



# 2010 expatriate update: International tax gap

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***Approximately how many  
of your employees are on  
foreign assignment?***

- > The Internal Revenue Service is giving top strategic priority to the reduction of a very large estimated international tax gap, and its efforts are likely to impact the large and growing population of U.S. expatriates and those moving to the United States (a.k.a., inpatriates).
- > Many members of these two groups will be involved in an expanding effort that the IRS is conducting as part of the activities of the newly organized IRS Global High Wealth Task Force (“task force”).

## Prepared remarks of IRS Commissioner Douglas Shulman before the 22nd Annual George Washington University International Tax Conference, December 10, 2009:

*To meet the broad array of challenges that we face in the international arena, the Administration and the IRS are focused on a multi-year international tax compliance strategy that is tailored for both corporate and individual taxpayers.*

*For businesses, we must recognize that the tax system has changed as the economy has become global in scope. We want to ensure that taxpayers do not use the international capital markets and tax code complexities to push tax planning beyond acceptable bounds. And for individuals, we want to better ensure that U.S. taxpayers with overseas assets pay what they owe.*

*Now, no discussion of offshore tax evasion by individuals would be complete without at least briefly discussing the UBS agreement and our special offshore voluntary disclosure program for unreported income that ran through October 15th of this year.*

*That program gave people a special chance to come in and get right with the government. And taxpayers took advantage of it in record numbers; our efforts brought more than 14,700 people back into compliance who hadn't been reporting offshore assets and income.*

*The unprecedented agreement with the Swiss authorities we reached this past August regarding UBS account holders – and the response to the special offshore voluntary disclosure program – together represent an historic milestone. They proved to the world – especially to account holders, promoters and banks – **that we're serious about our international efforts...we're serious about piercing the veil of bank secrecy...and we're serious about carrying forward the momentum to address offshore tax evasion. We will be mining the 14,700 voluntary disclosures for information to identify financial institutions, advisors, and others who promoted or otherwise facilitated U.S. persons hiding assets and income offshore and attempted to shirk their tax responsibilities at home.***

## Until now, only wealthy individuals and large corporations had the means to make sophisticated international investments.

- > Diminished legal barriers and technological advances have provided opportunities for offshore investments to a broader spectrum of the population.
- > Foreign companies and individuals see the United States as fertile ground for business and personal investments.
- > International tax picture becomes increasingly complex as companies expand their global reach and engage cross-border employees to manage business activities.
- > Under increased IRS international scrutiny, companies and their employees can easily run afoul of U.S. tax laws.

**The task force is taking a closer look at global financial transactions and reporting behaviors of high wealth U.S. citizens and residents living in the United States or overseas.**

- > Their scrutiny extends to U.S. citizens
  - Moving overseas
  - Investing overseas
  - Having closely-held family investments
  - Running businesses overseas

## Why the increased IRS effort and involvement?

- > Potential for legitimately collecting increased tax revenue.
- > International business investments in the United States grew from nearly \$188 billion in 1978 to more than \$14.5 trillion in 2007.
- > In the same period, U.S. business and investment overseas grew from nearly \$368 billion to nearly \$15 trillion.

- > Defined as taxes owed – but not collected on time, or ever – from a U.S. person or a foreign person whose cross-border transactions are subject to U.S. taxation.
- > Encompasses all revenue losses resulting from noncompliance with the U.S. tax laws due to international transactions. These include:
  - Taxpayer error
  - Conflicting legal interpretations
  - Misinterpretation of the facts
  - Outright tax evasion
- > Non-IRS estimates place the total international tax gap at a range of \$40 to \$123 billion annually.

### **In a post 9/11 world, there is an increased need to properly report overseas bank account activity.**

- > The federal government has a legitimate interest in money coming into the United States and watches for money-laundering schemes or money being sent to the United States for other criminal purposes.
- > It is monitoring money movement much more closely and the IRS is one of the tools that it is using to help protect U.S. citizens and their interests.

