

LB&I International Practice Service Transaction Unit

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|------------------|---|
| Unit Name | Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets |
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Issue and Transaction Overview

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

This Practice Unit focuses on a U.S. Person's proactive steps to "conceal" their ownership of foreign financial accounts, entities and other assets for the purposes of tax avoidance or evasion, even though, there may be some situations where there are legitimate personal or business purposes for establishing such arrangements. This unit falls under the outbound face of the matrix and thus, will focus on U.S. Persons living in the United States.

Offshore tax evasion commonly uses structures of offshore entities (e.g. corporations, trusts and foundations) to conceal U.S. taxpayers' (TP) beneficial ownership of assets. The assets held through such structures most commonly are foreign financial accounts, but can also include other foreign assets and even domestic financial accounts and assets, such as a taxpayer's domestic brokerage account or residence.

Most U.S. taxpayers using an offshore entity or structure of entities to hold foreign accounts are simply hiding the accounts from the Internal Revenue Service and other creditors. Such accounts may be the repository of funds skimmed from a U.S. business activity. Funds invested through secret offshore accounts may grow at a faster rate than domestic investments, because current earnings escape taxation. In addition, funds accumulated offshore are often passed to future generations free of transfer taxes. # [REDACTED]

#

Issue and Transaction Overview (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Many offshore jurisdictions have strict financial and bank secrecy laws which protect against disclosure of banking and business records. Such jurisdictions also typically provide little or no regulation of the ownership and operations of legal entities created within their jurisdiction. Additionally, some of these same jurisdictions generally do not tax entities on income earned beyond their borders. The use of the offshore secrecy jurisdiction, therefore, may hinder the Service's ability to obtain records necessary for examinations and create a barrier that may hinder the agent's investigation of an entity's relationships and activities. # [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

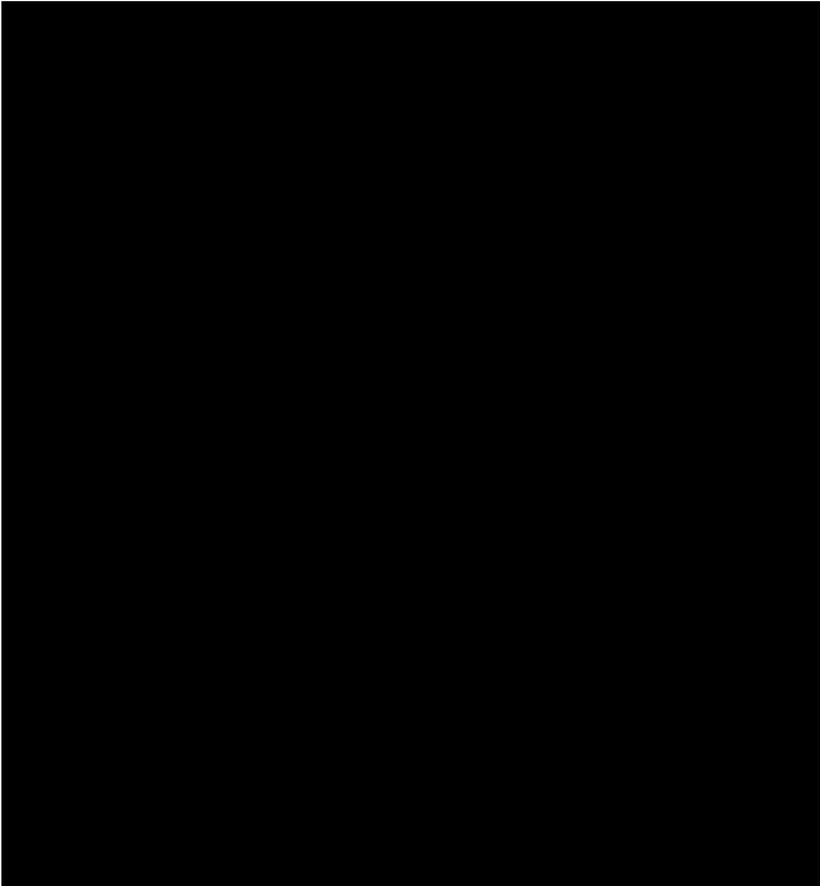
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This

Practice Unit provides the basic structures U.S. individuals utilize to conceal their beneficial ownership of foreign financial accounts, so that the funds deposited to those foreign accounts and/or the earnings on investment in those accounts go untaxed in the U.S.

