Excerpt from eBook

The IRS/Panama Papers - Money Laundering and Tax Evasion

IRS Offshore Tax Evasion: Criminal Matters

Offshore Tax Evasion: IRS Tax Audit

IRS Civil Tax Audits/Statute of Limitations

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Chapter 7 – IRS Offshore Tax Evasion: Criminal Matters

<u>6-Year Statute of Limitations</u>

1. Tax Evasion (Willful Evasion of Tax)
(IRC Sec. 7201) up to five years in prison
Fine: $100,000 (individual)
$500,000 (corporation)

2. Obstruct (Impede Tax Collection)
(IRC Sec. 7212) up to three years in prison
Fine: $5,000

3. Conspiracy to Impede Tax Collection
(18 USC 371) separate charge of impeding
Up to five years in prison

4. Failure to File Tax Return
(IRC Sec. 7203) up to one year in prison
Fine: $25,000 (individual)
$100,000 (corporation)

5. File False Tax Return
(IRC Sec. 7206(1)), up to three years in prison
Fine: $250,000

6. "FBAR Violation"
(31 USC Sec. 5322(b), 31 CFR 103.59(c))
Willful violation: up to ten years in jail and
$500,000 fine

Additional Criminal Penalties:

1. Perjury (U.S. taxpayers who fail to disclose foreign accounts under Form 1040/Schedule B, Part III, question 7(a))

2. FATCA Filings (i.e. Failure to disclose foreign financial assets on $50,000/IRS Form 8938)

3. Money Laundering: Disguise of the nature or the origin of funds (18 USC Sec. 1956 and 1957)

Chapter 8 – Offshore Tax Evasion: IRS Tax Audit

For those US taxpayers committing offshore tax evasion i.e. not reporting foreign income, not disclosing offshore accounts, they face a myriad of IRS tax audit issues: Civil and Criminal Penalties, and a myriad of Statute of Limitations.

The IRS Civil and Criminal Penalty Issues include the following:

Civil Penalty Issues

1. Civil Tax Fraud (75% of tax due) (no statute of limitations).

2. Underpayment of Tax (25% of tax due).

3. For voluntary disclosures, under the IRS Offshore Voluntary Disclosure Program (2012), the values of foreign accounts and other foreign assets are aggregated for each year and the penalty is calculated during the period covered by the voluntary disclosure. Under the 2012/IRS Voluntary Disclosure, total penalties of up to 90% of unpaid tax, and 27.5% of highest balance total foreign bank accounts/foreign assets as follows:

a. Failure to File a Tax Return (IRC Sec. 6651(a)(1), up to 25% tax due.

b. Failure to Pay Tax (IRC Sec. 6651(a)(2), up to 25% tax due.

c. Accuracy Related Penalty (IRC Sec. 6662), a 40% penalty for tax underpayment attributable to undisclosed foreign financial asset understatement.

d. Title 26 Penalty - 27.5% highest aggregate balance of foreign bank accounts, entities and assets.

Criminal Penalty Issues

U.S. taxpayers with undisclosed offshore bank accounts and unreported income face criminal charges for:

1. Tax Evasion (IRC 7201), five years in jail, $25,000 fine;

2. Filing False Tax Return (IRC Sec. 7206(1)), three years in jail, $250,000 fine;

3. Failure to File Tax Return (IRC Sec. 7203), one year in jail, $100,000 fine;

4. Willful failure to file FBAR or Filing False FBAR (31 USC Sec. 5322), ten years in jail, fines up to $500,000 with related civil penalty the greater of $100,000 or 50% of the total balance of the foreign account per violation (IRC Sec. 5321(a)(5).

In addition there are specialized tax, and other issues for offshore tax evasion:

1. The failure to file the Report of Foreign Bank and Financial Account ("FBAR", Fincen form 114, formerly TDF-90-22.1) can result in penalties that exceed the account balance e.g. the 50% yearly penalty imposed on the undisclosed account balance is imposed every year so if the FBAR report is not filed for 4 years the penalty is 200% of the account balance. So, if there was $5M on account, after 4 years of no FBAR filings the penalty would be $10M (which does not include the income tax on the unreported account earnings, additional penalties, see above, and interest);

2. An FBAR filing has a 6 year statute of limitations for imposition of the civil and related criminal penalty. These statutes do not begin to run until the FBAR is filed (this filing discloses all foreign bank and financial accounts over $10k).

In addition until the FBAR is filed, and the foreign bank accounts are disclosed, the Statute of Limitations on the related tax year Form 1040 filing does not commence.

3. Effective Tax Year 2011, Form 8938 is required to be attached to Taxpayer's Form 1040 to disclose the aggregate value of all foreign assets over $50k, which includes: Financial Accounts at foreign institutions, foreign stock, security, financial instrument or contract of interest in a foreign entity). Filing an FBAR does not eliminate the need to file Form 8938 to report foreign financial assets. For example, a US beneficiary of a foreign trust who is not within the scope of the FBAR reporting requirements because his interest in the trust is less than 50% may still be required to disclosed the interest with his tax return if the $50k threshold is met. As with the FBAR filing, failure to file the Form 8938 suspends the statute of limitations for the related tax year Form 1040, which does not commence until the Form 8938 (and any other information returns due are filed).

Statute of Limitations for IRS Audits

Civil and criminal tax proceedings have different statutes of limitation.

Civil Tax Fraud - For civil tax fraud (i.e. unreported income/undisclosed foreign bank accounts), there is no statute of limitations. The tax can be assessed at any time.

Criminal Tax Evasion - For criminal tax evasion (i.e. unreported income) the criminal statute of limitations is only on the prosecution of the crime of tax evasion, (not the assessment of the tax owed).

