Delays by IRS in Processing International Voluntary Disclosure Cases: Expatriations Thwarted, Estate Taxes Imposed, and Solutions Explored

By Hale E. Sheppard*

I. Introduction

Delays are inevitable when dealing with any large bureaucracy, like the IRS. Most of the time, excessive slowness by the IRS can be mitigated by filing a “protective” claim for refund to safeguard a position while a tax dispute is pending, making a cash deposit (instead of a payment) to stop the accrual of liabilities, nullifying IRS actions because they were taken outside the applicable assessment or collection period, submitting a claim for abatement of interest due to unreasonable postponements of ministerial duties, and more. However, certain delays by the IRS have serious consequences, and few effective ways for taxpayers to remedy them. This has occurred recently in connection with the offshore voluntary disclosure program (“OVDP”), for which the IRS stopped accepting applications in September 2018. While the OVDP is in the process of winding down, the unique problems that it has caused for certain taxpayers remain. This article analyzes issues triggered by the slow processing of OVDP cases by the IRS, as well as potential solutions.

II. Setting the Scene

The following hypothetical scenario places the problems in context.

The taxpayer, who we will call Accidental American Antonio, was born in the United States solely because his parents were temporarily working here for a foreign company. His parents were not U.S. citizens, not Green Card holders, and not considered U.S. persons for tax purposes because of the “substantial presence” test or any other reason. The parents were always non-resident aliens, even during their short work-related stay in the United States. Accidental American Antonio was a U.S. citizen by birth, but he did not enjoy the country for long. Indeed, he permanently returned with his parents, to their home country of

* Hale E. Sheppard is a Shareholder in the Tax Controversy Section of Chamberlain Hrdlicka and Chair of the International Tax Section.
Spain, when Accidental American Antonio was merely a few months old.

Accidental American Antonio remained in Spain the rest of his life, studying, working, marrying, paying taxes, and otherwise contributing to local society. Through a combination of hard work and good luck, Accidental American Antonio prospered in Spain, building a successful business and amassing considerable wealth.

One day, Accidental American Antonio receives a letter from one of the Spanish banks with which he has an account asking him, and presumably the rest of its accountholders, to confirm that he is not a U.S. person. Accidental American Antonio knew that he had been born in the United States and lived there a few brief months in his infancy, but he believed that this had no bearing on tax issues. How could it? He had been reporting all income and paying all required taxes in Spain his entire life, he had no assets outside of Spain, he only received income in Spain, and the only contact that he had with the United States consisted of periodic trips (business and pleasure) that resulted in him spending a total of about 40 days per year there, in hotels. To be certain, Accidental American Antonio had no education, training, or skills with respect to the unique worldwide system of taxation and reporting in the United States.

Alarmed by the letter from the bank, Accidental American Antonio consults his Spanish accountant. He had never inquired about tax matters beyond Spain because, as far as he knew, Accidental American Antonio was a full-blooded Spaniard, with the Real Madrid jersey to prove it. It is at this meeting that Accidental American Antonio learns, for the first time, that he has always had worldwide tax and information-reporting duties with the IRS solely because he had the fortune (or misfortune, depending on one’s perspective) of being born in the United States.

Accidental American Antonio is shocked, scared, and mad. His first instinct is to immediately expatriate from the United States to rid himself of these unwanted and unbefitting U.S. duties. However, after allowing his Spanish accountant to do some initial research, Accidental American Antonio learns that he cannot expatriate without first rectifying his past non-compliance. Therefore, he develops a two-step plan, consisting of getting in good standing with the IRS via the most appropriate method, and then expatriating as soon as possible thereafter. Accidental American Antonio starts to implement this plan by hiring U.S. tax professionals, discussing the available disclosure programs and eligibility requirements, gathering all relevant tax and financial data in Spain, and participating in the OVDP.¹

He was disappointed, though. After filing the application, receiving “pre-clearance” and then “preliminary acceptance” from the IRS, submitting all necessary U.S. returns and supporting documentation, and paying all required tax liabilities, the process stalled. It took many months for the OVDP case just to be assigned to a Revenue Agent. Then, the Revenue Agent did little more during the following months than demand that Accidental American Antonio “voluntarily” grant the IRS multiple extensions of the relevant assessment periods, by filing Forms 872 (Consent to Extend the Time to Assess Tax), or get “removed” from the OVDP for lack of cooperation.²

Unfortunately for Accidental American Antonio and his family, he died unexpectedly during this multi-year delay by the IRS in advancing the OVDP process. Thus, at the time of his death, Accidental American Antonio could not confirm U.S. tax compliance for the most recent five years because the IRS had not issued a Form 906 (Closing Agreement) under the OVDP. Therefore, he was unable to expatriate, and he was thus subject to U.S. estate tax on the value of his worldwide assets, including those in Spain.

