but were either denied access or withdrew from the OVDP of their own accord.¹⁰ In connection with this Campaign, the Service sends these taxpayers a Form 15023 (*Offshore Compliance Status Response*) seeking information and offering three methods of compliance. Form 15023 is accompanied by IRS Letter 5935 explaining the three options, which include: (1) if eligible, filing returns pursuant to the Streamlined procedures; (2) filing all required tax returns and related filings with an optional reasonable cause statement; or (3) if the taxpayer has come into compliance, providing a statement explaining the relevant facts and circumstances, including the complete history of any previously unreported income and actions undertaken.

Form 15023 and Letter 5935 are causing some confusion. For example, options two and three do not provide a limited look-back period for filing tax returns and FBARs. Taxpayers are left to wonder whether they must go back beyond the three-year period required under Streamlined procedures or the eight-year period under the 2014 OVDP, and when the look-back period, once established, begins. For example, a taxpayer applies for and is rejected from the OVDP in July 2011. The taxpayer begins filing accurate returns and FBARs for calendar year 2011 and has remained in full compliance since that time. In May 2018, the taxpayer receives Form 15023. It is unclear whether the taxpayer qualifies under option 3 as “fully compliant with *all* U.S. reporting requirements” based on the seven years of accurate filing, or whether option 2 should be used to file amended tax returns and FBARs for 2003 through 2010. We recommend that the Service accept the seven years of accurate filing in this example as “fully compliant,” with the understanding that if the Service is concerned about the returns, or believed that the facts warranted penalties, it can initiate an audit. Guidance in this area will be very helpful.

¹⁰ See *Large Business and International Launches Compliance Campaigns*, IRS, last accessed Apr. 23, 2018, <https://www.irs.gov/businesses/large-business-and-international-launches-compliance-campaigns>.

B. Comments on the Accuracy of the Agency's Estimate of the Burden of the Collection of Information

The Service estimates that a taxpayer will spend eight hours preparing either Form 14653 or Form 14654. We recognize that the burden estimates set out in IRS forms often do not reflect the actual effort required, something that is understood by many practitioners, but make the following observations to respond to the specific request for comments on this burden estimate. This estimate does not realistically account for the substantial time required to gather information regarding the taxpayer's compliance history, knowledge and understanding of tax and reporting obligations, and discussions with third parties such as the taxpayer's accountants, financial advisors, and others within and outside the United States, much less the time required to prepare the detailed explanations regarding non-compliance. The estimate also fails to properly consider the time that may be needed to calculate the exact number of days spent in the United States and other jurisdictions over a 3-year period.

C. Ways to Enhance the Quality, Utility, and Clarity of the Information to be Collected

The 2015 ABA Comments identified several issues relating to the collection of information within the OVDP, including repeated requests for the same information across multiple forms. Duplicative requests lead to confusion, inadvertent inconsistencies, and wasted time and resources. For example, Form 14452 requires information which is duplicative of that provided on other OVDP submissions. The following illustrates this point:

1. Information requested by boxes 1-3 (Name of Foreign Financial Institution; Country where Institution is located; and Contact person at this Institution) and 9-12 (Name under which the account was held; If held by an entity, type of entity; Date account was opened; and Date account was closed) of Form 14452 is provided on Form 14454.
2. Information requested by boxes 4-7 (Is the offshore account a bank account holding cash, money market, or CD; Is the offshore account a custodial account holding securities; Is the offshore account another type of account or asset; and If so, what type of account or asset) of Form 14452 is ordinarily included in the bank statements required by FAQ 25.
3. Information requested by box 8 (Source of funds within the account) of Form 14452 is provided on Form 14457.

4. Information requested by box 13 (Does the account include Passive Foreign Investment Company (PFIC) or mutual funds) of Form 14452 is provided as a statement required by FAQ 25.¹¹
5. Information requested by box 14 (Description and location of the asset) is provided on Form 14453 as part of the Penalty Computation Worksheet.
6. Information requested by boxes 15a-16b (Purchase price; Date acquired; Sales price (if sold); and Date of disposition) of Form 14452 is provided on the amended U.S. tax returns.
7. Information requested by box 17 (FMV at 12/31/2010 if asset is still owned) causes confusion as taxpayers do not understand the legal significance of the question.

Moreover, Form 14452 has no independent utility, and does not clarify any other information. It should be withdrawn[.]

II. Additional Comments Provided with Respect to the OVDP

A. *Whether a New OVDP Should be Announced and if so, on What Terms*

Since March 2009, various iterations of the offshore voluntary disclosure programs have elicited over 56,000 submissions, with more than \$11.1 billion in taxes, interest, and penalties collected.¹² The Service recently stated that the end of the 2014 OVDP “reflects advances in third-party reporting” and “increased awareness” of taxpayers’ reporting obligations. The Service noted that only 600 disclosures were received in 2017, down from a high of 18,000 disclosures in 2011.

Since the commencement of the 2014 OVDP, the United States has been receiving information regarding U.S. persons’ foreign accounts through an ever-expanding list of sources, including, but not limited to, foreign financial institutions, treaty partners, whistleblowers, and cooperators. With the increased likelihood that the Service will receive information regarding undisclosed foreign assets, taxpayers who are not eligible for the Streamlined procedures will be seeking an avenue to come into compliance. A new OVDP will bring those taxpayers to the Service and reduce demand on limited resources that would be required to initiate offshore audits of these taxpayers and pursue enforcement action.

The announcement of a new program will also provide structure to Service personnel and certainty to taxpayers. We learned following the 2009 OVDP and 2011 OVDI that without an established disclosure program, many taxpayers facing substantial international penalties will elect to remain out of

¹¹ See FAQ 25 (2)(l)[“(12)” in original comment], *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014* (“2014 OVDP FAQs”).

¹² IR-News Rel. 2018-52, 19 Stand. Fed. Tax Rep. (CCH) ¶ 46,250.

compliance, simply comply going forward, or file accurate returns for prior periods without initiating contact with the Service, otherwise known as a quiet disclosure. Under any of these scenarios, the Service will receive less tax, penalties and interest, will be forced to expend its limited resources if it wishes to hold the taxpayers at issue accountable, and if and when the taxpayers are identified for audit, will lose the nationwide consistency that comes with an established program.

If the Service's assumption regarding the decrease in the number of future disclosures is correct, then the Service can establish a centralized examination unit staffed with Service personnel experienced in the programs and international issues. These agents could address all disclosures under a new OVDP, as well as any offshore audits arising from FATCA disclosures and other third-party information. Moreover, the potential cost of identifying, auditing, proposing assessments, responding to administrative appeals, and litigating related issues (e.g., liability for a willful FBAR penalty) for 600 taxpayers certainly would far exceed the actual cost of maintaining the 2014 OVDP during the 2017 year for the 600 taxpayers who entered the OVDP in that year.

A new OVDP should be modeled on the prior and current OVDPs. The Service could increase the miscellaneous penalty, but we recommend that the increased penalty be limited to no more than 30% and that it apply only to assets that should have been reported on an FBAR or Form 8938, so that the new miscellaneous penalty remains lower than potential penalties that would be imposed following an audit under current guidance and mitigation provisions.¹³ Under a new OVDP, the predictability of the resolution in combination with the reduction in penalty exposure would continue to incentivize taxpayers to voluntarily disclose rather than risk the uncertainty of noncompliance.

In addition, a new OVDP could offer a last chance opportunity to non-compliant taxpayers identified through FATCA disclosures by sending those taxpayers a letter inviting them to either explain their lack of reporting (a "Nudge Letter")¹⁴ or enter the new OVDP, but pay a slightly higher mis-

¹³ See I.R.M. 4.26.16.6 (11-06-2015), incorporating penalty mitigation under the IRS Interim Guidance for FBAR Penalties, SBSE-04-0515-0025, dated May 13, 2015.