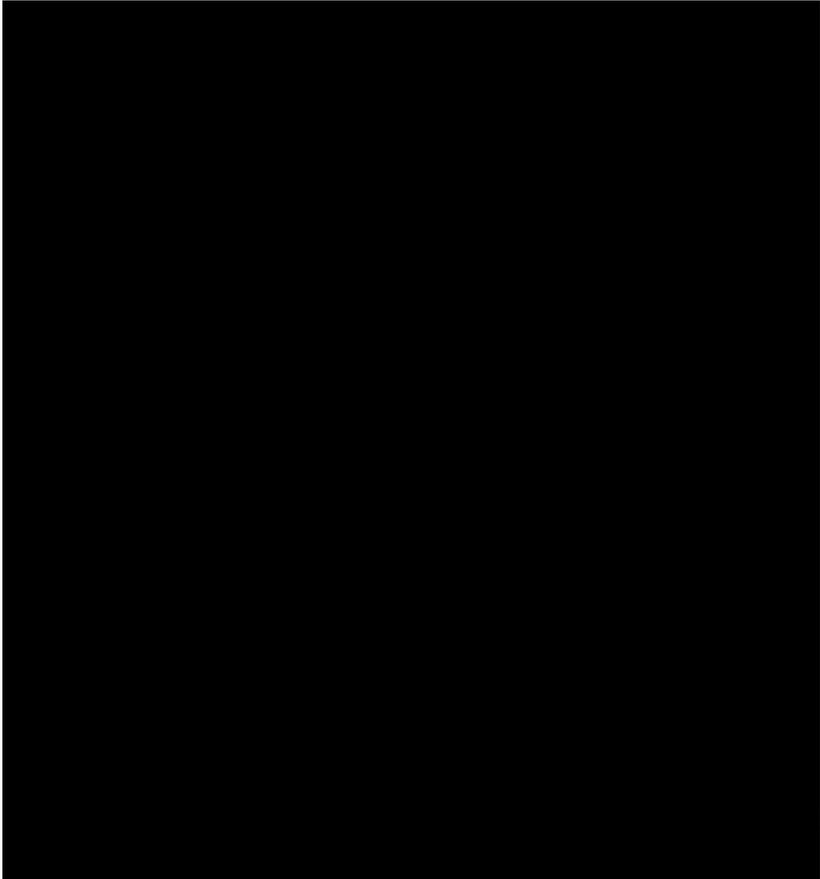
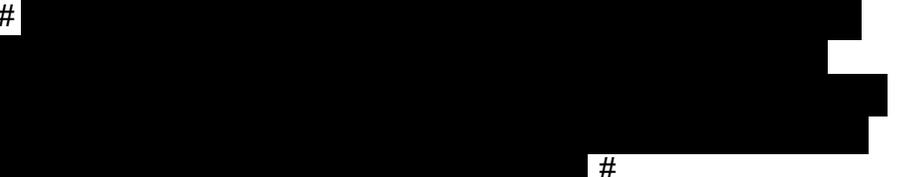
Transaction and Fact Pattern

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

| Diagram of Transaction | Facts |
|--|---|
| <p>#</p>  <p>#</p> | <p>As a result of case development or various sources, # [REDACTED]</p> <p>[REDACTED] # a U.S. taxpayer is identified as having authority over a foreign financial account. Funds deposited into these accounts may have escaped U.S. taxation (income, gift, estate).</p> <p>The U.S. person may directly or indirectly have held an interest in, or had signature or other authority over, a foreign financial account at an Offshore Bank.</p> <p># [REDACTED] #</p> <p># [REDACTED] #</p> <p># [REDACTED] #</p> |

Transaction and Fact Pattern (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

| Diagram of Transaction | Facts |
|--|--|
| #  # | #  # #  # #  # #  # #  # |

Any line marked with a # is for Official Use Only.

Summary of Potential Issues

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

| | |
|--------------------------------|--|
| <u>Issue 1</u> | Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings? |
| <u>Issue 2</u> | Whether the earnings on the foreign financial accounts or other assets held through foreign entities escaped U.S. taxes? |
| <u>Issue 3</u> | Whether the funds deposited into the foreign financial accounts or other assets held through foreign entities escaped U.S. taxes? |
| <u>Issue 4</u> | Whether taxpayer failed to file required Report of Foreign Bank and Financial Accounts (FBAR) under Title 31 and any required foreign information returns under Title 26? |

All Issues, Step 1: Initial Factual Development

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

U.S. persons are taxed on their worldwide income while foreign persons generally are only taxed in the U.S. on U.S. source income. As a result, some U.S. persons attempt through an offshore arrangement/structure to exploit this general rule and attempt to make it appear that income earning assets held offshore are those of a foreign entity rather than disclose that those assets are controlled by or for themselves as the beneficial owner. If the U.S. person is in fact the beneficial owner then the income earned on these assets, including foreign financial accounts, will be taxable in the U.S. to them.

| Fact Element | Resources | 6103 Protected Resources |
|---|-----------|--------------------------|
| <ul style="list-style-type: none"> <li data-bbox="89 661 824 1006">▪ # [Redacted] # <li data-bbox="89 1006 824 1196">▪ # [Redacted] # | | |

All Issues, Step 1: Initial Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

U.S. persons are taxed on their worldwide income while foreign persons generally are only taxed in the U.S. on U.S. source income. As a result, some U.S. persons attempt through an offshore arrangement/structure to exploit this general rule and attempt to make it appear that income earning assets held offshore are those of a foreign entity rather than disclose that those assets are controlled by or for themselves as the beneficial owner. If the U.S. person is in fact the beneficial owner then the income earned on these assets, including foreign financial accounts, will be taxable in the U.S. to them.

| Fact Element | Resources | 6103 Protected Resources |
|--|--|--------------------------|
| <ul style="list-style-type: none"> ▪ # [REDACTED] | <ul style="list-style-type: none"> ▪ # [REDACTED] # ▪ # [REDACTED] # ▪ FinCEN Query ▪ # [REDACTED] # | |

All Issues, Step 1: Initial Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

U.S. persons are taxed on their worldwide income while foreign persons generally are only taxed in the U.S. on U.S. source income. As a result, some U.S. persons attempt through an offshore arrangement/structure to exploit this general rule and attempt to make it appear that income earning assets held offshore are those of a foreign entity rather than disclose that those assets are controlled by or for themselves as the beneficial owner. If the U.S. person is in fact the beneficial owner then the income earned on these assets, including foreign financial accounts, will be taxable in the U.S. to them.