Il III. Potential Solution

Taxpayers, like Accidental American Antonio, often face intransigence from the IRS in these types of situations. Applying a black-and-white thought process, the IRS focuses on just one fact: that is, Accidental American Antonio was a U.S. citizen at the time of his death, such that he must pay U.S. estate tax on his sizable assets in Spain. One novel strategy for countering the IRS’s rigid stance would be for the estate of Accidental American Antonio (“Estate”) to file a request for a private letter ruling (“PLR”) under Reg. §301.9100-3 to effectively make a retroactive Code Sec. 877A election, thereby allowing Accidental American Antonio to expatriate from the United States before his death as a result of the excessive delays by the IRS in processing his OVDP case. This article examines, below, three rationales on which such a PLR request might be based.

A. First Rationale—Code Sec. 877A and Reg. §301.9100-3

1. Extensions to File Elections

a. In General. Reg. §§301.9100-1 through 301.9100-3 are the IRS’s procedural and administrative regulations allowing taxpayers to obtain extensions of time to make certain elections and apply for tax relief. In formulating the
standards for granting an extension, the IRS identified two policies that must be balanced. The first policy is promoting efficient tax administration by providing limited time periods for taxpayers to choose among alternative tax treatments and encouraging prompt tax reporting. The second policy is “permitting taxpayers that are in reasonable compliance with the tax laws to minimize their tax liability by collecting from them only the amount of tax they would have paid if they had been fully informed and well advised.”

Reg. §§301.9100-1 through 301.9100-3 contemplate three types of “elections.” First, the term “regulatory election” means one whose due date is set by a regulation published in the Federal Register or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin. Second, the term “statutory election” means one whose due date is contained in a statute. Third, the term “election” is broadly defined as an application for relief from tax or a request to adopt, change, or retain an accounting method or accounting period. The phrase “application for relief from tax” has been defined by the IRS to possess its ordinary and usual meaning, and includes actions taken by a taxpayer (other than elections) in compliance with a regulation, revenue ruling, revenue procedure, or published notice, at least in part to avoid the imposition of taxes.

If the deadline for a particular election has passed, taxpayers may request an extension of time to file a late election under the requirements of Reg. §301.9100-3.

b. Relief Under Reg. §301.9100-3. Extension requests “will be granted” by the IRS when the taxpayer provides the evidence (including the requisite affidavits) to establish to the satisfaction of the IRS that the following two factors have been met: (i) the taxpayer acted reasonably and in good faith, and (ii) granting the extension will not prejudice the interests of the U.S. Government. These two factors are examined below.

i. First Factor—Reasonably and in Good Faith. With respect to the first factor, a taxpayer is generally deemed to have acted reasonably and in good faith if one of the following is true:

- The taxpayer reasonably relied on the written advice of the IRS; or
- The taxpayer reasonably relied on a qualified, informed tax professional, and the tax professional failed to make, or advise the taxpayer to make, the election.

Notwithstanding the general rules described above, a taxpayer will be deemed not to have acted reasonably and in good faith if any of the following is true:

- The taxpayer seeks to alter a return position for which an accuracy-related penalty has been or could be imposed under Code Sec. 6662 at the time the taxpayer requests relief (taking into account any “qualified amended return” filed), and the new position requires or permits a regulatory election for which relief is requested; or
- The taxpayer was informed in all material respects of the required election and related tax consequences, but chose not to file the election; or
- The taxpayer uses hindsight in requesting relief. In other words, if specific facts have changed, since the due date for making the election, that make the election advantageous to a taxpayer, the IRS will not ordinarily grant relief. In such cases, the IRS will grant an extension request only when the taxpayer provides strong proof that the taxpayer’s decision to seek relief did not involve hindsight.

ii. Second Factor—Government’s Interests Not Be Prejudiced. With respect to the second element, the IRS applies two standards in determining whether the interests of the U.S. Government would be prejudiced by the granting of an extension request. First, the interests of the U.S. Government are prejudiced if granting the extension request would result in a taxpayer (or taxpayers) having a lower tax liability in the aggregate, for all taxable years affected by the election, than the taxpayer (or taxpayers) would have had if the election had been timely made, taking into account the time value of money. Second, the interests of the U.S. Government are ordinarily prejudiced if the taxable year in which the regulatory election should have been made, or any taxable years that would have been affected by the election, than the taxpayer (or taxpayers) would have had if the election had been timely made, are closed by the general period of limitations on assessment before the taxpayer receives an IRS ruling granting the extension request.