¹⁴ Using a Nudge Letter would be consistent with prior iterations of the OVDP and recent IRS announcements. Between 2003 and 2009, the IRS sent letters to taxpayers holding offshore payment cards in its Last Chance Compliance Initiative. By sending the letters, the IRS reduced enforcement costs, especially where audits may not have been worthwhile. See *An Analysis of Tax Settlement Programs as Amnesties—Why IRS's Offshore Voluntary Disclosure Settlement Programs Posed Risks to Voluntary Compliance (Part 2 of 3)*, NAT'L TAXPAYER ADVOCATE: (NTA) BLOG (Mar. 21, 2018), <https://taxpayeradvocate.irs.gov/news/nta-blog-an-analysis-of-tax-settlement-programs-as-amnesties-why-irs-s-offshore-voluntary-disclosure-settlement-programs-posed-risks-to-voluntary-compliance-part-2-of-3>. Similarly, an IRS official recently indicated that the Service might send letters to taxpayers identified in connection with the Swiss Bank programs. Alison Bennett, *IRS Letters Will 'Nudge' U.S. Clients for Swiss Bank Data*, DAILY TAX REP. (BNA), Dec. 1, 2017, at G-1.

cellaneous penalty of 32.5% in recognition of the fact that the taxpayers came in only after receiving contact from the Service. Again, this approach is in the best interest of the Service in that it can apply its resources pursuing those taxpayers who are truly intent on evading their U.S. tax and reporting obligations.

We also recommend that the Service reduce the OVDP look-back period to 6 years, which tracks the civil statute of limitations on the assessment of FBAR penalties and reduces the burden on the taxpayers and the Service in locating, translating, and reviewing documents, particularly in those cases where a taxpayer is required to calculate PFIC tax.

Finally, we recommend that the Service expedite the pre-clearance process. Taxpayers and practitioners are submitting pre-clearance requests and waiting months before receiving any response. In some cases, the pre-clearance request was overlooked by the Service, and the practitioner or taxpayer was asked to resubmit. In other cases, no explanation is given. The delays in the Service's approval or rejection of pre-clearance requests are causing significant concern among taxpayers seeking to come into compliance. We recommend that the Service establish a time frame within which it expects to respond to a pre-clearance request, and a procedure by which taxpayers and practitioners can follow up on requests pending beyond that time frame.

B. Guidance on Treatment of Undisclosed Cryptocurrencies

Cryptocurrencies have gained significant attention since the 2009 introduction of Bitcoin, the first decentralized cryptocurrency. Dozens of others have followed.¹⁵ The Service takes the position that virtual currencies are property, rather than currencies, and any transactions in virtual currencies are taxable just like any other transactions in property.¹⁶

Individuals or entities who acquire bitcoin¹⁷ generally hold it in a “wallet,” which is a program or online service that stores a public key and/or a private key that allows the owner to access, use or transfer the bitcoin. The wallet may

¹⁵ The terms “cryptocurrency,” “virtual currency,” and “digital currency” are sometimes, incorrectly, used interchangeably. “Digital currency” is the broadest term, which means an Internet-based medium of exchange with characteristics similar to physical currencies. “Virtual currency” is a subset of digital currency, which is defined by the Service in Notice 2014-21 as “a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value.” Notice 2014-21, 2014-16 I.R.B. 938. The European Banking Authority defines virtual currency as “a digital representation of value that is neither issued by a central bank or a public authority, nor necessarily attached to a FC [“fiat currency” in original comment], but is accepted by natural or legal persons as a means of payment and can be transferred, stored or traded electronically.” Eur. Banking Auth. Opinion on ‘virtual currencies’ (July 4, 2014), at 5. The term “cryptocurrency” is a subset of virtual currency in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds.

¹⁶ Notice 2014-21, 2014-16 I.R.B. 938.

¹⁷ “Bitcoin” with an uppercase B refers to the protocol or software, whereas “bitcoin” with a lowercase “b” refers to the unit of currency.

be a type of hardware (e.g., a device similar to a USB drive), a type of software, or even paper (with the public and private keys printed in QR form). The wallet may be held directly by the owner or through a third-party exchange or wallet service provider (custodial or noncustodial).¹⁸ Bitcoin may be purchased through an exchange or from a local seller or ATM.

Concurrent with the evolution of the cryptocurrencies, the Department of Treasury (“Treasury”) and the Service have focused on taxpayers who have unreported foreign financial assets and accounts. Most recently, the Service issued News Release IR 2018-71, reminding taxpayers that virtual currency transactions “are taxable by law just like transactions in any other property.”¹⁹ Cryptocurrency-related tax liabilities are estimated to be \$25 billion as a result of \$92 billion of taxable gains for U.S. cryptocurrency investors during 2017 alone.²⁰

The following comments make suggestions regarding the treatment of cryptocurrency within the context of the OVDP and the Streamlined procedures.

1. *Guidance on Taxation of, and Reporting Standards for, Virtual Currency*

The taxation of, and reporting standards for, virtual currency have become hot topics, especially due to the skyrocketing increases in value of some cryptocurrencies that occurred in 2017. However, it is also an area that has, to date, received little attention in the form of guidance from the Treasury and the Service. In 2014, Treasury and the Service issued Notice 2014-21, which indicated that virtual currency will be treated as property, not currency, for tax purposes.²¹ The Notice addressed some basic reporting issues, such as the requirement to report compensation paid in virtual currency on Form W-2 (*Wage and Tax Statement*) or Form 1099-MISC (*Miscellaneous Income*), and the requirement of third-party settlement organizations to file Forms 1099-K (*Payment Card and Third Party Network Transactions*) for payments in virtual currency. However, the Notice did not include any guidance on the filing of FBARs or Forms 8938. Thus, taxpayers with assets in domestic and foreign cryptocurrency exchanges and wallets are struggling to determine what rules apply to them, and whether and how to report assets.

Meanwhile, the Service and the Tax Division of the Department of Justice (“DOJ”) moved in the direction of enforcement. On November 17, 2016, on behalf of the Service, the DOJ requested permission from the U.S. District Court for the Northern District of California to serve on Coinbase, Inc.

¹⁸ A custodial wallet is a wallet where the private key for controlling the cryptocurrency is held by a third-party company. A noncustodial wallet is one where the service provider does not hold the private key but provides a software front-end to allow the owner to more easily interact with the blockchain.

¹⁹ IR-News Rel. 2018-71 (Mar. 23, 2018).

²⁰ Matthew De Silva, *US Cryptocurrency Tax Liabilities Estimated At \$25 Billion After 2017 Mania*, ETHNews, (Apr. 6, 2018, 5:08 PM), <https://www.ethnews.com/us-cryptocurrency-tax-liabilities-estimated-at-25-billion-after-2017-mania>.

²¹ Notice 2014-21, 2014-16 I.R.B. 938.

(“Coinbase”) a John Doe summons (“Coinbase Summons”).²² Coinbase is an exchange dealing in cryptocurrency that operates a bitcoin wallet and exchange business headquartered in San Francisco.²³ During 2013 through 2015, Coinbase maintained over 4.9 million wallets in 190 countries with 3.2 million customers served and \$2.5 billion exchanged.²⁴

The Coinbase Summons initially sought “information regarding United States persons who, at any time during the period January 1, 2013 through December 31, 2015, conducted transactions in a convertible virtual currency as defined in Notice 2014-21.”²⁵ That request was later narrowed to Coinbase users who “bought, sold, sent or received at least \$20,000” worth of cryptocurrency in a year.²⁶ The court authorized the issuance of the Coinbase Summons,²⁷ and Coinbase refused to comply. On November 28, 2017, the Court granted DOJ’s petition to enforce,²⁸ and on February 23, 2018, Coinbase informed approximately 13,000 customers that their information was being provided to the Service in compliance with the summons.²⁹ The notice Coinbase issued to affected customers stated that Coinbase expected to provide the information within 21 days of the notice.³⁰ The *Coinbase* decision raised additional awareness and concern among holders of cryptocurrency, prompting many to contact tax professionals with questions regarding reporting and tax treatment.

2. *Guidance on Undisclosed Cryptocurrency for Offshore Programs*

To assist taxpayers with the voluntary reporting of offshore virtual currencies held in foreign cryptocurrency exchanges and wallets (*e.g.*, Bitcoin, Ether, Ripple, etc.), we recommend that the Service provide clarification as to whether the reporting of these assets is required for purposes of the FBAR and Form 8938. This guidance should clarify the difference in reporting between cryptocurrency held in a wallet that is linked to an exchange as compared to cryptocurrency held in a wallet not linked to any exchange.