| Fact Element | Resources | 6103 Protected Resources |
|---|---|--------------------------|
| <p>– # [REDACTED] #</p> <p>– Research IDRS to determine if foreign information returns have been filed.</p> | <ul style="list-style-type: none"> ▪ IRM 20.1.9.13 — IRC 6677(a) - Foreign Trust Information Return - Form 3520 ▪ IRM 20.1.9.14 —IRC 6677(a) and (b) -Foreign Trusts With U.S. Owners - Form 3520-A | |

All Issues, Step 1: Initial Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

U.S. persons are taxed on their worldwide income while foreign persons generally are only taxed in the U.S. on U.S. source income. As a result, some U.S. persons attempt through an offshore arrangement/structure to exploit this general rule and attempt to make it appear that income earning assets held offshore are those of a foreign entity rather than disclose that those assets are controlled by or for themselves as the beneficial owner. If the U.S. person is in fact the beneficial owner then the income earned on these assets, including foreign financial accounts, will be taxable in the U.S. to them.

| Fact Element | Resources | 6103 Protected Resources |
|--|-----------|--------------------------|
| <ul style="list-style-type: none"> ▪ # [REDACTED] # -# [REDACTED] [REDACTED] # -# [REDACTED] [REDACTED] # -# [REDACTED] [REDACTED] # -# [REDACTED] [REDACTED] # | | |

All Issues, Step 1: Initial Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

U.S. persons are taxed on their worldwide income while foreign persons generally are only taxed in the U.S. on U.S. source income. As a result, some U.S. persons attempt through an offshore arrangement/structure to exploit this general rule and attempt to make it appear that income earning assets held offshore are those of a foreign entity rather than disclose that those assets are controlled by or for themselves as the beneficial owner. If the U.S. person is in fact the beneficial owner then the income earned on these assets, including foreign financial accounts, will be taxable in the U.S. to them.

| Fact Element | Resources | 6103 Protected Resources |
|--|-----------|--------------------------|
| <ul style="list-style-type: none">▪ Determine if U.S. person has deposited funds into foreign financial account(s) held under the name of the foreign entity (IBC and/or FTR) and has failed to disclose existence of account(s) and to report earnings on the account(s) on their U.S. Income Tax Return. | | |

All Issues, Step 1: Initial Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

U.S. persons are taxed on their worldwide income while foreign persons generally are only taxed in the U.S. on U.S. source income. As a result, some U.S. persons attempt through an offshore arrangement/structure to exploit this general rule and attempt to make it appear that income earning assets held offshore are those of a foreign entity rather than disclose that those assets are controlled by or for themselves as the beneficial owner. If the U.S. person is in fact the beneficial owner then the income earned on these assets, including foreign financial accounts, will be taxable in the U.S. to them.

| Fact Element | Resources | 6103 Protected Resources |
|---|-----------|--------------------------|
| <ul style="list-style-type: none"> - # [Redacted] <li style="padding-left: 20px;"># - # [Redacted] <li style="padding-left: 20px;"># ▪ # [Redacted] <li style="padding-left: 20px;"># | | |

All Issues, Step 1: Initial Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

U.S. persons are taxed on their worldwide income while foreign persons generally are only taxed in the U.S. on U.S. source income. As a result, some U.S. persons attempt through an offshore arrangement/structure to exploit this general rule and attempt to make it appear that income earning assets held offshore are those of a foreign entity rather than disclose that those assets are controlled by or for themselves as the beneficial owner. If the U.S. person is in fact the beneficial owner then the income earned on these assets, including foreign financial accounts, will be taxable in the U.S. to them.

| Fact Element | Resources | 6103 Protected Resources |
|---|---|--------------------------|
| <ul style="list-style-type: none"> ▪ Determine if U.S. person failed to file FinCEN Form 114 (previously FBAR TD F 90.22-1) with respect to the foreign accounts and failed to file any foreign information returns under Title 26 required due to U.S. persons ownership/control over foreign entity. <ul style="list-style-type: none"> – Review Form 1040 - Schedule B Part III Questions pertaining to Foreign Trusts and Foreign Accounts | <ul style="list-style-type: none"> ▪ FinCEN Query ▪ Foreign Entities IPN Practice Units – Volume ## 11-12 | |

All Issues, Step 1: Initial Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

U.S. persons are taxed on their worldwide income while foreign persons generally are only taxed in the U.S. on U.S. source income. As a result, some U.S. persons attempt through an offshore arrangement/structure to exploit this general rule and attempt to make it appear that income earning assets held offshore are those of a foreign entity rather than disclose that those assets are controlled by or for themselves as the beneficial owner. If the U.S. person is in fact the beneficial owner then the income earned on these assets, including foreign financial accounts, will be taxable in the U.S. to them.

| Fact Element | Resources | 6103 Protected Resources |
|--|---|--------------------------|
| <ul style="list-style-type: none"> – Review Form 1040 for all attachments related to required Foreign Information Returns (Forms 5471, 926, 8938) – Review FinCEN Form 114 (previously T.D. F 90.22-1 Report of Foreign Bank and Financial Accounts (FBAR) for completeness and accuracy. – Review IDRS for records to determine whether Forms 3520 and 3520A were filed with respect to known FTR | <ul style="list-style-type: none"> ▪ IRM 4.26.16 — Report of Foreign Bank and Financial Accounts (FBAR) ▪ IRM 4.26.17 — Report of Foreign Bank and Financial Accounts (FBAR) Procedures | |

