



A Primer on the IRS's Streamlined Filing Compliance Procedures

Freeman Law, PLLC

7011 Main Street

Frisco, Texas 75034

www.freemanlaw.com

Matthew Roberts, J.D., LLM

Matt is a Principal of the law firm Freeman Law, PLLC. He devotes a substantial portion of his legal practice to helping his clients successfully navigate and resolve their federal tax disputes, either administratively or, if necessary, through litigation. As a trusted advisor, he has provided legal advice and counsel to hundreds of clients, including individuals and entrepreneurs, non-profits, trusts and estates, partnerships, and corporations.

Having served nearly three years as an attorney-advisor to the Chief Judge of the United States Tax Court in Washington, D.C., Matt leverages his unique insight into government processes to offer his clients creative, innovative, and cost-effective solutions to their tax problems. In private practice, Matt has successfully represented clients in all phases of a federal tax dispute, including IRS audits, appeals, litigation, and collection matters. He also has significant experience representing clients in employment tax audits, voluntary disclosures, FBAR penalties and litigation, trust fund recovery penalties, and penalty abatement and waiver requests.

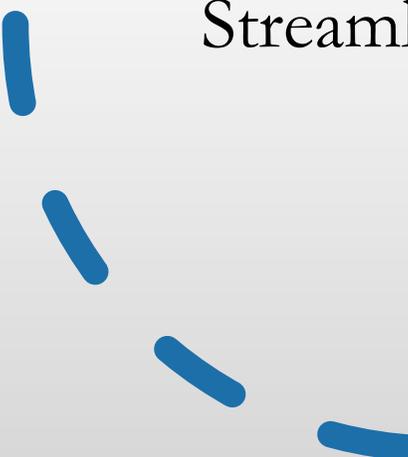
Matt is a frequent speaker and author on complex tax matters, and his articles have been published in national and regional publications including the Journal of Tax Practice and Procedure, Tax Notes, and Today's CPA. Matt also teaches Corporate Income Tax at the SMU Dedman School of Law in Dallas, Texas.

Matt can be reached by email at mroberts@freemanlaw.com or by phone at 469.998.8482.





Learning Objectives

1. Determine whether a taxpayer qualifies for the IRS's Streamlined Filing Compliance Procedures.
 2. Identify the risks and advantages of the IRS's Streamlined Filing Compliance Procedures.
 3. Recognize other options for taxpayers who do not qualify for the IRS's Streamlined Filing Compliance Procedures.
- 

History and Background of the SFCP

- Originally offered by the IRS on September 1, 2012.
- To qualify, taxpayers had to be residents of a foreign country since at least January 1, 2009, with no U.S. tax returns filed thereafter.
- “Low risk” taxpayers were not required to pay penalties; IRS determined “low risk” and “high risk” based on taxpayer responses to questionnaire.
- If taxpayer did not meet requirements, taxpayer had to use the OVDP or other compliance mechanism.

History and Background of the SFCP

- On June 18, 2014, IRS revised the requirements of the SFCP.
- Created two new procedures:
 - Streamlined Domestic Offshore Procedures (“SDOP”);
 - Streamlined Foreign Offshore Procedures (“SFOP”).
- Similar to the 2012 SFCP, eligible taxpayers required to file 3 years of tax returns, pay interest and tax, and file 6 years of FBARs.
- New Requirement: Taxpayers required to certify under penalties of perjury that the failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to non-willful conduct.

Threshold Eligibility Requirements

- Taxpayer must be an individual or an estate of individual taxpayer;
- Taxpayer must certify under penalties of perjury that conduct was non-willful;
- IRS must not have initiated a civil or criminal examination of the taxpayer;
- Must be unreported income from one or more foreign financial assets;
 - Note: The IRS has clarified that this means gross income amounts and not the net tax effect—*i.e.*, if a U.S. person earns foreign wages and claims the foreign earned income exclusion, reducing taxable income to zero, they still have a filing requirement and could still meet the requirement for unreported income.
- Must have valid Taxpayer Identification Number (if taxpayer qualifies for a SSN, must use SSN).