2. Overview of Expatriation and Code Sec. 877A

a. Relevant History. In 1966, Congress enacted the U.S. expatriation tax rules to discourage U.S. citizens...
from moving abroad and surrendering their citizenship in order to avoid paying U.S. taxes. The specific tax provisions created to further this congressional objective were Code Secs. 871 and 877. Code Sec. 877 originally imposed taxes on certain U.S. individuals who surrendered their U.S. citizenship within the prior 10 years with a tax-avoidance purpose. Later, in 1966, Congress revised Code Sec. 877 to cover long-term residents (“LTRs”) who terminated their residency, and imposed information-reporting requirements under Code Sec. 6039G. The IRS provided guidance about the rules of Code Sec. 877 in Notice 97-19. In 2004, Congress again revised Code Sec. 877 based on various recommendations from the Joint Committee on Taxation. Finally, in 2008, Congress made its final revision thus far by replacing Code Sec. 877 with a new provision, Code Sec. 877A. The IRS has not yet issued regulations concerning Code Sec. 877A, and the main guidance is found in Notice 2009-85. Code Sec. 877A is described in more detail below.

**b. Code Sec. 877A Generally.** Code Sec. 877A generally imposes a mark-to-market tax regime on certain taxpayers who decide to “expatriate.” These taxpayers generally must pretend to sell all their property at fair market value the day before their “expatriation date” and pay the corresponding U.S. income taxes on any gains. This so-called “exit tax” applies only to “covered expatriates.” Thus, in order for the “exit tax” to apply, a taxpayer must be not only an “expatriate,” but also a “covered expatriate.”

**c. Expatriate/U.S. Citizen.** The term “expatriate” means either a U.S. citizen who relinquishes his citizenship, or an LTR who ceases to be a “lawful permanent resident” of the United States. The IRS’s Instructions to Form 8854 (Initial and Annual Expatriation Statement) contain the following guidance determining the act of expatriation: “You are considered to have expatriated on the date you relinquished your citizenship (in the case of a former citizen) or terminated your long-term residency status (in the case of a former U.S. resident).”

A U.S. citizen is treated as relinquishing his U.S. citizenship on the earliest of the following dates: (i) The individual renounces his U.S. nationality before a diplomatic or consular office; (ii) The individual furnishes to the Department of State a signed statement of voluntary relinquishment of U.S. nationality; (iii) The Department of State issues to the individual a certificate of loss of U.S. nationality; or (iv) A U.S. court cancels a naturalized citizen’s certificate of nationalization.

**d. Expatriation Date.** The “expatriation date” for a U.S. citizen is the date he relinquishes U.S. citizenship under one of the four methods described above.

**e. Covered Expatriate and Exceptions.** For purposes of Code Sec. 877A, the term “covered expatriate” means an “expatriate” who either has an average annual U.S. income tax liability for the past five years of a particular amount (“Tax Liability Test”), or who has a net worth exceeding a certain threshold (“Net Worth Test”), or who cannot certify to the IRS that he has been in full U.S. tax compliance for the past five years (“Certification Test”). If the “expatriate” fails even one of the preceding three tests, then he will be considered a “covered expatriate.”

**f. Exceptions to Covered Expatriate Status.** There are two exceptions to classification as a “covered expatriate.” An individual shall not be treated as a “covered expatriate,” and thus shall not be subject to exit tax, if that individual either:

- Became at birth both a U.S. citizen and a citizen of another country and, as of the expatriation date, continues to be a citizen of, and is taxed as a resident of, such other country, and has not been a U.S. resident because of the “substantial presence” test for more than 10 taxable years during the 15-taxable-year period ending with the taxable year during which expatriation occurs,

- The individual’s relinquishment of U.S. citizenship occurs before such individual attains age 18 and the individual has not been a U.S. resident for more than 10 taxable years before the date of relinquishment.

According to relevant congressional reports, the two exceptions set forth above were created in order to relieve from the exit tax individuals whose principal purpose for expatriating was not tax avoidance and who were previously unaware of their status as U.S. citizens. Those falling into this category are often referred to as “accidental Americans.”