Issue 1, Step 2: Review Potential Issues

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 1

Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings?

| Fact Element | Resources | 6103 Protected Resources |
|---|--|--------------------------|
| <ul style="list-style-type: none"> ▪ Offshore arrangements/structures are often constructed using multiple offshore financial secrecy jurisdictions, multiple entities such as trusts and corporations and one or more nominees. This is done to confuse any person seeking information with respect to the beneficial owner's financial interest. ▪ The focus on any offshore arrangement/structure used to conceal the U.S. person's beneficial ownership of the foreign financial account should be a determination of whether the U.S. person has control and retains enjoyment of any funds transferred into the bank account(s). If the U.S. person has unrestricted use of the funds in that account and thus beneficial enjoyment of the funds, then the U.S. person is the beneficial owner. | <ul style="list-style-type: none"> ▪ IRC 671-679 ▪ Revenue Agent Foreign Trust and Other Offshore Entities Training Participant Guide (Training 11048-001) | |

Issue 1, Step 2: Review Potential Issues (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 1

Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings?

| Fact Element | Resources | 6103 Protected Resources |
|--|-----------|--------------------------|
| <ul style="list-style-type: none"> ▪ Beneficial ownership refers to the true owner of an entity, asset or transaction as opposed to any stated ownership provided in documents or oral representations. It is common practice in offshore financial secrecy jurisdiction to interpose entities, individuals or both as stated owners. The beneficial or true owner is contractually acknowledged in side agreements, statements or by other devices. ▪ In most offshore secrecy jurisdictions, local anti-money laundering laws require banks and companies who create corporations and trusts for clients to keep a record of who the beneficial owner is. # [REDACTED] # | | |

Issue 1, Step 2: Review Potential Issues (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 1

Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings?

| Fact Element | Resources | 6103 Protected Resources |
|---|---|--------------------------|
| <ul style="list-style-type: none"> ▪ U.S. person's control of funds in the financial account equals beneficial ownership. ▪ Beneficial ownership requires that the U.S. person may be taxed in the U.S. on the accounts earnings, since U.S. persons are taxed on worldwide income. ▪ The fact that the foreign financial account is held in the name of a foreign entity can be disregarded under a variety of theories <ul style="list-style-type: none"> – U.S. person has a retained interest in the property – Assignment of Income – Substance versus Form – Step Transaction Doctrine – Economic Substance Doctrine | <ul style="list-style-type: none"> ▪ IRC 61(a) ▪ Treas. Reg. 1.1-1(b) ▪ <i>Zmuda v. Commissioner</i> - 79 T. C. 714, 720 (1982) - affd. 731 F.2d 1417 (9th Cir. 1984) ▪ <i>Lucas v. Earl</i> - 281 U.S. 111 (1930) ▪ <i>Gregory v. Helvering</i> - 293 U.S. 465 (1935) ▪ <i>Knetsch v. United States</i> - 364 U.S. 361 (1960) ▪ LB&I Directive #4-0711-015 - Guidance for Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties (7/15/2011) ▪ Notice CC-2012-008 - Procedures for the Economic Substance Doctrine and Related Penalties | |

Issue 1, Step 3: Additional Factual Development

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 1

Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings?

| Fact Element | Resources | 6103 Protected Resources |
|------------------|-----------|--------------------------|
| ▪ # [REDACTED] # | | |

Issue 1, Step 3: Additional Factual Development

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 1

Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings?

| Fact Element | Resources | 6103 Protected Resources |
|----------------|-----------|--------------------------|
| ▪ # [Redacted] | | |
| ! # [Redacted] | | |
| - # [Redacted] | | |
| - # [Redacted] | | |

Issue 1, Step 3: Additional Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 1

Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings?

| Fact Element | Resources | 6103 Protected Resources |
|--|-----------|--------------------------|
| <ul style="list-style-type: none"> ▪ # [REDACTED] # ▪ # [REDACTED] # ▪ # [REDACTED] # ▪ # [REDACTED] # | | |

Issue 1, Step 3: Additional Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 1

Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings?

| Fact Element | Resources | 6103 Protected Resources |
|--|-----------|--------------------------|
| <ul style="list-style-type: none"> ▪ # [REDACTED] # [REDACTED] - # [REDACTED] # [REDACTED] | | |

Issue 1, Step 4: Develop Arguments (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 1

Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings?

| Fact Element | Resources | 6103 Protected Resources |
|------------------|-----------|--------------------------|
| ▪ # [REDACTED] # | | |

Issue 1, Step 4: Develop Arguments (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 1

Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings?

| Fact Element | Resources | 6103 Protected Resources |
|--|---|--------------------------|
| <p>U.S. person deposited funds into and/or has withdrawn funds from the foreign financial account(s). Funds withdrawn were either transferred to U.S. person's domestic or foreign personal financial account(s) or used for U.S. person's personal expenses/purposes.</p> <p>Consider Judicial Doctrines:</p> <ul style="list-style-type: none"> ▪ Assignment of Income ▪ Substance Over Form ▪ Sham Transaction ▪ Step Transaction ▪ Economic Substance | <ul style="list-style-type: none"> ▪ PPT for OA IPN Event on Economic Substance Doctrine and Other Judicial Doctrines April 2013 | |

Issue 1, Step 4: Develop Arguments (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 1

Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings?

