



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
Washington, D.C. 20224

Small Business/Self-Employed Division  
Large and Mid-Size Business Division

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MEMORANDUM FOR SBSE EXAMINATION AREA DIRECTORS  
LMSB INDUSTRY DIRECTORS

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SUBJECT: Emphasis on and Proper Development of Offshore Examination  
Cases, Managerial Review, and Revocation of Last Chance  
Compliance Initiative

The purpose of this memorandum is to ensure examinations with offshore transactions and/or entities continue to be emphasized and receive priority treatment during the examination process. This memorandum also provides for managerial oversight of offshore cases, and revokes the Last Chance Compliance Initiative.

**Offshore Case Development**

The IRS Strategic Plan for 2009-2013 outlines the Service's commitment to meet the challenges of international tax administration and of allocating compliance resources to target existing and emerging high-risk areas. Similarly, both the SBSE Examination Program Letter and the Servicewide Approach to International Tax Administration documents address our continuing commitment to prioritize and investigate abusive offshore transactions designed to defeat our tax system.

Offshore cases sent to the field are work of the highest priority. Examiners should utilize the full range of information gathering tools in properly developing offshore issues, with special emphasis on detecting unreported income. This includes interviewing taxpayers, making third party contacts, and timely issuing summonses to taxpayers and third parties. In particular, examiners should request foreign-based information through exchange of information under applicable treaties and tax

information exchange agreements (TIEAs) in any cases where the taxpayers have accounts or transactions in countries with such agreements. Examiners should be alert to the badges of fraud and consult with Fraud Technical Advisors in developing cases for criminal referrals or the assertion of the civil fraud penalty. Counsel is available to assist SBSE and LMSB personnel as needed. Attachment 1 contains a brief summary of potential foreign information reporting requirements and civil penalties that could apply to a taxpayer depending on his/her particular facts and circumstances.

### **Managerial Oversight**

Managers should ensure that income and penalty considerations are sufficiently developed and documented during both unagreed and Embedded Quality reviews. Cases should be discussed with employees regarding the need for additional income probes, use of indirect methods of proof to reconstruct income, penalty development and/or other considerations as necessary.

### **Revocation of Last Chance Compliance Initiative**

Effective as of the date of this memorandum, the Service will no longer afford taxpayers the opportunity to minimize their exposure to penalties through the terms of the Last Chance Compliance Initiative (LCCI). All notices and letters with respect to the LCCI and relevant portions of IRM sections 4.26.16, 4.26.17 and 25.6.23 are in the process of being obsoleted. On any currently open examinations where the LCCI terms have already been offered, taxpayers will be afforded the opportunity to resolve their cases under LCCI if they respond to the examiner within 15 days of their prior notification.

Attachment



## Attachment 1

The following summary of potential reporting requirements and civil penalties is not necessarily all encompassing, and it is unlikely that any one taxpayer would be subject to all of the reporting obligations or penalties listed below:

### **(1) Penalties for failure to comply with the Bank Secrecy Act requirement that United States persons report their financial interest in, or authority over, financial accounts located in a foreign country.**

U.S. citizens, residents, and certain other persons, must annually report their financial interest in, or signature authority (or other authority that is comparable to signature authority) over, a financial account (such as a bank or investment account) that is maintained with a financial institution located in a foreign country if, for any calendar year, the aggregate value of all foreign accounts exceeded \$10,000 at any time during the year. This reporting requirement is met by filing Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts, commonly known as an "FBAR"). FBARs are filed with a Department of the Treasury facility located in Detroit and are not to be filed with tax returns; the filing date for FBARs is June 30th. The requirement to file FBARs is in the regulations under 31 U.S.C. § 5314 (which is a provision of the Bank Secrecy Act). Generally, the civil penalty for willfully failing to file an FBAR can be as high as the greater of \$100,000 or 50 percent of the total balance of the foreign account. Criminal penalties may also apply. Refer to IRM 4.26.16.4 for additional FBAR penalty considerations.

### **(2) Fraud Penalties (Sections 6651(f) and 6663):**

Where an underpayment of tax, or a failure to file a tax return, is due to fraud, the taxpayer is liable for penalties that, although calculated differently, essentially amount to 75 percent of the unpaid tax.