**g. Requirement to File Form 8854.** U.S. citizens who relinquish their U.S. citizenship, and who are subject to the Code Sec. 877A rules (even if they are exempt from the exit tax), must file a Form 8854 either (i) as soon as possible after expatriation, or (ii) by the due date for the first Form 1040NR (U.S. Nonresident Alien Income Tax Return). As explained above, U.S. citizens remain subject to tax as U.S. citizens until they formally relinquish their citizenship with the appropriate U.S. Government authorities or file Form 8854.
The need to file Form 8854 is explained in various sources. For instance, Code Sec. 6039G(a) generally states that any individual to whom Code Sec. 877A applies for any taxable year shall provide a statement (i.e., Form 8854) for such year, which includes the basic information described in the statute, plus “such other information as the [IRS] may prescribe.” The IRS has not issued regulations yet, so taxpayers must look to Notice 2009-85. It explains that a “covered expatriate” is an expatriate who meets the Tax Liability Test, who meets the Net Worth Test, or who cannot meet the Certification Test. It expands on the third aspect, as follows:

A taxpayer is a covered expatriate if he “fails to certify, under penalties of perjury, compliance with all U.S. federal tax obligations for the five taxable years preceding the taxable year that includes the expatriation date, including, but not limited to, obligations to file income tax, employment tax, gift tax, and information returns, if applicable, and obligations to pay all relevant tax liabilities, interest, and penalties (the ‘certification test’). This certification must be made on Form 8854 and must be filed by the due date of the taxpayer’s federal income tax return for the taxable year that includes the day before the expatriation date.”

Notice 2009-85 contains additional language confirming the need for taxpayers to file Form 8854 to demonstrate requisite U.S. tax compliance during the relevant period. Below are a few of the many instances:

Certification of compliance with tax obligations for preceding five years. All U.S. citizens who relinquish their U.S. citizenship … must file Form 8854 in order to certify, under penalties of perjury, that they have been in compliance with all federal tax laws during the five years preceding the year of expatriation. Individuals who fail to make such certification will be treated as covered expatriates within the meaning of Code Sec. 877A(g), whether or not they also meet the tax liability test or the net worth test.

Example 22. A relinquishes his citizenship on December 1, 2009. Under Code Sec. 877A(a)(1), A is deemed to have sold all of A’s property on November 30, 2009, the day before the expatriation date. A must certify on a Form 8854 filed with Form 1040NR for the 2009 taxable year that he has complied with all of his federal tax obligations for 2004 through 2008. For the portion of the taxable year that includes the day before the expatriation date, A must attach a Form 1040 (or other schedule, as provided in Reg. §1.6012-1(b)(2)(ii)(b)) to his Form 1040NR. If A does not file Form 8854, A will be treated as a covered expatriate, even if A does not meet the tax liability test or the net worth test.

Like Notice 2009-85, Form 8854 itself clarifies that filing is mandatory for U.S. citizens desiring to leave the United States behind. Form 8854 poses the following question: “Do you certify under penalties of perjury that you have complied with all of your tax obligations for the 5 preceding tax years (see instructions)?” Taxpayers uncertain about the question can turn to the corresponding instructions from the IRS, which state the following:

Check the “Yes” box if you have complied with your tax obligations for the 5 tax years ending before the date on which you expatriated, including, but not limited to, your obligations to file income tax, employment tax, gift tax, and information returns, if applicable, and your obligations to pay all relevant tax liabilities, interest, and penalties. You will be subject to tax under Code Sec. 877A if you have not complied with these obligations, regardless of whether your average annual income tax liability or net worth exceeds the applicable threshold amounts.

3. Expatriation and Relief Under Reg. §301.9100-1 et seq.

Notice 97-19, which was the guidance issued by the IRS in connection with former Code Sec. 877, provided taxpayers the ability to obtain relief under Reg. §301.9100-1 et seq. for certain U.S. expatriation issues. Specifically, because Code Sec. 877 required not only relinquishing U.S. citizenship, but also doing so without a tax-avoidance purpose, many taxpayers filed PLR requests to rebut the presumption that they were leaving to avoid U.S. taxes. Since 1997, the IRS has reviewed over 250 such PLR requests. Although the rules of Code Sec. 877 differ from the current rules of Code Sec. 877A, these PLRs support the notion that expatriation and the related tax issues constitute “elections” for purposes of Reg. §301.9100-1 et seq.

B. Second Rationale—Remedying Harm Caused by IRS

Harm caused to taxpayers by the IRS comes in many forms. The IRS, along with the Tax Court, have
recognized that although this can occur unintentionally, rules must be in place to afford a remedy to affected taxpayers. Specific types of harm to taxpayers caused by the IRS include, but are not limited to, (i) excessive tax assessments, (ii) delays, and (iii) disparate treatment among the same class of taxpayers. These three types of harm are discussed below.

1. Excessive Assessments

Generally, Code Sec. 6404(a) provides relief for taxpayers when the IRS assesses certain excessive, illegal, or erroneously assessed tax liabilities. Specifically, it authorizes the IRS to abate the portion of the assessment of any liability that is excessive in amount, assessed after the expiration of the relevant statute of limitations, or assessed erroneously or delay occurs after the IRS has contacted the taxpayer or to a person related to the taxpayer; and (vi) The error or delay is attributable to the taxpayer or to a person related to the taxpayer; and (v) The error or delay occurs after the IRS has contacted the taxpayer in writing with respect to a deficiency. According to congressional reports and case law, Code Sec. 6404(e) was enacted to provide abatement in cases where it “would be widely perceived as grossly unfair” to penalize taxpayers and force them to pay interest resulting from an IRS delay.