| Fact Element | Resources | 6103 Protected Resources |
|--|-----------|--------------------------|
| <p>Certain judicial doctrines may be relevant to the analysis of whether the taxpayer should be considered the beneficial owner of these accounts.</p> <p># [REDACTED]</p> <p># [REDACTED]</p> | | |

Issue 1, Step 4: Develop Arguments (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 1

Whether the U.S. taxpayer is the beneficial owner of the foreign account or other assets held through foreign entities, subject to reporting requirements and tax on the account's earnings?

| Fact Element | Resources | 6103 Protected Resources |
|---|--|--------------------------|
| <p> CONSULTATION: Local counsel should be consulted about the development and presentation of facts necessary to support judicial doctrines that permit the disregarding of the form of the offshore transactions.</p> <ul style="list-style-type: none"> ▪ Alternative Argument is to use the Grantor Trust Rules to show the entity is a grantor trust. The income and expenses of a grantor trust are reported on the U.S. Person's income tax return, who is determined to be the grantor/owner of the trust. The assets owned by the trust are treated as owned by the grantor/owner. ▪ Alternative Argument is to use the Subpart F Income rules (CFC) , or PFIC rules in order to tax the U.S. shareholder on the income. | <ul style="list-style-type: none"> ▪ IRC 671-679 ▪ IRC 951-964 ▪ IRC 1291 ▪ IRC 1293-1298 ▪ Foreign Entities IPN Practice Units – Volume ## 11-12 | |

Issue 2, Step 2: Review Potential Issues

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 2

Whether the earnings on the foreign financial accounts or other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|---|--|--------------------------|
| <p>U.S. persons are taxed on their worldwide income while foreign persons generally are only taxed in the U.S. on U.S. source income. As a result, some U.S. persons attempt through an offshore arrangement/structure to exploit this general rule and attempt to make it appear that income earning assets held offshore are those of a foreign entity rather than disclose that those assets are controlled by or for themselves as the beneficial owner. If the U.S. person is in fact the beneficial owner then the income earned on these assets, including foreign financial accounts, will be taxable in the U.S. to the U.S. person.</p> <p>Evidence reveals that the U.S. person is the beneficial owner of the foreign financial accounts and has unrestricted use of the funds within those accounts. (see issue 1)</p> | <ul style="list-style-type: none"> ▪ Jurisdiction to Tax IPN Practice Units – Volume ## 9 | |

Issue 2, Step 2: Review Potential Issues (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 2

Whether the earnings on the foreign financial accounts or other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|---|--|--------------------------|
| <p>Person who earns the income is taxed on it. # [REDACTED]</p> <p>[REDACTED]</p> <p>[REDACTED] #</p> <p>Gross income means all income from whatever source derived, including (but not limited to) the following items: Interest, Dividends, Gains derived in dealing with property etc.</p> | <ul style="list-style-type: none"> ▪ IRC 61(a) ▪ Treas. Reg. 1.1-1(b) ▪ IRC 1291 ▪ IRC 1293-1296 | |

Issue 2, Step 3: Additional Factual Development

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 2

Whether the earnings on the foreign financial accounts or other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|--|--|--------------------------|
| <ul style="list-style-type: none"> ▪ U.S. person fails to disclose existence of account on Schedule B of U.S. person's income tax return and fails to report earnings on the account(s) on their U.S. Income Tax Return. <ul style="list-style-type: none"> – Review income tax return Schedules B, D and Form 8621 ▪ Funds on deposit in foreign financial account(s) earn interest and/or dividends and/or are invested in accounts that resemble offshore mutual funds resulting in gains and losses. <ul style="list-style-type: none"> – # [REDACTED] # | <ul style="list-style-type: none"> ▪ # [REDACTED] # | |

Issue 2, Step 4: Develop Arguments

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 2

Whether the earnings on the foreign financial accounts or other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|--|---|--------------------------|
| <p>U.S. person has been determined to be the beneficial owner of the foreign financial account. (See issue 1)</p> <p>Review Income Tax Return (i.e., Schedule B) to determine if foreign financial account(s) were disclosed and whether any income earned on accounts are included.</p> <p>U.S. persons are taxed on worldwide income. Gross income includes income from whatever source derived, including (but not limited to) the following items: Interest, Dividends, Gains derived from dealing in property, etc.</p> | <ul style="list-style-type: none"> ▪ <i>Lucas v. Earl</i> - 281 U.S. 111, (1930) | |

Issue 2, Step 4: Develop Arguments

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 2

Whether the earnings on the foreign financial accounts or other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|---|-----------|--------------------------|
| <p># [REDACTED]</p> <p># [REDACTED]</p> <p>▪ # [REDACTED]</p> <p># [REDACTED]</p> | | |

Issue 3, Step 2: Review Potential Issues

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 3

Whether the funds deposited into the foreign financial accounts or used to fund other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|---|---|--------------------------|
| <p>U.S. persons are taxed on their worldwide income, where foreign persons are generally taxed in the U.S. only on their U.S. source income.</p> <p># [REDACTED] #</p> <p>Consider Judicial Doctrines</p> <ul style="list-style-type: none"> ▪ Assignment of Income ▪ Substance Over Form ▪ Sham Transaction ▪ Step Transaction and ▪ Economic Substance | <ul style="list-style-type: none"> ▪ IRC 61(a) ▪ Treas. Reg. 1.1-1(b) ▪ Foreign Entities IPN Practice Units – Volume ## 11-12 ▪ IRC 1291 ▪ IRC 1293-1296 | |