Streamlined Domestic Offshore Procedures

- Must meet domestic requirements—defined in the negative as not meeting the foreign residency requirements under the Streamlined Foreign Offshore Procedures (discussed more *infra*).
- Taxpayer must have previously filed U.S. tax returns (if required to do so) for each of the most recent three years in which the U.S. tax return due date (or properly applied for extended due date) has passed.

Streamlined Domestic Offshore Procedures

- Taxpayer who meets the requirements can enter the Streamlined Domestic Offshore Procedures through:
 - Filing Amended Tax Returns. File amended tax returns for the **most recent three tax years** reporting all omitted income and submitting all required foreign information returns (Forms 8938, 5471, 3520, etc.).
 - Filing FBARs. File delinquent FBARs for the **most recent six years** in which the FBAR due date has passed.
 - Paying Tax and Interest. Pay the full amount of tax and interest with the submission.
 - Paying Title 26 Misc. Penalty. Pay the full amount of the Title 26 miscellaneous penalty with the submission.
 - Filing Form 14654. File the Form 14654 which contains summary information and non-willful certification (must be signed by taxpayer).

Streamlined Domestic Offshore Procedures

- More on the Title 26 Miscellaneous Penalty . . .
 - 5% civil penalty on the highest aggregate valance/value, at the end of each applicable year in the lookback period, of the taxpayer's applicable foreign financial assets during the 3-year amended return period or the 6-year FBAR period.
 - For these purposes, foreign financial asset means the asset should have been, but was not, disclosed on either an FBAR or Form 8938 during the covered-year periods above. However, if a foreign financial asset was properly disclosed but income from the foreign asset was not properly reported in such year, then also constitutes a foreign financial asset.
 - Examples of foreign financial assets: (i) financial accounts held at foreign bank; (ii) financial accounts held at foreign branch of U.S. bank; (iii) foreign stocks, securities, and mutual funds held in foreign investment account. Foreign financial asset does not include foreign bank account in which taxpayer has only signature authority and no financial interest in account.

Streamlined Domestic Offshore Procedures

- Effect of successful SDOP:
 - Subject to Title 26 Misc. Penalty, but **not** subject to accuracy-related penalties, information return penalties, or FBAR penalties.
 - Example: John filed original returns for 2018, 2019, and 2020, but failed to report a foreign bank account with \$300,000 in it for each year. If John submits a SDOP, he will be subject to a Title 26 Misc. Penalty of \$15,000. John will not be subject to FBAR penalties, Form 8938 penalties, or accuracy-related penalties for his failure to properly report the foreign accounts.

Streamlined Foreign Offshore Procedures

- Taxpayer must meet all of the threshold requirements discussed *supra*.
- Must meet the non-residency requirements of the SFOP.
- Unlike the SDOP, the SFOP **does not require that the taxpayer to have filed 3 years of tax returns (i.e., you can file original returns under this procedure).**

Streamlined Foreign Offshore Procedures

- Non-Residency Requirement for U.S. Citizens and Lawful Permanent Residents
- In any 1 year or more of the last 3 years in which tax return due date (or extension due date) has passed, taxpayer did not have: (1) **U.S. abode**; and (2) was physically outside the United States **for at least 330 days or more**.
 - U.S. Abode: *See* IRC sec. 911 and regulations and IRS Publication 54.
 - Neither IRC sec. 911 nor the regulations define “abode.” *See* CCA 2009-003.
 - “Abode” does not mean one’s principal place of business, which is the test used under section 162(a)(2) for “tax home.” Rather, the term “abode has a domestic rather than vocational meaning . . .” *Id.*
 - Thus, a taxpayer’s “abode” is where the taxpayer maintains family, economic, and personal ties. *See id.*; *see also* IRS Publication 54. Relevant factors are where foreign accounts are located, issuance of driver’s license, voter registration, etc.
 - Taxpayer can have an abode overseas even if the taxpayer maintains a dwelling in the United States and has his/her spouse and kids there. *But* these factors can contribute to having an abode in the United States, if other factors are present.
 - Taxpayer should be able to prove that he/she was outside the United States for the required time through passport entries, official records of employment, or other documentation.