Offenses arising under the Internal Revenue laws generally have a 3-year period of limitation for prosecution (IRC Sec. 6531).

When the prosecution is for the offense of willfully attempting in any manner to evade or defeat any tax, the statute of limitations is 6-years (i.e. unreported Income).

IRC Sec. 6531(1): for offenses involving the defrauding or attempting to defraud the United States (whether by conspiracy or not, and in any manner);

IRC Sec. 6531(2): for the offense of willfully attempting in any manner to evade or defeat any tax;

IRC Sec. 6531(3): for the offense of willfully aiding or assisting in the preparation of a false or fraudulent tax return.

IRC Sec. 6531(4): for the offense of willfully failing to pay any tax or make any tax return.

IRC Sec. 6531(5): for offenses relating to false statements and fraudulent documents under IRC Sec. 7206(1) and Sec. 7207.

IRC Sec. 6531(8): for offenses arising under 18 U.S.C. 371, where the object of the conspiracy is to attempt in any manner to evade or defeat any tax.

Under IRC Sec. 6531, the 6-year statute of limitations shall be tolled, while the U.S. taxpayer who committed the offenses is outside the United States.

Generally, the IRS has 3 years from the date of the tax filing (Form 1040) to commence an audit. However, the 3 years are extended to 6 years if the Taxpayer:

1. Omitted more than 25% of gross income;

2. Omitted more than $5000 of foreign income;

3. Failed to file the FBAR and disclose the foreign account (which is required under Form 1040/Schedule B, Part III, question (7)(a), and if not disclosed is both perjury and a felony for filing a false tax return with up to 3 years in jail), which 6-year statute does not commence until the FBAR is filed (due June 30 each year, for the prior year, no extensions, in 2014 required to be filed electronically i.e. no paper filing, no "lost in the mail excuses".)

As stated above, for the reasons specified the Statute of Limitations for the IRS to audit the Form 1040 may be extended from 3-6 years. Even if there is no understatement of income, if there is a failure to file information returns for offshore holdings/entities then the Form 1040 Statute of Limitations is suspended until the complete Form 1040 is filed with all information filings due.

The following information filings are due annually for offshore holdings/entities:

1. FBAR for accounts over $10k (due 6/30)

2. Form 8938 ("FATCA Filing" since 2011) for Foreign Financial Assets over $50k (due 4/15, unless extension (with Form 1040).

Under Form 8938 (Statement of Specified Foreign Financial Assets): a 3-year statute of limitations for failure to report a specified foreign financial asset or failure to file Form 8938;

A 6-year statute of limitations for U.S. taxpayer's failure to include in gross income an amount relating to specified foreign financial assets and the amount omitted is more than $5,000.

3. Form 3520-A to report annual foreign trust income; (with Form 1040)

4. Form 3520 to report transfers to the trust and distributions to trust beneficiaries; (with Form 1040)

5. Form 5471 for any US person who controls a foreign corporation. Control is defined as ownership of more than 50% of the outstanding stock or voting power for at least 30 consecutive days during that tax year. Control also includes: five or fewer US Persons who collectively own more than a 50% interest and individually own more than a 10% interest in the corporation.

A US person who becomes an Officer or Director of a foreign corporation and owns at least 10% of the corporation stock by vote or value, must also file Form 5471 (with Form 1040).

6. Form 8865 Foreign Partnerships (same rules as Form 5471 re: control, filing dates);

7. Form 8858 for US persons who are owners of foreign disregarded entities (with Form 1040).

US Taxpayers with foreign income, entities should carefully review their annual tax filings due.

Chapter 9 – IRS Civil Tax Audits/Statute of Limitations

IRS civil tax audits generally have a 3-year statute of limitations which commences the later of:

1. Tax Return due date or,

2. Date of Tax Return Filing (evidenced by either electronic filing acceptance, or certified mail return receipt).

The 3-year statute of limitations is extended to 6 years if 25% or more of gross income received by the Taxpayer is omitted from the tax return. For this tax issue (i.e. omission of gross income), the Burden of Proof is on the IRS, but if their burden is satisfied all deductions are also subject to the IRS audit (not just the omitted income).

There is no Statute of Limitations if a tax return is not filed. There is no Statute of Limitations if Taxpayer commits tax fraud (however, the burden of proof is on the IRS).

The IRS often requests a statute extension if the statute will soon expire. If the statute is not extended the IRS will assess tax which can be a bad result (i.e. the tax is due) but have a good benefit (i.e. the audit is then terminated with no further tax disallowance issues to be raised by the auditor) with the taxpayer entitled to file a Notice of Protest and seek an IRS administrative appeal (to a separate division of the IRS/Appeals) without paying tax and no IRS tax lien filed or IRS collection instituted on the assessed tax (i.e. no IRS levy).

The only exception would be a jeopardy assessment if the IRS considers tax collection to be "at risk" (i.e. the Taxpayer hides assets, flees the US et al.) the IRS may seize the Taxpayer assets under a levy, "freezing these assets" pending resolution of the audit assessment.

Taxpayers who elect to file amended tax returns face the following statute of limitations issues:

1. The amended tax return/claim for refund must filed within 3 years of the filing of the original tax returns

2. If the amended tax return increases tax and is filed within 60 days of the statute expiration date, the IRS gets an additional 60 days to assess from the date of the amended tax return filing;

3. For unfilled tax returns the Taxpayer has 2 years from the date the tax was paid to file a tax refund claim.

Caveat:

If the amended tax return does not increase the tax due, the Statute of Limitations is not extended. For Taxpayers who wish to file a tax refund claim, it may be advisable to file the claim within 60 days before the statute expiration which may preclude IRS review and audit before the expiration of the Statute of Limitations so the Taxpayer receives an uncontested tax refund.