As stated above, in Notice 2014-21,³¹ the Service determined that cryptocurrencies were “property” (rather than currencies) for federal income tax purposes. However, Notice 2014-21 did not provide guidance with respect

²² United States v. Coinbase, Inc., No. 17-cv-01431, 2017 WL 3035164, at *1-2 (N.D. Cal. July 18, 2017).

²³ *Id.* at *1.

²⁴ *Id.*

²⁵ *Id.* [“from” substituted for “during the period” in original comment].

²⁶ United States v. Coinbase, Inc., No. 17-cv-01431, 2017 WL 5890052, at *4 (N.D. Cal. Nov. 28, 2017).

²⁷ *Id.* at *1.

²⁸ *Id.* at *8-9.

²⁹ See Nathan J. Richman, *Coinbase Notifies Customers Who Will Be Identified to the IRS*, 158 TAX NOTES (TA) 1444 (Mar. 5, 2018).

³⁰ Coinbase Support, *IRS Notification*, <https://support.coinbase.com/customer/portal/articles/2924446-irs-notification> (Feb. 23, 2018).

³¹ See *supra* note 21 [“13” in original comment].

to a taxpayer's reporting requirement(s) in the context of FBARs and Forms 8938.³²

3. *FBAR and Form 8938*

U.S. citizens, lawful permanent residents, persons with substantial presence in the United States, and U.S. entities (*i.e.*, U.S. persons) must file an FBAR³³ with FinCEN if the person has a financial interest in, or authority over, any financial account outside of the United States where the aggregate maximum value of the account(s) exceeds \$10,000 at any time during the calendar year. For purposes of FBAR reporting requirements, a reportable "financial account" includes the following:

- i. Banks accounts (*e.g.*, savings accounts), checking accounts, time deposits or any other account maintained at a financial institution;
- ii. Securities accounts such as brokerage or custodial accounts;
- iii. Commodity futures or options accounts;
- iv. Insurance policies or annuity contracts which have a cash value;
- v. Mutual funds or pooled funds; and
- vi. Some pension funds and retirements accounts (excluding those under sections 401(a), 403(a), or 403(b)).

Very generally, a "U.S. person" has a "financial interest" where: (i) the U.S. person is the beneficial owner of the account or has legal title to the account; or (ii) the holder of the account is a person acting as an agent, nominee, attorney, or otherwise a person acting on behalf of the U.S. person with respect to the account.

It is unclear whether a taxpayer holding cryptocurrencies on a foreign cryptocurrency exchange (*e.g.*, Xapo.com or Binance.com) or in a wallet maintained by a foreign wallet service provider (*e.g.*, Blockchain.com) is required to report the account(s) on an FBAR as it is unclear whether cryptocurrencies may qualify as a reportable account for FBAR purposes. There is tension between the Service's classification of cryptocurrency as "property," the Securities Exchange Commission's ("SEC") classification of cryptocurrency, in certain circumstances, as a "security," and the Commodity Futures Trading

³² See ABA Sec. of Taxation, Comment Letter on Notice 2014-21 (March 24, 2015), <https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/032415comments.authcheckdam.pdf>; AICPA Comment Letter on Notice 2014-21: Virtual Currency Guidance (June 10, 2016), <https://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Comment-Letter-on-Notice-2014-21-Virtual-Currency-6-10-16.pdf>. The Section on March 19, 2018, submitted additional comments in response to Notice 2014-21. [ABA Section of Taxation, Comment Letter on Tax Treatment of Cryptocurrency Hard Forks for Taxable Year 2017 (Mar. 19, 2018),] <https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/031918comments2.authcheckdam.pdf>.

³³ FinCEN Form 114, formerly Treasury Form TD F 90-22.1.

Commission's ("CFTC") classification of cryptocurrency as a "commodity."³⁴ This tension is perhaps most pronounced in the context of the FBAR reporting requirements, which blend concepts of tax, securities, commodities, and money and finance laws. On the one hand, if cryptocurrency is property, then it is arguably not subject to FBAR reporting requirements because it is not, under the current regulatory definitions, a "bank, securities, or other financial account."³⁵ On the other hand, if cryptocurrency is a "security," then FBAR reporting requirements may apply under the general rule: "[e]ach United States person having a financial interest in, or signature or other authority over, a bank, securities, or other financial account in a foreign country shall report such relationship to the Commissioner"³⁶ Moreover, by treating cryptocurrency as "property," the answer to whether cryptocurrency held in foreign wallets must be reported likely depends on what functions the wallet provider actually provides, which may be difficult for taxpayers to determine in many cases. Furthermore, it is unclear how these requirements may apply to taxpayers who hold cryptocurrencies directly on a distributed blockchain.

Additional guidance is needed with respect to whether, and the extent to which, the FBAR reporting requirements apply to cryptocurrency.³⁷ Assuming an FBAR may be required in particular cases, it would also be helpful if

³⁴ In July 2017, the SEC released an investigative report concluding a decentralized autonomous organization's offerings were securities and therefore subject to the federal securities laws. See SEC, Press Release: *SEC Issues Investigative Report Concluding DAO Tokens, a Digital Asset, Were Securities* (July 25, 2017), <https://www.sec.gov/news/press-release/2017-131>. Rather than bring charges against the German-based promoters, the SEC issued an advisory report discussing the circumstances in which reporting is required within the meaning of U.S. securities laws. See Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, Exchange Act Release No. 81207 (July 25, 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf>. More recently, the SEC has taken the position that tokens issued in connection with an initial coin offering are securities. See *Testimony on "Virtual Currencies": The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission: Hearing Before the Committee on Banking, Housing, and Urban Affairs*, 115th Cong. 6-8 [4-5] (2018) (testimony of Jay Clayton, Chairman, SEC). On September 17, 2015, the CFTC took the position in an administrative order that cryptocurrencies are a commodity, a position which was recently sustained by the United States District Court for the Eastern District of New York. See *Commodity Futures Trading Comm'n v. McDonnell*, No. 1:18-cv-00361 [287 F. Supp. 3d 213, 228] (E.D.N.Y. 2018) (memorandum & order).

³⁵ See generally 31 C.F.R. § 1010.350. In particular, 31 C.F.R. § 1010.350(c)(3) defines the term "other financial account" to mean: (i) an account with a person that is in the business of accepting deposits as a financial agency; (ii) an account that is an insurance or annuity policy with a cash value; (iii) an account with a person that acts as a broker or dealer for futures or options transactions in any commodity on or subject to the rules of a commodity exchange or association; or (iv) certain accounts with mutual funds or similar pooled funds.

³⁶ 31 C.F.R. § 1010.350 ["or other" absent from quote in original comment].

³⁷ This guidance is especially needed considering comments an IRS official made in June 2014 suggesting that FBARs were not then required, but potentially subject to future reporting. See Lydia Beyoud, *Bitcoin Exchange Accounts Should Be Reported on FBARs*, *Analysts Say*, DAILY TAX REP. (BNA), June 9, 2014, at G-2.

guidance addresses the differences in filing requirements for cryptocurrency held on an exchange, cryptocurrency held through a wallet service company (custodial or noncustodial), or cryptocurrency held directly through a wallet address maintained by the taxpayer. We believe that cryptocurrency that is held directly by a taxpayer or held through a noncustodial wallet should not be reportable on the FBAR as there is no “financial account” maintained by a third party as there is with other reportable accounts.

In addition to the FBAR, U.S. persons who are “specified individuals” or “specified domestic entities” must report “specified foreign financial assets” on Form 8938 with their annual income tax returns.³⁸ The financial assets that must be reported on Form 8938 are broader than what is required to be reported on an FBAR, and include among other categories, “any financial account . . . maintained by a foreign financial institution” and “any interest in a foreign entity.”³⁹

For example, a taxpayer holding cryptocurrencies on a foreign exchange or a wallet may be required to report the cryptocurrencies on Form 8938 given that the taxpayer is holding a financial account (the wallet) maintained by a foreign financial institution (the exchange). To assist taxpayers with accurate reporting of cryptocurrencies for purposes of Form 8938, it would be helpful if the Service issued a notice clarifying the reporting requirements for cryptocurrencies held “offshore” through an exchange or wallet service company (custodial or noncustodial) that is formed outside of the United States and for cryptocurrencies held directly by the taxpayer on a distributed blockchain.