### The UBS scandal has created political pressure to enhance overseas enforcement efforts.

- > The UBS scandal: U.S. citizens investing or living abroad created foreign bank accounts with the Swiss bank and did not disclose the existence of these accounts or interest earned on them to the IRS.
- > UBS admitted responsibility in the case and in helping U.S. taxpayers conceal more than \$20 billion in offshore accounts from the U.S. government in an effort to avoid paying U.S. income tax.
- > In the agreement reached between the IRS, the U.S. Department of Justice, and the Swiss government, UBS turned over information on thousands of offshore accounts and names of account holders.
- > The IRS offered an amnesty program, which ended last year, to those who came forward to make voluntary disclosures and may criminally prosecute those who did not.

## The top five surprises

1. The U.S. income tax is globally assessed on residents irrespective of the source of their income or where the U.S. resident lives. This is particularly true for green card holders who are deemed to be residents of the United States for tax purposes even though they may live abroad and have numerous sources of foreign income.
2. The United States has a death tax assessed on domiciles and citizens of the United States and that tax is assessed on global assets irrespective of where the U.S. citizen or domicile dies.
3. The United States has a gift tax which is assessed on U.S. citizens or domiciles globally.

## Surprises recently resident U.S. persons face



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4. Our anti-deferral rules (controlled foreign corporation rules or the passive foreign investment company rules) govern many interests in foreign corporations that are privately held and may, when applied, produce current income to the shareholder, even in the absence of actual distributions.
5. Holding a green card for eight of the last 15 years can result in a global exit tax assessed on all global assets worldwide on a deemed sale basis if one gives up the green card after seven years and moves back to one's original foreign country of residence. This tax is assessed as if all global assets were sold at fair market value on the date of expatriation.

## U.S. international tax laws address a multitude of potentially taxable transactions that are engaged in by millions of entities worldwide, including:

- > Large multinational enterprises
- > U.S.-based companies operating internationally
- > Foreign-based companies operating in the United States
- > Non-resident individual investments in the United States
- > Individual U.S. investors' international investments
- > Individual U.S. residents residing abroad
- > Non-resident aliens residing in the United States

### **Individuals or companies, employers or employees, expatriates or the recently resident: Seek the best advice you can to be in compliance with U.S. international tax laws.**

- > In an increasingly complex world where borders are vanishing, it is incumbent that U.S. tax advisors understand the unique U.S. tax compliance and planning needs (and world views) of their expatriate and recently resident clients.
- > The IRS's legitimate and good-faith efforts at enhancing the level of compliance from such globally situate individuals will soon and directly impact their lives in a cross-border world.

## Some questions our international tax professionals ask:

- > Do you have foreign bank accounts?

*Failure to report on them annually can lead to a penalty of \$10,000 per year per bank account.*

- > Do you have interests in foreign privately-held corporations?

*Failure to report the presence of such interests can lead to a \$10,000 per year penalty for failure to file a Form 5471 for instance in the case of controlled foreign corporations.*

***Which scenario below is a  
“reportable event” and  
requires a Form 3520?***

- A. Receiving gifts from abroad in excess of 100,000 in any one year from any one donor or any one estate
- B. Receiving distributions from foreign trusts
- C. Creating or settling foreign trusts
- D. All of the above

## All three scenarios require the filing of IRS Form 3520 to report the transactions or gifts.

- > Though no actual tax may be due, failure to report the transactions or gifts can result in severe penalties.
- > The penalty for failure to report the creation of a foreign trust is 35% of the transfer to the trust.
- > Failure to report a distribution from a foreign trust results in a penalty of 35% of the value of any distribution.
- > Failure to report a foreign gift can be up to 25% of the value of the gift.

### Prepared remarks of IRS Commissioner Douglas Shulman before the 22nd Annual George Washington University International Tax Conference, December 10, 2009:

*The response to the voluntary disclosure program will have ramifications extending far beyond 2009. It will change the conversations that practitioners and tax return preparers will be having with many of their clients this coming tax filing season. Those taxpayers that sought advice from advisors, but chose not to come forward in the voluntary disclosure program, will once again have to confront whether they come clean and properly report these accounts.*

*We know that many preparers will be expanding their due diligence regarding offshore account issues, both regarding FBAR and income tax reporting. With both preparers and the IRS stepping up their efforts in the area, a “hide-in-the-sand” approach to reporting offshore accounts and income has become a much riskier calculus for U.S. taxpayers holding assets anywhere around the world.*

***Questions and comments***

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