Streamlined Foreign Offshore Procedures

Non-Residency Requirement for Non-U.S. Citizens/Non-Permanent Residents

- If in any one year out of last three years for which the U.S. tax return due date (or properly applied for extension due date) has passed, the individual did not meet the substantial presence test under I.R.C. sec. 7701(b)(3).
- Substantial Presence Test: Physically present in the United States on at least: (1) 31 days of the year at issue; and (2) 183 days in the 3-year period that includes the year at issue and the 2 years immediately before that, counting:
 - All the days that the taxpayer was present in the year at issue; and
 - 1/3 of the days that the taxpayer was present in the year before the year at issue; and
 - 1/6 of the days that the taxpayer was present in the second year preceding the year at issue.

Streamlined Foreign Offshore Procedures

- Example: Mary is not a U.S. citizen or a lawful permanent resident. Rather, she was born in France and resided in France until July 1, 2018, when her employer transferred her to the United States. Mary was physically present in the United States 183 days in both 2019 and 2020. The most recent three years for which Mary's United States income tax returns deadlines have passed are 2018, 2019, and 2020.
- Mary meets the substantial presence test for 2019 and 2020.
- Mary does not meet the substantial presence test for 2018.
 - 2018 = 183 days
 - 2017 = 0 days
 - 2016 = 0 days
- Result: Mary qualifies for the Streamlined Foreign Offshore Procedures because she does not meet the substantial presence test for 2018.

Streamlined Foreign Offshore Procedures

- Effect of successful SFOP:
 - Must file 3 years of tax returns and 6 years of FBARs.
 - Must pay income tax and interest on tax.
 - Must file Form 14653 with non-willful narrative.
 - **Not subject to Title 26 Miscellaneous Penalty.**
 - Not subject to failure-to-file, failure-to-pay, or accuracy-related penalties.
 - Not subject to information return penalties, including FBAR.

The Non-Willful Narrative

- Extremely important!
- Required under both the SDOP and the SFOP.
- Must include all information requested—*i.e.*, “good” and “bad” facts.
- IRS has publicly commented that they believe some taxpayers are wrongfully certifying that they were non-willful when, in fact, they were willful.
- Some taxpayers who have submitted a submission under the Streamlined Program have found themselves subject to criminal prosecution for statements made on the Streamlined forms regarding the non-willful conduct.

The Non-Willful Narrative

- What is “willful”?
- REMEMBER: Taxpayer must certify under penalties of perjury that failure to report all income, pay all tax, and file all required information returns was non-willful.

“We have said before that ‘willfully’ is a word of many meanings whose construction is often dependent on the context in which it appears . . . and where willfulness is a statutory condition of civil liability, we have generally taken it to cover not only knowing violations of a standard, but reckless ones as well[.] This construction reflects common law usage, which treated actions in ‘reckless disregard’ of the law as ‘willful’ violations. The standard civil usage thus counsels reading the phrase ‘willfully’ . . . as reaching reckless . . . violations . . .” *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47 (2007).

The Non-Willful Narrative

- What is “willful”?
 - Knowing Violations. Most commonly-believed meaning of the term, but least used by the IRS because of evidentiary issues. Means that the taxpayer knew he had income, had tax obligations, and/or international reporting obligations and failed to meet any of those obligations.
 - Reckless Violations. Least understood meaning of the term, but most used by the IRS because of evidentiary issues.
 - Taxpayer recklessly disregards an obligation when person clearly ought to have known (under an objective standard) that there was a grave risk they were not complying with their United States tax obligations and could have easily found out for certain about the obligation.
 - Under the concept of “willful blindness,” a form of reckless conduct, the IRS can show willfulness if a person made a conscious effort to avoid learning about their United States tax obligations.
- To the IRS, non-willful conduct means that the failure to meet an obligation was due to negligence, inadvertence, or mistake or conduct that is the result of a good-faith misunderstanding of the requirements of the law.
- Very gray area between “reckless” conduct and “negligent” conduct.