4. *Framework for a Cryptocurrency Voluntary Disclosure Program*

U.S. taxpayers may disclose unreported federal income tax liabilities from cryptocurrency transactions that include a foreign asset component through either the 2014 OVDP or the Streamlined procedures. However, any penalties, much less the OVDP penalties, may be unduly harsh in the context of taxpayers who failed to properly report cryptocurrency transactions when so little guidance has been issued and so much uncertainty exists as to if and when taxpayers with cryptocurrency must file FBARs, Forms 8938, or other international forms.

We recommend that the Service offer an offshore voluntary compliance initiative focused on virtual currency (and equivalent assets) for a limited time that mirrors the penalty regime contained in Revenue Procedure 2003-11 (from which the 2003 OVCI originated).⁴⁰ This would allow taxpayers who have underreported their U.S. tax liabilities relating *solely* to cryptocurrency through financial arrangements that relate to foreign asset noncompliance, an opportunity to correct their past noncompliance with a penalty regime (and

³⁸ See I.R.C. § 6038D and Treas. Reg. §§ 1.6038D-0 through and including -8.

³⁹ See *2017 Instructions for Form 8938, Parts I and V*, <https://www.irs.gov/pub/irs-pdf/i8938.pdf>.

⁴⁰ Rev. Proc. 2003-11, 2003-1 C.B. 311.

in a manner) more appropriate to their circumstances. In exchange for filing amended or delinquent returns for a three-year period and paying all tax, delinquency penalties, and accrued interest, the Service should agree to waive all other applicable penalties.

C. *The 50% OVDP Super Penalty*

Since August 2014, a taxpayer who participates in the 2014 OVDP is subject to an enhanced miscellaneous offshore penalty equal to 50% of the high balance of all of the taxpayer's unreported assets ("50% Super Penalty") if, at the time the taxpayer's pre-clearance letter is submitted, "an event has already occurred that constitutes a public disclosure as to one of the following: (a) the foreign financial institution where the account is held, or another facilitator who assisted in establishing or maintaining the taxpayer's offshore arrangement, is or has been under investigation by the Service or DOJ in connection with accounts that are beneficially owned by a U.S. person; (b) the foreign financial institution or other facilitator is cooperating with the Service or DOJ in connection with accounts that are beneficially owned by a U.S. person; or (c) the foreign financial institution or other facilitator has been identified in a court-approved issuance of a summons seeking information about U.S. taxpayers who may hold financial accounts (a "John Doe summons") at the foreign financial institution or have accounts established or maintained by the facilitator." A foreign financial institution or facilitator is treated as "blacklisted" as of the effective date provided on the Service's website listing of Foreign Financial Institutions or Facilitators.⁴¹

Shortly after announcing the 50% Super Penalty, the Service issued interim guidance providing that, except in limited circumstances where the facts call for a different result, the willful FBAR penalty would be limited to 50% of the highest aggregate balance of all unreported offshore accounts during the years under examination.⁴² Because the miscellaneous penalty under the 2014 OVDP has a broader base than the FBAR penalty regime, there are instances where disclosure through the 2014 OVDP will result in higher penalties than a taxpayer would incur in a traditional audit.

We recommend that any new OVDP either eliminate the 50% Super Penalty or reduce the base to only those accounts at the blacklisted financial

⁴¹ *Foreign Financial Institutions or Facilitators*, IRS, last accessed Apr. 23, 2018, <https://www.irs.gov/businesses/international-businesses/foreign-financial-institutions-or-facilitators>.

⁴² IRS Interim Guidance for FBAR Penalties, SBSE-04-0515-0025 (May 13, 2015), [https://www.irs.gov/pub/foia/ig/spder/SBSE-04-0515-0025\[1\].pdf](https://www.irs.gov/pub/foia/ig/spder/SBSE-04-0515-0025[1].pdf).

institutions⁴³ or managed by the blacklisted facilitators.⁴³ We further recommend a *de minimis* exception to the 50% Super Penalty where a taxpayer's aggregate balances in accounts with blacklisted financial institutions do not exceed \$25,000 during the OVDP period.

D. *Broadness of the OVDP Penalty Base*

Under FAQ 36 of the 2014 OVDP, foreign assets such as land and artwork will be included in the miscellaneous penalty base if the asset was purchased with funds subject to U.S. taxation, which were not properly taxed, or the asset produced gross income subject to U.S. tax which was not properly taxed. The inclusion of the value of these assets in the miscellaneous penalty base often results in a 2014 OVDP penalty that far exceeds the aggregate penalties that could or would be imposed if the taxpayer were simply selected for audit.

Another significant problem with the inclusion of foreign assets is valuation. Appraisals of foreign real estate or foreign operating companies are difficult, if not impossible, to obtain and often come at a considerable cost. If the taxpayer is fortunate enough to have an independent appraisal, the revenue agent assigned to the disclosure often requires the taxpayer to obtain additional information, requiring the taxpayer to incur additional expenses and professional fees. And finally, practitioners have found that there is little or no opportunity to appeal findings by the revenue agent and his/her technical reviewer, even regarding valuation issues. Taxpayers are forced to either accept what they believe to be an erroneous valuation, or opt out and incur the time, effort, and cost of an audit, potential administrative appeal, and litigation, all after spending a year or more working toward a resolution in the OVDP.

As a result, taxpayers with income producing assets outside the United States often avoid a voluntary disclosure, preferring instead to do nothing, or come into compliance through a quiet disclosure. Under either scenario, the Service recovers far less in terms of information and tax, penalties, and interest due.

We recommend that the Service remove foreign assets that are not otherwise reportable on the FBAR or Form 8938 from the miscellaneous penalty base. In the alternative, the Service could establish a *de minimis* exception in which an offshore asset that is not subject to FBAR reporting may be

⁴³ See also *An Analysis of Tax Settlement Programs as Amnesties: A Discussion of Belated Alternatives to the Offshore Voluntary Disclosure Program and Recommendations for Further Improvements (Part 3 of 3)*, NTA BLOG (Mar. 30, 2018), <https://taxpayeradvocate.irs.gov/news/an-analysis-of-tax-settlement-programs-as-amnesties-a-discussion-of-belated-alternatives-to-the-offshore-voluntary-disclosure-program-and-recommendations-for-further-improvements-part-3-of-3> (“as new automated information exchanges and other types of third-party information reporting become available for use by the IRS, it has a rare opportunity to use settlement programs and other forms of amnesty as a lower-cost way to improve compliance norms while respecting taxpayer rights, provided it can address legitimate concerns about the misuse of confidential tax information”).

excluded from the penalty base if the unreported annual income generated by the asset does not exceed \$5,000.

E. Eliminating the Use of Substantive Information Required on Pre-Clearance Requests

Before the advent of the 2009 OVDP, there was no formal method by which taxpayers could determine eligibility for a voluntary disclosure without identifying themselves and thereby, exposing themselves to criminal investigation if their submission was not timely. To address this concern, the Service established the pre-clearance process, under which a taxpayer submitted his or her name, date of birth, social security number, and address. If the Service determined that a submission was not timely based on other information within its possession, the taxpayer would be so advised and could walk away without having made any admissions or revealing incriminating information.

In June 2014, the Service began requiring information regarding a taxpayer's unreported foreign financial accounts, foreign financial institutions, and foreign entities in the pre-clearance requests.⁴⁴ The purpose of the increased disclosure was to prevent erroneous pre-clearance approvals where an entity related to a taxpayer might be under audit or investigation. While the additional pre-clearance information has been successful in reducing the incidence of these "false" pre-clearances, the new requirement forces taxpayers to divulge potentially incriminating information prior to receiving assurances that they will be afforded the benefits of the OVDP.

To ensure that the pre-clearance process works properly without creating a disincentive to making a voluntary disclosure, we recommend that the Service issue clear guidance that any information submitted as part of a pre-clearance request may not be used as an admission by, or to develop leads against, the taxpayer.