The term “ministerial act” means a procedural act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer’s case after all the prerequisites to the act, such as conferences and review by supervisors, have taken place. Issuing either a notice of deficiency or a notice and demand for payment after all procedural and substantive preliminaries have been completed constitutes a “ministerial act.” Similarly, once a tax liability has been determined, the assessment of the tax is a “ministerial act.”

The term “managerial act” means an administrative act that occurs during the processing of a taxpayer’s case involving the temporary or permanent loss of records or the exercise of judgment or discretion relating to management of personnel. For example, assigning only one employee to multiple cases such that review and settlement is extremely delayed constitutes a managerial error. Code Sec. 6404(e) authorizes the IRS to abate interest during the period in which the settlement of a case is set aside as the result of a managerial error.

b. Confirmation of Delays Caused by IRS.

The Treasury Inspector General for Tax Administration (“TIGTA”), Taxpayer Advocate Service (“TAS”), and various tax practitioners have confirmed the delays caused by the IRS in connection with the voluntary disclosure programs, including the OVDP.

In its 2011 report to Congress, TAS stated its concern that the IRS’s international tax administration was “one-sided” and focused on stepped-up enforcement without any corresponding increase in services. The report described the voluntary disclosure initiatives as “poorly designed” and stated there was a lack of transparency and inadequate taxpayer service, caused at least in part by a lack of coordination with the international taxpayer service. The TAS report called for “greater internal coordination and strategic, service wide direction of international taxpayer service.”

In 2012, TAS cited similar concerns. It expressed concern that the IRS had increased the burden and cost for taxpayers to correct past violations through voluntary disclosure programs and forced taxpayers to either opt in or opt out of the OVDP, which increased processing times. The “average” processing time was 550 days (i.e., over a year and a half) for those opting out of the relevant

2. Delay

a. Description of Code Sec. 6404(e) and Relevant Regulations. Code Sec. 6404(e)(1)(A) provides that the IRS may abate part or all of an assessment of interest under the following circumstances: (i) There was an error or delay; (ii) Such error or delay was unreasonable; (iii) The error was made, or the delay was caused, by an officer or employee of the IRS who was acting in his/her official capacity; (iv) The employee or officer was performing a ministerial act or a managerial act; (v) No significant aspect of the error or delay is attributable to the taxpayer or to a person related to the taxpayer; and (vi) The error or delay occurs after the IRS has contacted the taxpayer.
Expatriation elections can be made for three types of U.S. persons under Code Sec. 877A. First, Green Card holders who are not LTRs, and who are residents of a foreign country, can simply make an election on Form 1040NR and Form 8833 (Treaty-Based Return Position Disclosure), pursuant to an applicable tax treaty, to expatriate from the United States for the entire year for which the forms are filed.72 For example, Green Card holders for the past five years can file their 2015 Form 1040 by April 15, 2016, making an expatriation election under Code Sec. 877A, effective as of January 1, 2016. This essentially allows a “retroactive” expatriation election, and these individuals are not subject to the exit tax under Code Sec. 877A and are not required to file Form 8854.73 Moreover, because these individuals would be considered to have elected to expatriate as of January 1, 2016, they would not be subject to U.S. federal estate tax if they died in 2016.

Second, individuals who are considered U.S. residents by virtue of their “substantial presence” in the United States are able to file a Form 1040NR attaching a statement establishing their U.S. residency termination date and effectively expatriate “retroactively” from the United States. For example, U.S. residents who had a “substantial presence” in the United States for the past five years can file their 2015 Forms 1040NR by April 15, 2016, with the attached statement, and the IRS will not treat them as a U.S. resident past January 1, 2016. These individuals are not subject to the exit tax under Code Sec. 877A and are not required to file Form 8854.74 Moreover, because these individuals would be considered to have elected to expatriate as of January 1, 2016, they would not be subject to U.S. federal estate tax if they died in 2016.