Issue 3, Step 2: Review Potential Issues (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 3

Whether the funds deposited into the foreign financial accounts or used to fund other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|---|---|--------------------------|
| <p># [REDACTED]</p> <p># [REDACTED]</p> | <ul style="list-style-type: none"> ▪ Practice Unit, "Structures Used for Income Shifting – Re-Invoicing," DCN: OAR/9435.04_02(2015) ▪ Practice Unit, "Structures Used for Income Shifting – False Invoicing," DCN: OAR/9435.04_03(2015) | |
| <p># [REDACTED]</p> <p># [REDACTED]</p> | | |

Issue 3, Step 3: Additional Factual Development

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 3

Whether the funds deposited into the foreign financial accounts or used to fund other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|--|-----------|--------------------------|
| <ul style="list-style-type: none"> ▪ # [Redacted] ▪ # [Redacted] ▪ # [Redacted] ▪ # [Redacted] | | |

Issue 3, Step 3: Additional Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 3

Whether the funds deposited into the foreign financial accounts or used to fund other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|------------------|-----------|--------------------------|
| - # [REDACTED] # | | |

Issue 3, Step 3: Additional Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 3

Whether the funds deposited into the foreign financial accounts or used to fund other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|--|--|--------------------------|
|  DECISION POINT: Issue summons on the U.S. taxpayer to provide records if no cooperation. | ▪ OA International Practice Network (IPN) Summons Desk Guide | |

Issue 3, Step 3: Additional Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 3

Whether the funds deposited into the foreign financial accounts or used to fund other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|--|-----------|--------------------------|
| <ul style="list-style-type: none"> ▪ # [REDACTED] # – # [REDACTED] # | | |

Issue 3, Step 3: Additional Factual Development (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 3

Whether the funds deposited into the foreign financial accounts or used to fund other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|--|--|--------------------------|
| <ul style="list-style-type: none"> ▪ # [REDACTED] ▪ # [REDACTED] | <ul style="list-style-type: none"> ▪ Practice Unit, "Issuing a Formal Document Request When a US Taxpayer is Unresponsive to an IDR," DCN: IGA/9460.02_02(2013) | |

Issue 3, Step 4: Develop Arguments

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 3

Whether the funds deposited into the foreign financial accounts or used to fund other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|---|--|--------------------------|
| <p># [REDACTED]</p> <p># [REDACTED]</p> <p>▪ # [REDACTED]</p> <p># [REDACTED]</p> <p>▪ # [REDACTED]</p> <p># [REDACTED]</p> <p>▪ # [REDACTED]</p> <p># [REDACTED]</p> | <ul style="list-style-type: none"> ▪ <i>Gregory v. Helvering</i> - 293 U.S. 465, 469 (1935) - "One has the right to decrease one's taxes in any way permitted by law; however, this right is not absolute. A transaction will not be respected if it has no business or corporate purpose, but is "a mere device ... as a disguise for concealing its real character." ▪ Foreign Entities IPN Practice Units – Volume ## 11-12 ▪ IRC 1291-1296 ▪ Practice Unit, "Structures Used for Income Shifting – Re-Invoicing," DCN: OAR/9435.04_02(2015) ▪ Practice Unit, "Structures Used for Income Shifting – False Invoicing," DCN: OAR/9435.04_03(2015) | |

Issue 3, Step 4: Develop Arguments (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 3

Whether the funds deposited into the foreign financial accounts or used to fund other assets held through foreign entities escaped U.S. taxes?

| Fact Element | Resources | 6103 Protected Resources |
|---|--|--------------------------|
| <p>Consider Judicial Doctrines:</p> <ul style="list-style-type: none"> ▪ Assignment of Income ▪ Substance Over Form ▪ Sham Transaction ▪ Step Transaction ▪ Economic Substance <p> CONSULTATION: Local counsel should be consulted about the development and presentation of facts necessary to support judicial doctrines that permit the disregarding of the form of the offshore transactions.</p> | <ul style="list-style-type: none"> ▪ <i>Weller v. Commissioner</i> - 270 F.2d 294, 297 (1959)(quoting <i>Transport Trading & Terminal Corp v. Commissioner.</i>, 176 F.2d 570, 572 (2d Cir. 1949), revg. 9 T.C. 247 (1947)). The tax statutes apply only "to transactions entered upon for commercial purposes and 'not to transactions entered upon for no other motive but to escape taxation.'" ▪ IRC 61(a) ▪ Treas. Reg. 1.1-1(b) | |

Issue 4, Step 2: Review Potential Issues

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 4

Whether taxpayer failed to file required Report of Foreign Bank and Financial Accounts (FBAR) under Title 31 and any required foreign information returns under Title 26?

| Fact Element | Resources | 6103 Protected Resources |
|---|---|--------------------------|
| <p>Title 31 and the IRC contain several information return filing requirements for taxpayers with foreign accounts and entities. # [REDACTED]</p> <p># Taxpayers who fail to file required foreign information returns are subject to substantial penalties unless they establish reasonable cause for the failure to file. The filing requirements may include:</p> <ul style="list-style-type: none"> Title 31 FBAR – required of a U.S. person that has a financial interest in or signature authority over foreign financial accounts with an aggregate value exceeding \$10,000 at any time during the calendar year. | <ul style="list-style-type: none"> FinCEN Form 114 (previously T.D. F 90.22-1 Report of Foreign Bank and Financial Accounts (FBAR)) IRM 4.26.16 — Report of Foreign Bank and Financial Accounts (FBAR) IRM 4.26.17 — Report of Foreign Bank and Financial Accounts (FBAR) Procedures | |