F. Request for a Settlement Program to Accelerate the Efficient Conclusion of Ongoing Audits

Audits involving foreign financial accounts and assets can easily last a year or more. In responding to information document requests and preparing foreign tax calculations such as the PFIC tax, a taxpayer's expenses and professional fees often far exceed the tax liability. These audits also require hundreds of hours spent by revenue agents, appeals officers, and/or attorneys, obtaining and reviewing documents, seeking information from third parties, interviewing taxpayers and their accountants, and calculating income, expenses, and tax due.

To preserve and make the most efficient use of limited resources and to encourage cooperation and compliance in offshore audits, we recommend that the Service consider a settlement initiative akin to the Classification Settlement Program offered in worker classification audits. The Service can

⁴⁴ FAQ 23, 2014 OVDP FAQs.

issue a letter to taxpayers identified for offshore audits similar to the Letter 5935, in which the taxpayer can apply for the initiative at the outset of the exam. The Service can develop guidelines for participation in the initiative based on the degree of culpability, the size and value of foreign accounts and assets, and the anticipated tax liability. The settlement initiative can incorporate the terms of any existing OVDP with an enhanced miscellaneous penalty.

G. Collection Alternatives for Taxpayers Unable to Full[y] Pay the OVDP Liability

Under the terms of the 2014 OVDP, if a taxpayer is unable to make advance payment of all liabilities due, he or she must submit a collection alternative and collection information statement.⁴⁵ However, the 2014 OVDP does not adequately address the availability of collection due process (“CDP”) proceedings or collection alternatives where collectability is in doubt. In the absence of such guidance, agents have included in Form 906 (*Closing Agreement on Final Determination Covering Specific Matters*) provisions that limit a taxpayer’s ability to seek payment alternatives. For example, one closing agreement provides:

The parties recognize that the Taxpayers have not paid in full the liabilities set forth in the closing agreement, as of the date that the Taxpayers sign this agreement. The Taxpayers represent that they will pay the liabilities set forth in this Closing Agreement without unnecessary or unreasonable delay. The Taxpayers understand and agree that through this closing agreement they waive any right to contest the amount of the liabilities determined consistent with this closing agreement through a Collection Due Process hearing or otherwise. The Taxpayers waive any right to challenge the filing of any Notice of Federal Tax Lien with respect to any unpaid balance of any portion of the liabilities set forth in this closing agreement, through a Collection Due Process hearing, Collection Appeals Program hearing, or otherwise. *The parties agree that the Taxpayers may pay the unpaid balance of the liabilities set forth in this closing agreement through a lump sum payment, or through an installment agreement containing terms acceptable to the Service, or in any other manner acceptable to the Service.* (Emphasis added.)

The final clause is problematic because it does not clearly define the taxpayer’s collection alternatives and appears to leave too much to the discretion of the revenue agent assigned to the disclosure. Further, to the extent the clause can be interpreted as limiting a taxpayer’s ability to seek an Offer in Compromise, it is seemingly contrary to the Service’s policy that “[a]n offer in compromise is a legitimate alternative to declaring a case currently not collectible or to a protracted installment agreement.”⁴⁶ Indeed, the Collection function of the Service does not blindly attempt to extract the maximum amount possible in every case, but rather “to achieve collection of what is

⁴⁵ See FAQ 20, 2014 OVDP FAQs

⁴⁶ I.R.M. 1.2.14.1.17(2) (01-30-1992) (Policy Statement 5-100).

potentially collectible at the earliest possible time and at the least cost to the Government.”⁴⁷ Finally, the final clause does not adequately take into account the Service’s policy that, in general, “accounts will be reported as currently not collectible when the taxpayer has no assets or income which are, by law, subject to levy.”⁴⁸

We recommend that the Service provide clear guidance that when a taxpayer establishes an inability to pay the liabilities due under the 2014 OVDP, the taxpayer will execute a Closing Agreement that authorizes the assessment of the OVDP liabilities and clearly provides that the taxpayer has the right to pursue any available collection alternatives, including, but not limited to, an installment agreement, partial pay installment agreement, or an Offer in Compromise. The Closing Agreement should also provide that the taxpayer has the right to pursue all available CDP rights under section 6320 and 6330. Finally, if the taxpayer is unable to obtain foreign information or documents either to establish an inability to pay, or to repatriate assets to fund a collection alternative, we recommend that the Service involve its personnel experienced in asset collection outside the United States.

H. *Clarification as to When an OVDP Disclosure is Deemed Timely*

A taxpayer’s voluntary disclosure is not timely under the 2014 OVDP if the Service or DOJ already has information concerning the taxpayer’s non-compliance. Specifically, if a taxpayer is already under audit, even if the audit does not involve offshore assets, the taxpayer’s submission will not be timely. However, under FAQ 21, taxpayers can still qualify for the OVDP even if a John Doe summons or treaty request has been issued that identifies them in a class or group. In fact, the Service encourages such taxpayers to take immediate action to enter the OVDP before the Service or DOJ obtains information responsive to a John Doe summons or treaty request. However, notably missing from FAQ 21 is clear guidance on what step in the OVDP process a taxpayer must achieve before the Service or DOJ receives information regarding the taxpayer. This lack of clarity is compounded by vague statements in FAQs 23 & 24, which indicate that pre-clearance does not guarantee acceptance into the OVDP and that preliminary acceptance is conditioned on compliance with all program provisions.

This ambiguity often discourages taxpayers from filing pre-clearance requests upon learning of the issuance of John Doe summons or a suspected treaty request. This problem is exacerbated by the Service’s recent delays in responding to pre-clearance requests, which causes [cause] corresponding delays in starting the disclosure process. In this regard, we recommend that the Service allocate adequate resources to the pre-clearance function so that requests for pre-clearance are processed in a timely manner for the remainder of the current OVDP and with respect to any new OVDP.

⁴⁷ *Id.*

⁴⁸ I.R.M. 1.2.14.1.14(4) (11-19-1980) (Policy Statement 5-71).

Even if the Service does not announce a new OVDP, we recommend that the Service issue guidance on this issue because similar issues regarding timeliness after the issuance of a John Doe summons arise in the Domestic Voluntary Disclosure Program and other traditional methods for making voluntary disclosures to the Service.

We recommend that, for the 2014 OVDP, FAQ 21 and any future OVDP, the Service confirm that timeliness is measured solely by the date of a taxpayer's pre-clearance request. If, as of that date, the Service or DOJ has not received information responsive to a John Doe summons or treaty request concerning the taxpayer, and no other triggering event has occurred, an otherwise eligible taxpayer should be permitted to enter the program.

I. Request for Additional Safeguards for the Removal Process

The Service issued guidance with respect to when a taxpayer can be removed from the 2014 OVDP. This guidance reads in relevant part:

It is anticipated that removal will occur only in those cases where the taxpayer or the taxpayer's representative has been demonstrably uncooperative, the lack of cooperation has been documented by the examiner, and the examiner has concluded that the case will not be resolved in an appropriate timeframe pursuant to the civil settlement structure of the 2009 OVDP or 2011 OVDI. This may occur, for example, in cases where the taxpayer/representative has not communicated with the agent after repeated requests since first filing the offshore disclosure; where the taxpayer/representative has been nonresponsive to both written and telephonic requests for longer than 60 days; or where a taxpayer/representative has received the Form 906 Closing Agreement for signature, but after 60 days, the taxpayer refuses to sign it and declines to opt out of the program.

Removal is an IRS determination based upon all of the facts and circumstances of the case and such determinations will only be made where agreement with the taxpayer cannot be reached within the parameters of the civil settlement structure of the 2009 OVDP or 2011 OVDI.⁴⁹

Revenue agents assigned to disclosures have been threatening taxpayers with removal where the taxpayer is unable to timely respond to the Service's requests despite good faith efforts and all due diligence; for example, when a taxpayer's accountants are tied up during the annual filing season, or foreign financial institutions are not responding to requests for records. This threat has also been levied in cases where there is good faith disagreement with the Service over a substantive legal issue or characterization of income or expenses. These unwarranted threats force the taxpayer to either agree with what the taxpayer believes to be an erroneous position or opt out and face substantially increased penalties.

⁴⁹ See IRS Opt Out and Removal Guide for 2009 OVDP and 2011 OVDI[. at 4] (June 1, 2011), https://www.irs.gov/pub/newsroom/2011_ovdi_opt_out_and_removal_guide_and_memo_june_1_2011.pdf ["of" in second paragraph absent in original comment].