Third, individuals who are U.S. citizens by birth, including “accidental Americans” who were born in the United States solely because their parents were in the United States temporarily, must formally relinquish U.S. citizenship and file a Form 8854 certifying that they have been U.S. tax compliant for the last five years. These requirements even apply to those U.S. citizens who have never resided in the United States for any substantial amount of time, as well as to those who have been specifically exempted from the exit tax under Code Sec. 877A.75 As a result, these “accidental Americans” are forced to spend a considerable amount of time and money to become U.S. tax compliant for at least the most recent five years, generally through voluntary disclosure programs like the OVDP, in order to comply with the requirements for a valid expatriation for U.S. tax purposes. Moreover, these “accidental Americans” are deprived of the opportunity, which is available to many Green Card Holders and U.S. residents because of the “substantial presence” test, to effectively fix the expatriation date retroactively.
C. Third Rationale—Consistency with Tax Policy

The Obama Administration, made aware of the unfair treatment of accidental Americans, proposed legislation that would provide relief to dual-citizens meeting certain criteria.\(^76\) Specifically, as part of the “revenue proposals” for 2016, the Obama Administration recognized that “individuals who became citizens of both the United States and another country at birth may have had minimal contact with the United States and may not learn until later in life that they are U.S. citizens.”\(^77\) It also acknowledged that, in order for these individuals to relinquish their U.S. citizenship in accordance with current law, many would be subject to significant U.S. taxes.\(^78\) To correct this situation, the Obama Administration proposed an exception, which would exempt an individual from the exit tax under Code Sec. 877A if he meets the following criteria:

- Became at birth a U.S. citizen and a citizen of another country;
- At all times, up to and including the individual’s expatriation date, has been a citizen of a country other than the United States;
- Has not been a U.S. resident because of the “substantial presence” test since attaining age 18;
- Has never held a U.S. passport, or has held a U.S. passport for the sole purpose of departing from the United States;
- Relinquishes his U.S. citizenship within two years after the later of January 1, 2016, or the date on which the individual learns that he is a U.S. citizen; and
- Certifies under penalties of perjury his compliance with all U.S. federal tax obligations that would have applied during the five years preceding the year of expatriation if the individual had been a non-resident alien during that period.\(^79\)

The exception proposed by the Obama Administration, above, is similar to the existing exceptions in Code Sec. 877A(g)(1)(B), which liberates from the exit tax those individuals who (i) became at birth a U.S. citizen and a citizen of another country, and as of the expatriation date, continues to be a citizen of, and is taxed as a resident of, such other country, and has not been a U.S. resident because of “substantial presence” for more than 10 taxable years during the 15-taxable-year period ending with the taxable year during which expatriation occurs, or (ii) the individual’s relinquishment of U.S. citizenship occurs before such individual attains age 18 and the individual has not been a U.S. resident for more than 10 taxable years before the date of relinquishment.

The major difference in the proposal by the Obama Administration is the last requirement. The individual would only need to have complied with U.S. tax reporting for income from U.S. sources, if we were to assume that he were a non-resident alien, instead of a U.S. person. This means that the individual would not have needed to report worldwide income to the IRS, disclosed information about foreign assets, etc. Rather, he only would have been required to report to the IRS all income derived from U.S. sources, which likely would be $0 if he were truly an “accidental American.” Thus, individuals electing to expatriate under the proposal by the Obama Administration would not need to participate in the OVDP, and would not be subject to detrimental multi-year delays by the IRS.

IV. Application of the Three Rationales Accidental American Antonio

A. First Rationale—Reg. §301-9100-3 Applies to Expatriation Elections

1. Expatriation Constitutes a “Regulatory Election”

As explained above, the IRS has discretion to grant a reasonable extension, pursuant to Reg. §301.9100-3, to make certain “regulatory elections.”\(^80\) Also, as explained above, the term “regulatory election” means one whose due date is set by a regulation published in the Federal Register or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.\(^81\) The due date for expatriating by filing Form 8854 originates in Notice 2009-85, thereby making it a “regulatory election.”\(^82\) The relevant portion of the document, titled “Filing and Reporting Requirements,” and featuring subsections called “Initial Filing Obligations for the Year of Expatriation” and “Time and Manner of Filing Form 8854,” confirms that taxpayers must utilize Notice 2009-85 to determine due dates and other aspects of compliance:

Background … The Treasury Department and the IRS intend to issue regulations under Code Sec. 877A that will require covered expatriates who are
liable for tax under Code Sec. 877A to report certain information in connection with their expatriation. Until the issuance of such regulations, covered expatriates must report information in compliance with the rules set forth in this notice and any other information that the IRS may require.

Because the election to expatriate under Code Sec. 877A is a “regulatory election,” Accidental American Antonio can request an extension under Reg. §301.9100-3.

2. Analysis of Standards

Extension requests “will be granted” by the IRS when the taxpayer demonstrates that the following two factors have been met: (i) the taxpayer acted reasonably and in good faith, and (ii) granting the extension will not prejudice the interests of the U.S. Government.83 Both of these elements are met in Accidental American Antonio’s case.

a. First Factor—Acting Reasonably and in Good Faith.