Non-Willful Narrative

Provide specific reasons for your failure to report all income, pay all tax, and submit all required information returns, including FBARs. Include the whole story including favorable and unfavorable facts. Specific reasons, whether favorable or unfavorable to you, should include your personal background, financial background, and anything else you believe is relevant to your failure to report all income, pay all tax, and submit all required information returns, including FBARs. Additionally, explain the source of funds in all of your foreign financial accounts/assets. For example, explain whether you inherited the account/asset, whether you opened it while residing in a foreign country, or whether you had a business reason to open or use it. And explain your contacts with the account/asset including withdrawals, deposits, and investment/management decisions. Provide a complete story about your foreign financial account/asset. If you relied on a professional advisor, provide the name, address, and telephone number of the advisor and a summary of the advice. If married taxpayers submitting a joint certification have different reasons, provide the individual reasons for each spouse separately in the statement of facts. The field below will automatically expand to accommodate your statement of facts.

Non-Willful Narrative

- “We realize that many taxpayers failed to acknowledge their financial interest in or signature authority over foreign financial accounts on Form 1040, Schedule B. If you (or your return preparer) inadvertently checked “no” on Schedule B, line 7a, simply provide your explanation.”
- “We realize that some taxpayers that owned or controlled a foreign entity (e.g., corporation, trust, partnership, etc.) failed to properly report ownership of the entity or transactions with the foreign entity. If you (or your return preparer) inadvertently failed to report ownership or control of the foreign entity or transactions with the foreign entity, explain why and include your understanding of your reporting obligations to the IRS and to foreign jurisdictions.”
- “If you relied on a professional advisor, provide the name, address, and telephone number of the advisor and a summary of the advice. Also provide background such as how you came into contact with the advisor and frequency of communication with the advisor.”

Non-Willful Narrative

- Relevant questions for determining whether the conduct was willful or not:
 - If taxpayer filed Schedule B and marked “no” for foreign accounts/trusts, why?
 - Did taxpayer rely on a tax advisor and, if so, did taxpayer provide the tax advisor with all relevant information? Did tax advisor provide the taxpayer with an organizer? What questions were asked on organizer?
 - Where did foreign accounts/foreign assets originate? How much interaction did taxpayer have with foreign accounts/foreign assets?
 - Has taxpayer had income tax audits in past or filed international information returns in the past?
 - Dollar amount of foreign accounts/foreign assets and dollar amounts of unreported income?
 - Educational and business background of taxpayer?
 - Did taxpayer comply with tax laws in foreign jurisdiction?
 - Etc., etc., etc.

Non-Willful Narrative

- Warning: Filing a false non-willful narrative can result in criminal actions by the IRS/United States government.
- Forms 14653/14654: “I recognize that if the Internal Revenue Service receives or discovers evidence of willfulness, fraud, or criminal conduct, it may open an examination or investigation that could lead to civil fraud penalties, FBAR penalties, information return penalties, or even referral to Criminal Investigation.”
 - *United States v. Gyetvay*, No. 21-cr-83 (M.D. Florida): Dual U.S./Russian citizen indicted for, among other things, certifying under penalties of perjury that failure to report and pay tax and file international information returns was non-willful.
 - *United States v. Rahman*, No. 1:21-cr-22 (E.D. Virginia): Taxpayer who did not disclose all foreign accounts in Streamlined submission and asserted that failure to report tax and income was non-willful indicted for making false statements to the IRS.
 - DOJ attorneys have commented on prior occasions that they are reviewing streamlined filings to determine whether information is truthful and complete.

IRS Streamlined Submission FAQs

- Married Taxpayers
 - Taxpayers who have filed joint income tax returns can jointly file a Streamlined Submission. Additional requirements: (1) non-willful narrative must address specific facts relevant to each spouse; and (2) if filing under SFOP, both spouses must meet non-residency requirements.
- Foreign Stock
 - Title 26 Misc. Penalty applies to value of stock, and not foreign assets held by foreign corporation, unless foreign corporation is treated as a disregarded entity.
 - Taxpayer may use “any reasonable method” to value foreign stock—however, no valuation discounts are permitted.

IRS Streamlined Submission FAQs

- Taxpayers who are eligible for a SSN but who do not have one may not use the Streamlined Filing Compliance Procedures. If the taxpayer makes a submission without a valid SSN, the IRS will process the returns outside the IRS Streamlined Submission procedures, which subjects the amended returns/FBARs to all applicable penalties.

Example of SFCP - Domestic

Adam, a United States citizen, established a foreign grantor trust in the United Kingdom. He transferred \$200,000 to the foreign trust in 2015. The foreign trust used the funds to make investments in various foreign stocks. In 2018, 2019, and 2020, the foreign trust generated \$10,000 of income for each year. As the trustee and primary beneficiary of the foreign trust, Adam also had signature authority over the foreign investment account.