Issue 4, Step 2: Review Potential Issues (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 4

Whether taxpayer failed to file required Report of Foreign Bank and Financial Accounts (FBAR) under Title 31 and any required foreign information returns under Title 26?

| Fact Element | Resources | 6103 Protected Resources |
|--|--|--------------------------|
| <ul style="list-style-type: none"> ▪ Form 8938, Statement of Foreign Financial Assets – required of a United States person that has foreign financial assets exceeding certain thresholds, for tax years beginning after March 18, 2010 ▪ Form 5471 – required with respect to Controlled Foreign Corporations ▪ Form 926 – required to report transfers of property to a foreign corporation ▪ Forms 3520 – required to report transactions with foreign trusts and receipt of large gifts, inheritances or bequests from foreign persons ▪ Form 3520A – required to report foreign trusts with a U.S. owner | <ul style="list-style-type: none"> ▪ Form 8938 ▪ Form 5471 ▪ Practice Unit, “Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5,” DCN: IGA/9560.01_03(2014) ▪ Form 926 ▪ Form 3520 and Form 3520-A ▪ IRC 6038, 6038B, 6038D, 6046, 6048, 6038(b), 6038B(c), 6038D(d), 6039F, 6679, 6677 | |

Issue 4, Step 3: Additional Factual Development

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 4

Whether taxpayer failed to file required Report of Foreign Bank and Financial Accounts (FBAR) under Title 31 and any required foreign information returns under Title 26?

| Fact Element | Resources | 6103 Protected Resources |
|---|--|--------------------------|
| <ul style="list-style-type: none"> ▪ Aggregate balance of foreign financial accounts exceed \$10,000 of any day during the year ▪ U.S. Person has interest in or signature authority over an account. ▪ U.S. Person did not file FBAR | <ul style="list-style-type: none"> ▪ IRM 4.26.16 — Report of Foreign Bank and Financial Accounts (FBAR) ▪ IRM 4.26.17 — Report of Foreign Bank and Financial Accounts (FBAR) Procedures ▪ FBAR Lead sheet ▪ FinCEN Query | |
| <ul style="list-style-type: none"> ▪ U.S. person created and controls foreign entity that holds the foreign financial accounts and assets. ▪ U.S. person did not file appropriate foreign information returns required when U.S. person controls the foreign entity | <ul style="list-style-type: none"> ▪ Form 5471 Lead Sheet ▪ IRM 20.1.9 - International Penalties ▪ IRM 21.8.2.18 - Information Reporting Under IRC 6048 ▪ Foreign Entities IPN Practice Units – Volume ## 11-12 ▪ Practice Unit, “Monetary Penalties for Failure to Timely File a Substantially Complete Form 5471 – Cat. 4 & 5,” DCN: IGA/9560.01_03(2014) | |

Issue 4, Step 4: Develop Arguments

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 4

Whether taxpayer failed to file required Report of Foreign Bank and Financial Accounts (FBAR) under Title 31 and any required foreign information returns under Title 26?

| Fact Element | Resources | 6103 Protected Resources |
|--|--|--------------------------|
| <p>If U.S. person is the beneficial owner of the foreign financial account(s) and if the aggregate balance exceeds \$10,000 for which he has an ownership or signature authority there is a filing requirement. Investigation should focus on determination of willfulness and, for non-willful penalty, whether taxpayer can show reasonable cause.</p> | <ul style="list-style-type: none"> ▪ IRM 4.26.16 - Report of Foreign Bank and Financial Accounts (FBAR) ▪ IRM 4.26.17 - Report of Foreign Bank and Financial Accounts (FBAR) Procedures ▪ FBAR Lead sheet ▪ <i>U.S. v. Curran</i> - 12-cr-80206, U.S. District Court, Southern District of Florida (West Palm Beach) ▪ <i>U.S. v. McBride</i> - 908 F. Supp. 2d 1186 (D. Utah 2012) ▪ <i>U.S. v. Williams</i> - 489 Fed. Appx. 655 (4th Cir. 2012). ▪ <i>Zmuda v. Commissioner</i> - 79 T.C. 714, 720 (1982), affd. 731 F.2d 1417 (9th Cir. 1984) | |

Issue 4, Step 4: Develop Arguments (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 4

Whether taxpayer failed to file required Report of Foreign Bank and Financial Accounts (FBAR) under Title 31 and any required foreign information returns under Title 26?

| Fact Element | Resources | 6103 Protected Resources |
|--------------|---|--------------------------|
| | <ul style="list-style-type: none">▪ <i>Lucas v. Earl</i> - 281 U.S. 111 (1930)▪ <i>Gregory v. Helvering</i> - 293 U.S. 465 (1935)▪ <i>Knetsch v. United States</i> - 364 U.S. 361 (1960)▪ FinCEN Query | |

Issue 4, Step 4: Develop Arguments (cont'd)

Basic Offshore Structures Used to Conceal U.S. Person's Beneficial Ownership of Foreign Financial Accounts and Other Assets

Issue 4

Whether taxpayer failed to file required Report of Foreign Bank and Financial Accounts (FBAR) under Title 31 and any required foreign information returns under Title 26?