A taxpayer generally is deemed to have acted reasonably and in good faith if any one of five factors is met.84 Here, three of these factors have been satisfied.

First, Accidental American Antonio is requesting an extension to make the expatriation election with respect to Code Sec. 877A before the IRS has discovered his failure to make the election. To date, the IRS has not communicated with Accidental American Antonio or his Estate about this issue.

Second, Accidental American Antonio failed to make the election because of events beyond his control, including (i) the IRS requirement that he participate in a voluntary disclosure program to rectify his past, unintentional U.S. tax non-compliance, (ii) his inability to make an election under Code Sec. 877A because of the requirement on Form 8854 for him to certify to full U.S. tax compliance, as a U.S. citizen (as opposed to as a non-resident alien) for the last five years before expatriating, (iii) the IRS’s multi-year delay in processing his OVDP submission, and (iv) his unexpected and untimely death while waiting for the IRS to process his OVDP submission, conduct the required certification/audit/review of his Voluntary Disclosure Packet, and, ultimately, issue the Form 906 (i.e., Closing Agreement) confirming tax compliance during the OVDP period.

Third, Accidental American Antonio failed to make the expatriation election before his untimely death because, even after exercising reasonable diligence to maintain tax compliance in his home country, Spain, for his entire life, Accidental American Antonio was unaware of his U.S. tax non-compliance, the steps necessary to rectify it, and the ability and need to make an expatriation election under Code Sec. 877A. As discussed above, Accidental American Antonio was unaware of his U.S. tax non-compliance until shortly before he started participating in the OVDP because (i) he is a U.S. citizen solely because he was born here by happenstance, (ii) his entire family consists of Spanish citizens and residents, (iii) he had been reporting all income and paying all required taxes in Spain his entire life, (iv) he had no assets outside of Spain, (v) he only received income in Spain, (vi) the only contact that he had with the United States was related to short-term business trips, and (vii) he had no education, training, or skills with respect to the unique worldwide system of taxation and reporting in the United States.

After filing the application for the OVDP, receiving “pre-clearance” and then “preliminary acceptance” from the IRS, submitting all necessary U.S. returns and supporting documentation, and paying all required tax liabilities, the process stalled for Accidental American Antonio. It took many months for the OVDP case just to be assigned to a Revenue Agent. Then, the Revenue Agent did little more during the following months than demand that Accidental American Antonio grant the IRS extensions of the relevant assessment periods.

Accidental American Antonio died during this extended waiting period. In other words, due to the delay by the IRS in advancing the OVDP process and thus confirming U.S. tax compliance by Accidental American Antonio for the most recent five years by issuing a Form 906 (i.e., Closing Agreement), Accidental American Antonio was unable to expatriate, as planned, before his unexpected death. As a result, Accidental American Antonio was considered a U.S. citizen upon death, and is detrimentally subjected to U.S. estate tax.

Notwithstanding that Accidental American Antonio meets the general rules described above, Reg. §301.9100-3(b)(3) provides that a taxpayer will still be deemed not to have acted reasonably and in good faith if any one of three factors is met. Here, none of these factors is present. First, Accidental American Antonio is not seeking to alter a return position for which an accuracy-related penalty under Code Sec. 6662 has been or could be imposed because an expatriation election under Code Sec. 877A is not subject to such penalties, and, in all events, there was reasonable cause for the oversight and Accidental American Antonio acted in good faith.85 Second, Accidental American Antonio was not informed in all material respects about the
expatriation election under Code Sec. 877A and simply opted not to make it. As an “accidental American,” he was unaware of the expatriation election until just before applying for the OVDP, and he would not be eligible to make the expatriation election until he completed the OVDP and received the fully-executed Form 906 (i.e., Closing Agreement) from the IRS. Third, Accidental American Antonio is not using hindsight in requesting an extension.

b. Second Factor—Granting the Extension Will Not Cause Prejudice. Even if a taxpayer acts reasonably and in good faith, an extension will not be granted if the interests of the U.S. Government would be prejudiced by doing so.86 Allowing Accidental American Antonio to make an expatriation election before his death will not prejudice the U.S. Government’s interests because it would not result in a lower tax liability in the year affected by the election if the election had been made when Accidental American Antonio discovered his unintentional U.S. tax non-compliance and began participating in the OVDP. Accidental American Antonio would have been considered a non-resident alien at the time of death either way.

B. Second Rationale—Curing Harm Caused by IRS Delay

Failing to grant Accidental American Antonio’s request would result in an excessive tax liability. If the IRS were not to allow Accidental American Antonio to make an expatriation election, the tax imposed upon death would be excessive under Code Sec. 6404(a), as expanded and clarified by the Tax Court in H & H Trim & Upholstery Co., Inc. and The Law Offices of Michael B.L. Hepps.