Risks to Adam:

- Form 3520 penalty for 2015, or 35% of \$200,000.
- Form 3520-A penalties for 2015 through 2020, or 5% of \$200,000 per year (not taking into account investment gains).
- Non-willful or willful FBAR penalties.

Example of SFCP - Domestic

- If Adam enters into the SDOP, Adam will have to: (1) file amended returns for 2018, 2019, and 2020; (2) file Forms 3520 and 3520-A for 2018, 2019, and 2020; (3) file FBARs for 2015, 2016, 2017, 2018, 2019, and 2020; and (4) pay taxes and interest on \$30,000 of investment gains for 2018, 2019, and 2020. Adam will also have to pay a Title 26 Misc. Penalty, which would be 5% of aggregate balance of the applicable foreign assets (here, assume \$230,000, or \$11,500).

Example of SFCP - Foreign

- Assume the same facts in the prior slides but assume that Adam meets the 330 day/non-U.S. abode requirement.
- Adam will still have to: (1) file amended returns for 2018, 2019, and 2020; (2) file Forms 3520 and 3520-A for 2018, 2019, and 2020; (3) file FBARs for 2015, 2016, 2017, 2018, 2019, and 2020; and (4) pay taxes and interest on \$30,000 of investment gains for 2018, 2019, and 2020.

Streamlined Nota Bene

- There is no closing agreement with a Streamlined Filing Compliance Procedure submission.
- Taxpayers agree to retain tax records for 6 years and make them available upon request to IRS.
- Special Section 965 rules apply
 - Taxpayers who are not in compliance with section 965(a) inclusion and who use the Streamlined Filing Compliance Procedures must come into compliance for the section 965 transition tax in their submission and include the tax year in which the transition tax might occur (generally 2017 and/or 2018) even if that tax year is not in the 3-year income tax return lookback period. It must also include all subsequent tax years.

What if a Taxpayer does not Meet the Requirements of the SFCPs?

- For various reasons, a taxpayer may not meet the requirements of the SFCP, *e.g.*:
 - The taxpayer may be an entity (corporation, partnership, etc.);
 - The taxpayer may have strong indicia of willfulness.
- What other options does the taxpayer have?
 - Voluntary Disclosure Program;
 - Delinquent FBAR Submission Procedures;
 - Delinquent International Information Return Submission Procedures.

Voluntary Disclosure Program

- If conduct is willful, IRS permits taxpayers in certain instances to make a submission through the VDP.
- Threshold Requirements:
 - Must be timely (*i.e.*, disclosure must be made before IRS has information from third parties or before IRS initiates criminal/civil investigation);
 - Income cannot be from unlawful sources (under federal law).
- Effects of a Voluntary Disclosure: (1) 6 years of tax returns (original or amended) and FBARs filed; (2) payment of tax and interest for 6 years; (3) 75% fraud penalty (generally) on highest year of income; and (4) FBAR mitigation guidelines applicable for FBAR penalties.
- No accuracy-related penalties, late-filing or late-payment penalties, or information return penalties (Forms 5471, 3520, etc.) as a general matter.

Example of VDP

- Let's return to example of Adam—

Adam, a United States citizen, establish a foreign grantor trust in the United Kingdom. He transferred \$200,000 to the foreign trust in 2015. The foreign trust used the funds to make investments in various foreign stocks. In 2018, 2019, and 2020, the foreign trust generated \$10,000 of income for each year. As the trustee and primary beneficiary of the foreign trust, Adam also had signature authority over the foreign investment account.

Example of VDP

- Under VDP:
 - Adam must file 6 years of tax returns and FBARs (2015-2020).
 - Adam must pay tax and interest on \$30,000 of income from 2018 through 2020.
 - Adam must pay a 75% fraud penalty on highest income tax year.
 - Adam will not have to pay accuracy-related penalties/delinquency penalties.
 - Adam will not have to pay penalties for failure to file Forms 3520/3520-A.
 - FBAR mitigation guidelines apply, *see* IRM pt. 4.26, resulting in \$20,000 FBAR penalty.