Aside from the fact that such threats of removal are unfair and contrary to the spirit of the OVDP, these tactics result in unwarranted processing delays and the unnecessary expenditure of limited resources on both sides of the table. Moreover, taxpayers faced with unreasonable threats of removal are more likely to reach out for assistance from the National Taxpayer Advocate. We recommend that the Service revise its Removal Guide to clearly state that removal may not be used as a threat against a taxpayer where progress in the case is delayed for reasons beyond the taxpayer's control. Where there is disagreement on a substantive tax issue, we recommend that the Removal Guide expressly provide that a taxpayer should be given an opportunity to fully and meaningfully be heard on the issue by a subject matter expert, and that the issue will be decided using ordinary tax principles and without undue consideration (and leverage) of the fact that the taxpayer is participating in the OVDP.

III. Additional Comments Provided with Respect to Streamlined Procedures

A. Guidance for U.S. Citizens, including Accidental Americans, Without Social Security Numbers

The Streamlined procedures require U.S. citizens, U.S. residents, and certain other individuals to have a valid social security number ("SSN"). Failure to include an SSN will result in a rejection of the Streamlined submission. Yet, there are individuals living abroad who are otherwise eligible for the Streamlined procedures but do not have, or cannot locate, their SSN. Some of these individuals are referred to as "Accidental Americans," because they fall within the following categories:

1. Individuals who were born in the United States and moved to a foreign country when they were relatively young. Most of these individuals were usually raised abroad and consider themselves to be citizens only of the foreign country. However, as a result of being born in the U.S., under the U.S. Constitution, they are also U.S. citizens; or
2. Individuals born abroad to a parent with U.S. citizenship, whose parent properly applied at a U.S. Embassy to get the child U.S. citizenship. Many of these individuals first become aware of their status due to FATCA requests from a foreign financial institution.

Accidental Americans often do not have an SSN or a U.S. passport and many have never received any benefit from their U.S. citizenship.

The SSN application process for U.S. persons who reside outside the United States is onerous and protracted. Individuals over the age of twelve must apply in person and may be required to provide voluminous background

information such as education, employment, and residence history.⁵⁰ Even after all the necessary documents are collected and submitted, it may take anywhere from six to 15 months to receive an SSN. Moreover, because applicants for SSNs must appear in person for an interview, often at a location outside their country of residence, many U.S. persons must travel substantial distances, making the application process unavailable to those who do not have the necessary time or financial resources.

Because the pre-clearance letter and all tax returns for U.S. citizens require a valid SSN, taxpayers are unable to alert the Service of their intention to pursue either the OVDP or the Streamlined procedures while they wait for an SSN application to be processed. During this delay, these taxpayers could find themselves ineligible due to a triggering event such as the commencement of an audit, the initiation of a criminal investigation, or the receipt of information from an automatic exchange of information, treaty request, or John Doe summons.

We recommend that the Service accept Streamlined submissions from taxpayers who have applied for an SSN and are waiting for the application to be processed and approved. These taxpayers can provide an alternative identification number (*e.g.*, foreign passport number or foreign tax ID number), which can already be used to file an FBAR, and the Service could assign a temporary control number, like the internal submission index numbers assigned to taxpayers participating in the OVDP, that will be replaced with the taxpayer's SSN when issued.

We further recommend, as a second option or an alternative, that the Service establish a process by which a taxpayer can put the Service on notice of his or her intent to make a Streamlined submission and request assistance in obtaining an SSN on an expedited basis. The Service in turn can communicate with the Social Security Administration to expedite the SSN application process.

Finally, because Accidental Americans often have strong reasonable cause defenses, we recommend that the Service add a box on Form 14653 that can be checked if a taxpayer is seeking this designation and that the Service require a written statement with the following information when that box is checked:

- How did you become a U.S. citizen (*e.g.*, by birth in U.S., etc.)?
- When/how did you learn you are a U.S. citizen?
- Do you have a U.S. passport?
- Do you have an SSN?
- When did you leave the U.S. and why (in what year and at what age)?
- Have you ever returned to the U.S.? If so, when and for how long?

⁵⁰ See *Documents required to obtain a Social Security Card* [Learn what documents you will need to get a Social Security Card], SSA, last accessed Apr. 23, 2018, <http://www.ssa.gov/ssnumber/ss5doc.htm>.

Finally, to be eligible for SFOP, taxpayers must demonstrate that within one of the past three years, they were physically present in the U.S. for no more than 35 days. We recommend that the Service expand eligibility to include taxpayers that spend up to 90 days in the United States, at least for Accidental Americans who may not have been aware that their temporary presence in the U.S. would trigger any tax issues, much less ineligibility for the SFOP.

B. *Equity of Including Tax Compliant Assets in the Penalty Base*

The Streamlined procedures for U.S. residents require participants to pay a penalty equal to five percent of the highest aggregate balance/value of the taxpayer's foreign financial assets subject to the penalty. A foreign financial asset is subject to the penalty in a given year if (1) the asset should have been, but was not, reported on an FBAR; (2) if the asset should have been, but was not, reported on Form 8938; or (3) the asset was properly reported on an FBAR and/or Form 8938 but gross income in connection with the asset was not reported in that year.

SDOP FAQ 1 excludes from the penalty base assets or portions of assets in which the taxpayer had no financial interest. SDOP FAQ 1 also incorporates by reference 2014 OVDP FAQ 31 (exchange rate), FAQ 32 (inclusion of personal and business accounts in the penalty base), FAQ 33 (no *de minimis* income exception), FAQ 35.1 (disallowance of valuation discounts), FAQ 38 (exclusion of accounts with only signatory authority), FAQ 39 (children not required to pay penalty for parents' accounts), FAQ 40 (allocation of penalty among co-owners of the offshore asset), and FAQ 41 (reporting and penalties for signatories of a trust account). Missing from this list is a reference to 2014 OVDP FAQ 35, discussing the type of assets to which the offshore penalty applies.

It is understandable that incorporating FAQ 35 in the definition of foreign financial assets subject to the SDOP penalty base may create some confusion because FAQ 35 covers a broader group of assets, such as real estate, than the SDOP penalty base was intended to include. However, a key premise of FAQ 35 is that the OVDP penalty base only includes the taxpayer's offshore holdings that "are related in any way to tax noncompliance," which is defined to include "failure to report gross income from the assets" and "failure to pay U.S. tax that was due with respect to the funds used to acquire the asset." By relying on OVDP FAQ 35 in conjunction with former OVDP FAQs 17 and 18, which provided that the Service would not impose a penalty for failure to file an FBAR or information returns if all the income in connection with the asset was reported and the tax was paid, the Service excludes all tax compliant accounts and assets from the OVDP penalty base.

By contrast, the SDOP does not have an analogous provision that excludes tax compliant assets from the penalty base. Consequently, assets like non-interest-bearing accounts and assets for which the gross income was properly reported on the tax return are, [*sic*] included in the SDOP penalty base for

the year in which the asset was not reported on an FBAR or Form 8938. This inclusion can grossly inflate the SDOP penalty base even though there is no tax loss in connection with the foreign asset.

This problem is best described by example. A non-willful taxpayer (“TP”) is a French citizen living and working in the United States and is a permanent U.S. tax resident. TP’s mother, a French citizen and resident, sets up a usufruct bank account of \$2,000,000 in a Swiss bank. Under the terms of the usufruct, TP’s mother is the owner of all income earned in the bank account, which she properly includes on her own income tax return. TP and his sister are the beneficial owners of the bank account and TP has signature authority over the bank account. TP prepares his own U.S. tax return but does not realize that he has an FBAR filing obligation. Once TP realizes his mistake, he enters the SDOP. Since the income on the bank account properly belongs to TP’s mother and not to TP, there is no unreported income by TP. But, since TP failed to file an FBAR with respect to this bank account, he must include it in the penalty calculation for the SDOP. However, if TP had entered the OVDP instead, he can exclude the same bank account from the OVDP penalty calculation since the income stream belonged to TP’s mother and not to TP, and thus, there was no unreported income by TP.