| Fact Element | Resources | 6103 Protected Resources |
|--|---|--------------------------|
| <p>If the U.S. taxpayer holds the foreign financial account or other assets through an entity or structure of entities and has failed to file required information returns, then he is subject to penalties unless there was reasonable cause for the failure to file.</p> <p>Even though the Service is not recognizing the foreign entity as owner of the account or assets for U.S. tax purposes, the foreign entity does legally exist and the taxpayer has a foreign information return filing requirement with respect to that entity. Penalty examination should focus on determining whether there was reasonable cause for failing to file.</p> | <ul style="list-style-type: none"> ▪ IRC 6038(b), 6038B(c), 6038D(d), 6039F(c), 6677, 6679 ▪ IRM 20.1.9 - International Penalties | |

Training and Additional Resources

Chapter 13.4.1 Unreported Income

| Type of Resource | Description(s) and/or Instructions for Accessing | References |
|------------------|---|---|
| Issue Toolkits | The Examining Income Procedures and Guidance section provides examiners easy access to sufficient guidance in examining and developing the issue of income, including the appropriate tax treatment of diverted income. Access through Forms/Pubs/Products Repository. In-Depth Examination of Income | <ul style="list-style-type: none">▪ Examiner's Toolkit Training for Income Examinations (Revenue Agent) (Student Guide) Training 27046-002▪ IRM 4.10.4.5 - In-Depth Examinations of Income |

Training and Additional Resources (cont'd)

| Chapter 13.4.1 Unreported Income | | |
|----------------------------------|---|--|
| Type of Resource | Description(s) and/or Instructions for Accessing | References |
| Other Training Materials | <ul style="list-style-type: none"> ▪ This training publication is the Student Guide for course 5710 (course catalog 82701g). Offshore Credit Card Training covers procedures to establish and determine offshore credit card schemes and actions to counteract such schemes. Access through Forms/Pubs/Products Repository. ▪ Power Points describing how foreign entities may be used in evading U.S. tax and how we tax U.S. persons and foreign persons on various types of income. Access through Office of Chief Counsel Intranet Webpage. | <ul style="list-style-type: none"> ▪ Offshore Credit Card Training (Student Guide) Training 5710-002 ▪ 2011 – (IIC) CPE - Offshore Arrangements & Jurisdiction to Tax sessions |

Glossary of Terms and Acronyms

| Acronym | Definition |
|---------|---|
| CBRS | Currency Banking Retrieval System |
| CCA | Chief Counsel Advise |
| CFC | Controlled Foreign Corporation |
| EOI | Exchange of Information |
| FBAR | Report of Foreign Bank and Financial Accounts |
| FE | Foreign Entities |
| FFA | Foreign Financial Account |
| FFE | Foreign Financial Entity |
| FTR | Foreign Trust |
| IBC | International Business Company |
| IDRS | Information Document Retrieval System |
| IPN | International Practice Network |
| IRC | Internal Revenue Code |
| IRM | Internal Revenue Manual |

Glossary of Terms and Acronyms (cont'd)

| Acronym | Definition |
|----------------|--------------------------------|
| JDS | John Doe Summons |
| KYC | Know Your Customer |
| LB&I | Large Business & International |
| OA | Offshore Arrangements |
| # [REDACTED] # | # [REDACTED] # |
| # [REDACTED] # | # [REDACTED] # |
| TP | Taxpayer |
| Treas. Regs. | Treasury Regulations |
| U.S. | United States |

Any line marked with a # is for Official Use Only.

Index of Related Issues

| Issue | Associated UIL(s) | References |
|--|--|---|
| Subpart F | <ul style="list-style-type: none"> ▪ 9412 | <ul style="list-style-type: none"> ▪ Practice Unit, “Subpart F Overview,” DCN: DPL/CU/V_2_01(2013) |
| Offshore Arrangement Practice Unit – Structures Used for Income Shifting Re-Invoicing | <ul style="list-style-type: none"> ▪ 9435.04-01 | <ul style="list-style-type: none"> ▪ Practice Unit, “Structures Used for Income Shifting – Re-Invoicing,” DCN: OAR/9435.04_02(2015) |
| Offshore Arrangement Practice Unit – Structures Used for Income Shifting False Invoicing | <ul style="list-style-type: none"> ▪ 9435.04-01 | <ul style="list-style-type: none"> ▪ Practice Unit, “Structures Used for Income Shifting – False Invoicing,” DCN: OAR/9435.04_03(2015) |
| Determination of CFC Status | <ul style="list-style-type: none"> ▪ 9433.01-01 | <ul style="list-style-type: none"> ▪ Practice Unit, “Determination of US Shareholder and CFC Status,” DCN: FEN/9433.01_03(2013) |
| Transfer of property to Foreign Corporations - §367 | <ul style="list-style-type: none"> ▪ 9411 | <ul style="list-style-type: none"> ▪ Practice Unit, “Outbound Transfers of Property to Foreign Corporation – IRC 367 Overview ,” DCN: ISO/9411.08_01(2013) |
| PFIC | <ul style="list-style-type: none"> ▪ 9433.02 | <ul style="list-style-type: none"> ▪ Practice Unit, “Determination of PFIC Status,” DCN: FEN/9433.02_04(2013) |
| Withholding Effectively Connected Income (ECI) | <ul style="list-style-type: none"> ▪ 9442 | <ul style="list-style-type: none"> ▪ Practice Unit, “Effectively Connected Income,” DCN: USB/CU/P_14.2_01 (2014) |