Delinquent FBAR Submission Procedures

- Requirements:
 - Conduct was non-willful;
 - Taxpayer properly reported on U.S. tax returns, and paid all tax on, the income from the foreign financial accounts reported on the delinquent FBARs;
 - Taxpayer has not been contacted by IRS for civil/criminal investigation regarding income tax returns and/or delinquent FBARs;
 - Must include statement explaining why the FBARs are late;
- Effects of successful submission:
 - No penalties for failure to file the delinquent FBARs.

Delinquent International Information Return Submission Procedures

What do I do if I have a delinquent international information return?

Taxpayers who have identified the need to file delinquent international information returns who are not under a civil examination or a criminal investigation by the IRS and have not already been contacted by the IRS about the delinquent information returns should file the delinquent information returns through normal filing procedures.

Penalties may be assessed in accordance with existing procedures.

- All delinquent international information returns other than Forms 3520 and 3520-A should be attached to an amended return and filed according to the applicable instructions for the amended return.
- All delinquent Forms 3520 and 3520-A should be filed according to the applicable instructions for those forms.
- Taxpayers may attach a reasonable cause statement to each delinquent information return filed for which reasonable cause is being asserted. During processing of the delinquent information return, penalties may be assessed without considering the attached reasonable cause statement. It may be necessary for taxpayers to respond to specific correspondence and submit or resubmit reasonable cause information.

Information returns filed with amended returns will not be automatically subject to audit but may be selected for audit through the existing audit selection processes that are in place for any tax or information returns.

Delinquent International Information Return Submission Procedures

- No man's land.
- If taxpayer does not qualify for any other program or does not want to use any other program, taxpayer advised to submit delinquent international information return (Forms 3520, 3520-A, 5471, 5472, etc.) and attach a reasonable cause statement.
- "The longstanding authorities regarding what constitutes reasonable cause continue to apply, and existing procedures concerning establishing reasonable cause, including requirements to provide a statement of facts made under the penalties of perjury, continue to apply."

Delinquent International Information Return Submission Procedures

- Problems with DIIRSP:
 - Reports that IRS is not reviewing reasonable cause statement, if attached, and systemically assessing civil penalties.
 - 2020 NTA Report: Noted that 9,889 penalties were assessed in 2018 totaling close to \$253 million; yet, 5,468 abatements totaling close to \$180 million were ultimately granted.
 - Note: Abatement percentages have decreased over time, meaning that the IRS is more carefully scrutinizing reasonable cause statements and not granting relief in certain instances.
 - When IRS makes these systemic assessments, deficiency procedures do not apply. Thus, IRS assesses and moves straight to collection with taxpayer not having any resort to judicial challenge, unless the taxpayer pays in full the civil penalties or otherwise does not have an opportunity to challenge the penalty prior to CDP hearing.
 - Taxpayer may have to file more than 3/6 years of tax returns, as statute of limitations for unfiled information returns remains open indefinitely. *See* IRC sec. 6501(c)(8)(A) (assessment remains open if certain information returns are not filed); *see also* IRS LB&I International Practice Service Process Unit – Audit (“The statute of limitations for assessing IRC sec. 6677(a) and IRC 6677(b) penalties [*i.e.*, 3520/3520-A penalties] ends three years after a complete and accurate Form 3520 and/or 3520-A is filed.”).

Example of DIIRS

- One more time with Adam:

Adam, a United States citizen, establish a foreign grantor trust in the United Kingdom. He transferred \$200,000 to the foreign trust in 2015. The foreign trust used the funds to make investments in various foreign stocks. In 2018, 2019, and 2020, the foreign trust generated \$10,000 of income for each year. As the trustee and primary beneficiary of the foreign trust, Adam also had signature authority over the foreign investment account.

Example of DIIRS

- Adam files original/amended tax returns, paying all tax, with proper information returns (Forms 3520, 3520-A, 8938).
- Adam attaches reasonable cause statement to each return.
- Adam files FBARs late and puts explanation as to why they were filed late.
- IRS will likely assess penalties against Adam for late-filing of Forms 3520, 3520-A, and 8938. Adam will have to fight these in IRS Appeals.
- IRS *may* assess FBAR penalties for late-filed FBARs.