The inclusion of tax compliant assets in the penalty base runs contrary to the purpose of the SDOP, which is designed to provide a simpler and less costly path to come into compliance for taxpayers whose failure to report foreign assets was non-willful. It is difficult to imagine that the Service would allow such assets to be excluded from the OVDP penalty base, a much broader and more punitive base with a significantly higher penalty, and yet include it in the SDOP penalty base, where the taxpayer’s failure to report the assets is usually due to a lack of familiarity with or misunderstanding of the foreign asset reporting requirements. Furthermore, in most respects, the Service has exhibited its intent to appropriately narrow the SDOP penalty base by excluding tangible assets and real estate. Thus, the inclusion of tax compliant assets in the penalty base is inconsistent with the spirit of the SDOP.

We understand that the Service may view the current approach as desirable from an administrative perspective, as the determination of whether an asset was or was not reported on a timely filed FBAR or Form 8938 typically should be extremely straightforward. By contrast, determining whether an asset generated income and whether such income was properly reported on the taxpayer’s timely income tax return would expend more of the Service’s limited resources. However, the amount of additional resources required is outweighed by the SDOP’s key objective of providing a less punitive compliance option for non-willful taxpayers.

For the foregoing reasons, we recommend that the Service expand SDOP FAQ 1 to provide that tax compliant assets are excluded from the five percent penalty base. To effectuate that, we propose adding the following fourth sentence to the answer to SDOP FAQ 1: “Nor is the penalty intended to reach assets for which there were no unreported tax liabilities even if the assets were

omitted from the FBAR or Form 8938.” This revision would ensure that the SDOP penalty base is narrower than the OVDP penalty base in all aspects, which appears to be the underlying intent of the Service with the expanded Streamlined procedures.

C. *Expanding SDOP to Non-filers*

Taxpayers eligible for the SDOP must have “previously filed a U.S. tax return (if required) for each of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed.” Therefore, the SDOP categorically excludes without exception any taxpayer who did not file a required original return (*i.e.*, non-filers).

The intent of the SDOP is to provide a streamlined procedure for taxpayers who were non-willful with respect to the failure to report the foreign financial asset. The failure to file a required return should not exclude a taxpayer from SDOP if the failure to file was also non-willful. For example, there are many individuals living in the United States whose parents are not U.S. citizens and who transfer or bequeath income-producing assets. In many cases, the recipient is not aware of the transfer, the fact that the asset in question produces income, or that the receipt results in U.S. tax and reporting obligations. If these individuals failed to file a return because they were not aware of their filing obligation and the facts and circumstances establish non-willful conduct, they should be permitted to come into compliance through the SDOP.

In addition, many U.S. persons, including Accidental Americans, who have lived most of their lives in Canada, but spend winters in the United States for the warmer climates, often spend too much time in the United States to qualify as nonresidents for purposes of the SFOP and are ineligible for the SDOP because they have not filed U.S. tax returns. Most of these Canadian snowbirds are clearly non-willful but fall between the cracks of the SDOP and SFOP, largely because they were unaware of their U.S. filing and reporting obligations. While such taxpayers can utilize the DSP, there is no mechanism, other than the OVDP, for these taxpayers to correct any failure to report income and pay U.S. tax.

We recommend that the Streamlined procedures be expanded to include all residents and nonresidents whose failure to report foreign financial assets did not result from willful conduct, regardless of whether the individuals filed original U.S. tax returns. If the Service does not want to expand SDOP to include those individuals who have not filed a return that includes other U.S. source income, it could limit this revision to those delinquent original returns that do not report more than a *de minimis* amount of U.S. source income.

D. *Allowing Submission of Treaty Tie-breaker Returns*

As indicated above, the Streamlined procedures only apply to U.S. individual taxpayers who file Forms 1040 under the SFOP, or Forms 1040X under the SDOP. Unfortunately, this excludes individuals who are technically U.S. residents but file their returns on Form 1040NR because of treaty provisions.

Most U.S. income tax treaties include so-called “tie-breaker” provisions that generally permit an individual who would otherwise qualify as a resident of both treaty countries to be treated, for treaty purposes, as a resident of only one country.⁵¹ Pursuant to longstanding Treasury Regulations, an individual who is a U.S. person under the Code (whether by reason of being a lawful permanent resident or having a substantial presence in the United States) and who “tie-breaks” to another country under an applicable U.S. income tax treaty (a “tie-breaker individual”) is taxed as a nonresident, and must file a nonresident return on Form 1040NR, but generally is considered a U.S. person for other purposes.⁵²

Generally, for purposes of the Internal Revenue Code other than the computation of the individual’s United States income tax liability, the individual shall be treated as a United States resident. Therefore, for example, the individual shall be treated as a United States resident for purposes of determining whether a foreign corporation is a controlled foreign corporation under section 957 or whether a foreign corporation is a foreign personal holding company under section 552.⁵³

Notwithstanding the lack of clear guidance on point (and the confusing instruction to file *nonresident* returns), the above regulation appears to impose on tie-breaker individuals the obligation to file FBARs and most other information returns that are required of U.S. citizens and other U.S. residents.⁵⁴ To the extent tie-breaker individuals are subject to such filing obligations, they are also subject to the risk of penalties for noncompliance.

Based on guidance issued to date, it appears that tie-breaker individuals are not eligible for the Streamlined procedures because such individuals file Forms 1040NR. This exclusion may have been unintentional, as there

⁵¹ See, e.g., 2016 U.S. Model Income Tax Convention, art. 4(3) (Feb. 17, 2016). Pursuant to the “savings clause” included in U.S. income tax treaties, however, a U.S. citizen generally may not be treated as a resident of another treaty country, as the savings clause generally allows the United States to tax its citizens to the same extent as if the income tax treaty were not in effect (with certain specified exceptions). See, e.g., 2016 U.S. Model Income Tax Convention, art. 1(4).

⁵² Treas. Reg. § 301.7701(b)-7(a), -7(b).

⁵³ Treas. Reg. § 301.7701(b)-7(a)(3).

⁵⁴ However, this general rule does not apply to the extent applicable guidance provides otherwise. In this regard, Treasury Regulation section 1.6038D-2(e)(2) generally relieves tie-breaker individuals of the obligation to disclose specified foreign financial assets on IRS Form 8938 and Treasury Regulation section 1.1298-1(c)(5) generally relieves tie-breaker individuals of the obligation to file IRS Form 8621 with respect to certain interests in passive foreign investment companies; but in each case such relief applies only if the tie-breaker individual timely files IRS Form 1040NR (or 1040NR-EZ) and includes a Form 8833 disclosing the tie-breaker treaty position. In addition, the flush language at the end of section 7701(b)(6) provides that an individual “shall cease to be treated as a lawful permanent resident of the United States” if such individual files as a nonresident under a treaty tie-breaker provision and meets certain other requirements. The interaction of such flush language with the Treasury Regulations discussed above is beyond the scope of these Comments.

appears to be no policy reason served by this restriction. To the contrary, tie-breaker individuals who are, by definition, not taxed on their offshore income,⁵⁵ are among the least likely to have been willful in their noncompliance and the most deserving of the full or partial penalty relief afforded under the Streamlined procedures.

We recommend that the Service modify the Streamlined procedures to allow tie-breaker individuals filing Form 1040NR to participate.

I. Other

A. *Delinquent International Information Return Submission Procedures (“DSP”)*

Taxpayers with delinquent international information returns, such as Form 5471 and 5472, may under certain circumstances file those returns under the DSP, also referred to as Option 4 among the Options Available for U.S. Taxpayers with Undisclosed Foreign Financial Assets, without international penalties assessed under sections 6038 and 6038A.⁵⁶ DSP is available to taxpayers who do not need to use the OVDP or Streamlined procedures to file delinquent or amended tax returns to report and pay additional tax, but who have not filed one or more international information returns, have reasonable cause for not filing the information returns, are not under civil examination or criminal investigation, and have not already been contacted by the Service about the delinquent information returns.