### **(3) Failure to File Tax Return (Section 6651):**

When a taxpayer is required to file a tax return and does not do so on or before the due date of the return, Section 6651(a)(1) imposes a penalty of 5 percent of the net tax amount required to be shown on the tax return for each month (or fraction of a month) that the return is late. The maximum penalty is 25 percent. This penalty is increased to 15%, with a maximum of 75%, if the taxpayer's failure to file is fraudulent.

### **(4) Failure to Pay Tax Penalties (Sections 6651(a)(2) and 6651(a)(3)):**

When a taxpayer fails to timely pay the amount of tax shown on the return, Section 6651(a)(2) imposes a late payment penalty equal to .5 percent of the late payment for



each month (or part of a month) that the payment is late. The maximum penalty is 25 percent.

When a taxpayer fails to pay a tax that is required to be (but was not) shown on a return within 21 days after the date of the Service's notice and demand for that tax, Section 6651(a)(3) imposes a penalty of .5 percent for each month (or part thereof) that the assessment remains unpaid. The maximum penalty is 25 percent.

**(5) Accuracy- Related Penalty (Section 6662):**

The accuracy-related penalty for underpayments is imposed at the rate of 20 percent on the portion of any underpayment of tax required to be shown on a return attributable to negligence, a substantial understatement of tax, a substantial overstatement of pension liabilities or a substantial estate or gift tax valuation understatement. The accuracy-related penalty with respect to a substantial valuation misstatement can be as high as 40 percent.

**(6) Penalties for failure to file certain information returns (Sections 6035, 6038, 6038A, 6038B, 6038C, 6039F, 6046, 6046A, and 6048):**

**Form 5471**, Information Return of U.S. Persons With Respect To Certain Foreign Corporations. U.S. persons who are officers, directors, or shareholders in certain foreign corporations (including, for example, an International Business Corporation used in an offshore scheme) report information required by Sections **6035, 6038, and 6046**, and compute income from controlled foreign corporations under Sections 951–964. The penalty for failing to file each one of these information returns is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return.

**Form 5472**, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Reports transactions between a 25% foreign-owned domestic corporation or a foreign corporation engaged in a trade or business in the United States and a related party as required by Sections **6038A and 6038C**. The penalty for failing to file each one of these information returns, or to keep certain records regarding reportable transactions, is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return.

**Form 926**, Return by a U.S. Transferor of Property to a Foreign Corporation. Reports transfers of property to a foreign corporation and to report information under Section **6038B**. The penalty for failing to file each one of these information returns is ten percent of the value of the property transferred, up to a maximum of \$100,000 per return, with no limit if the failure to report the transfer was intentional.

**Form 3520**, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts. Reports various transactions involving foreign trusts, including creation of a foreign trust by a U.S. person, transfers of property from a U.S. person to a foreign trust, and receipt of distributions from foreign trusts under Section **6048**. This return also reports the receipt of gifts from foreign entities under Section **6039F**. The penalty for failing to file each one of these information returns, or for filing an incomplete return, is 35 percent of the gross reportable amount, except for returns reporting gifts, where the penalty is five percent of the gift per month, up to a maximum penalty of 25 percent of the gift.

**Form 3520-A**, Annual Information Return of Foreign Trust with a U.S. Owner. Reports ownership interests in foreign trusts, by U.S. persons with various interests in and powers over such trusts under Section **6048(b)**. The penalty for failing to file each one of these information returns, or for filing an incomplete return, is five percent of the gross value of trust assets determined to be owned by the U.S. person.

**Form 8865**, Return of U.S. Persons With Respect to Certain Foreign Partnerships. U.S. persons with certain interests in foreign partnerships use this form to report interests in and transactions of the foreign partnerships, transfers of property to the foreign partnerships, and acquisitions, dispositions, and changes in foreign partnership interests under Sections **6038**, **6038B**, and **6046A**. Penalties include \$10,000 for failure to file each return, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return, and ten percent of the value of any transferred property that is not reported, subject to a \$100,000 limit.