Under DSP, taxpayers file delinquent international forms, such as Forms 5471 or 5472, with an *amended* income tax return, such as a Form 1120X or 1065X, and include a reasonable cause statement and certification that the entity for which an information return is being filed was not engaged in tax evasion. However, DSP is not available to taxpayers who have not filed the original income tax returns, and the Service is automatically assessing penalties under sections 6038 and 6038A on late-filed international forms, including on Forms 1120 and 1065 that include Forms 5471 or 5472,⁵⁷ regardless of whether the taxpayer's income tax return reflects any tax due. The penalty for late-filing a Form 5471 is \$10,000, and the penalty for late-filing a Form 5472 is \$25,000.⁵⁸ These penalties are not subject to administrative waivers.⁵⁹

⁵⁵ An exception would apply in the event such income was effectively connected with a U.S. trade or business.

⁵⁶ See *Options Available For U.S. Taxpayers with Undisclosed Foreign Financial Assets*, IRS, last accessed Apr. 23, 2018, <https://www.irs.gov/individuals/international-taxpayers/options-available-for-u-s-taxpayers-with-undisclosed-foreign-financial-assets>.

⁵⁷ See I.R.M. 21.8.2.20.2 (12-16-2016) and I.R.M. 21.8.2.21.2 (04-28-2017).

⁵⁸ Under the Tax Cuts and Jobs Act (P.L. 115-97), the penalty for not timely or completely filing a Form 5472 was increased from \$10,000 to \$25,000. See Pub. L. No. 115-97, § 14401(b).

⁵⁹ IRM 20.1.1.3.3.2.1 (11-21-2017).

The automatic assessment of penalties discourages voluntary compliance.⁶⁰ Taxpayers that inadvertently fail to timely file Forms 1120 or 1065 may be subject to tens of thousands of dollars in information return penalties, even if there is no tax due with the return, and these taxpayers are more likely than not to challenge the penalties through administrative appeals and litigation. Forcing taxpayers to go through an audit, administrative appeal, and quite possibly, litigation, to abate these penalties where the taxpayer's conduct was non-willful imposes a heavy and wholly unnecessary burden on the Service and the taxpayers.

We recommend that the Service eliminate automatic assessment of penalties for delinquent international forms, including Forms 5471 and 5472 that are attached to late-filed original Forms 1120 and 1065 with no tax due, and similarly forego such penalties when the evidence establishes benign, non-volitional, and innocent errors.⁶¹ We also recommend that the Service consider expanding the First Time Abate procedures to include late-filed international forms, including Forms 5471 and 5472.

On a related note, the FAQs issued for the DSP clarified that taxpayers who have unreported income or unpaid tax are not precluded from using the DSP.⁶² Nonetheless, many practitioners are reluctant to counsel taxpayers to use the DSP because of the uncertainty over the *amount* of acceptable unreported income or unpaid tax. Practitioners also may have advised taxpayers to use the Streamlined procedures instead of the DSP because proving a taxpayer was not willful is a lower standard than showing the taxpayer had reasonable cause for a failure to file. In 2015, an official at the Service affirmed that non-willful taxpayers with *de minimis* unreported income and tax due could use the DSP.⁶³ We recommend that the Service issue formal guidance advising non-willful taxpayers with *de minimis* unreported income and tax due to use the DSP if they meet the eligibility requirements.

⁶⁰IRM 20.1.1.2 (11-21-2017). See also Internal Revenue Service Advisory Council (IRSAC) 2015 Public Report, at 112[-16] (Nov. 18, 2015), <https://www.irs.gov/pub/irs-utl/2015-IRSAC-Full-Report.pdf>.

⁶¹See IRSAC 2015 Public Report, at 115 (providing examples of benign noncompliance, including (1) problems with timely filing Form 7004, when the information returns are filed by the extended due date; (2) electronic filing problems; and (3) little or no tax due with the return, such that there is no financial detriment to the Treasury).

⁶²See *Delinquent International Information Return Submission Procedures Frequently Asked Questions and Answers*, IRS, last accessed Apr. 23, 2018, <https://www.irs.gov/individuals/international-taxpayers/delinquent-international-information-return-submission-procedures-frequently-asked-questions-and-answers>.

⁶³See generally Lee A. Sheppard, *Did You Really Mean to Hide Those Foreign Accounts?*, 78 TAX NOTES INT'L (TA) 1018 (June 15, 2015). Public comments made by government officials are not necessarily official pronouncements but are useful to understand IRS enforcement priorities. In this case, an IRS official made the comments at the New York University Tax Controversy Forum in New York on June 9, 2015.

B. *Inbound Voluntary Disclosure*

Pursuant to sections 874(a) and 882(c) and related regulations, a foreign taxpayer who is required to file a U.S. income tax return and fails to do so by a specified deadline is subject to a punitive rule pursuant to which all otherwise permissible deductions are disallowed. In the case of a foreign corporation, the deadline to avoid such penalty is 18 months after the due date of the corporation's U.S. federal income tax return.⁶⁴ In addition, a foreign corporation that is required to file Form 5472 is subject to an initial penalty of \$25,000, plus further penalties if such form is not provided within 90 days following notice from the Service of such noncompliance.⁶⁵ In the case of a nonresident alien individual, the deadline is 16 months after the due date for filing the U.S. federal income tax return.⁶⁶

Where the deduction disallowance rule applies, the consequences are likely to be grossly disproportionate to the amount of tax owed. In fact, a taxpayer who suffers a loss may be subject to taxation on a gross basis, plus interest and substantial penalties. The Service may waive the applicable filing deadline, thereby restoring the foreign taxpayer's entitlement to deductions, but the requirements for such relief are intimidating, as the waiver may be granted only if the taxpayer "establishes to the satisfaction of the Commissioner" that the taxpayer "acted reasonably and in good faith in failing to file a U.S. income tax return (including a protective return [. . .])."⁶⁷ Among the factors to be considered is whether the taxpayer "failed to file a U.S. income tax return because, after *exercising reasonable diligence* (taking into account its relevant experience and level of sophistication), the corporation was unaware of the necessity for filing the return."⁶⁸

Unfortunately, many foreign taxpayers who are engaged (or deemed to be engaged) in a U.S. trade or business are unfamiliar with the U.S. tax rules and often fail to understand their U.S. tax filing requirements. For example, foreign members of a U.S. limited liability company ("LLC") conducting a U.S. real estate transaction or other business may not understand that the LLC is fiscally transparent for U.S. federal tax purposes or may not realize that they are required to file U.S. federal income tax returns even if the LLC has losses. Alternatively, a foreign taxpayer who is a member of a domestic partnership may have some awareness of the section 1446 rules, which require an entity classified as a partnership for U.S. federal tax purposes to withhold on the foreign partner's distributive share of the partnership's effectively connected income, but may not realize that he or she is nevertheless required to file a

⁶⁴ Treas. Reg. § 1.882-4(a)(3). We are aware that the validity of this regulation has been subject to some litigation, see *Swallows Holding, Ltd. v. Commissioner*, 126 T.C. 96 (2006), *rev'd*, 515 F.3d 162 (3d Cir. 2008), but for purposes of the present discussion, we assume it to be valid.

⁶⁵ I.R.C. §§ 6038A(d), 6038C(c).

⁶⁶ Treas. Reg. § 1.874-1(b)(1).

⁶⁷ Treas. Reg. § 1.882-4(a)(3)(ii).

⁶⁸ Treas. Reg. § 1.882-4(a)(3)(ii)(D) (emphasis added).

U.S. federal income tax return. Upon learning of these errors and omissions, many foreign taxpayers want to come into compliance but choose not to do so because of the substantial penalties imposed, despite the facts and circumstances that support inadvertence or mistakes.

We recommend that the Streamlined procedures be modified, or new procedures be implemented, to allow foreign taxpayers to come into compliance without fear of overly punitive tax consequences. Foreign taxpayers who failed to file U.S. income tax returns and are not already under audit could submit delinquent returns, along with all applicable information returns, for each year during a specified "streamlined submission period," in exchange for a waiver of the deduction disallowance rule and any penalties for failure to file, failure to pay, and failure to file information returns, such as Form 5472. For foreign taxpayers who owe no tax for the streamlined submission period, we recommend zero penalties. For the remaining foreign taxpayers, the Service could impose a miscellaneous penalty equal to a specified percentage, such as 50%, of the aggregate tax due. Finally, we recommend foregoing any requirement that the foreign taxpayer certify non-willful conduct because the high percentage penalty effectively presumes a degree of willfulness and because doing so will minimize the resources required by the Service to process the returns.