In addition, the IRS should grant relief because the inability of Accidental American Antonio to make an expatriation election back when he began the OVDP is direct result of the delays caused by the IRS. The following requirements under Code Sec. 6404(a) have been met in Accidental American Antonio’s case: (i) There was an error or delay; (ii) Such error or delay was unreasonable; (iii) The error was made, or the delay was caused, by the IRS acting in its official capacity; (iv) The IRS was performing a ministerial act or a managerial act of assigning an OVDP case to a Revenue Agent and having such Revenue Agent process it; (v) No significant aspect of the error or delay is attributable to Accidental American Antonio or to a person related to him; and (vi) The error or delay occurred after Accidental American Antonio voluntarily approached the IRS regarding a deficiency, and the IRS confirmed that Accidental American Antonio was participating in the OVDP by sending a “pre-clearance letter” and a “preliminary acceptance letter” for the OVDP. As explained earlier in this PLR request, numerous reports from TIGTA and TAS describe the excessive delays by the IRS in processing cases submitted by taxpayers, like Accidental American Antonio, under the OVDP. Furthermore, imposing the additional tax on Accidental American Antonio resulting from the excessive delays by the IRS “would be widely perceived as grossly unfair.”87

C. Third Rationale—Disparate Treatment of Taxpayers

As explained above, an individual can be considered a “U.S. person” for federal tax purposes if he is a U.S. citizen, he is a Green Card holder, or he has a “substantial presence” in the United States. Taxpayers falling into all three categories are considered “U.S. persons,” but the options available to them for making an election to expatriate under Code Sec. 877A differ drastically. Also, as explained above, many Green Card holders, as well as individuals who are considered U.S. residents by virtue of their “substantial presence” in the United States, can essentially file a retroactive expatriation election (i.e., filing by April 15 of Year 2 to confirm expatriation as of December 31 of Year 1), which might allow them to avoid being subject to the U.S. estate tax if they died in Year 2.

By contrast, “accidental Americans,” like Accidental American Antonio, who were born in the United States solely because their parents were in the United States temporarily, must formally relinquish U.S. citizenship and file a Form 8854 certifying that they have been U.S. tax compliant for the last five years. Consequently, these “accidental Americans” are forced to spend a considerable amount of time, effort, and money to become U.S. tax compliant for at least the most recent five years, generally through voluntary disclosure programs like the OVDP, in order to comply with the requirements for a valid expatriation for U.S. tax purposes. Moreover, these “accidental Americans” are deprived of the opportunity, available to many Green Card holders and U.S. residents because of “substantial presence,” to effectively fix the expatriation date retroactively. The IRS should grant relief to Accidental American Antonio in order to avoid this disparate, unjust treatment, of similarly-situated taxpayers.

Granting relief to Accidental American Antonio under Reg. §301.9100-3 would also be consistent with the recent legislative proposal by the Obama Administration for “accidental Americans.” The Obama Administration
proposed an exception, which would exempt individuals from the exit tax under Code Sec. 877A, if they meet the following criteria: Became at birth both a U.S. citizen and a citizen of another country; At all times, up to and including the individual’s expatriation date, has been a citizen of a country other than the United States; Has not been a U.S. resident because of “substantial presence” since attaining age 18; Has never held a U.S. passport, or has held a U.S. passport for the sole purpose of departing from the United States; Relinquishes his U.S. citizenship within two years after the later of January 1, 2016, or the date on which the individual learns that he is a U.S. citizen; and Certifies under penalties of perjury his compliance with all U.S. tax obligations that would have applied during the five years preceding the year of expatriation, if the individual had been a non-resident alien (instead of a U.S. person) during that period.88

ENDNOTES

8 Hale E. Sheppard specializes in tax audits, tax appeals, and tax litigation. You can reach Hale by phone at (404) 658-5460 or by email at hale.sheppard@chamberlainlaw.com.

9 Please note that, despite the fact that his violations were non-willful, Accidental American Antonio was ineligible for all voluntary disclosure programs, other than the OVDP: (i) He was ineligible for the Streamline Foreign Offshore Procedure because he was not physically outside the United States for at least 330 full days during one of the three most recent closed years; (ii) He was ineligible for the Streamline Domestic Offshore Procedure because he did not file a timely and accurate or incomplete Form 1040 for the past three closed years; and (iii) He was ineligible for the Delinquent International Information Return Submissions Procedure and the Delinquent FBAR Submissions Procedure because his sole violation was not the failure to file these types of returns, as he also had unreported income.

2 Revenue Agents generally make such demands for Forms 872 pursuant to the Frequently Asked Questions (“FAQs”) issued by the IRS as guidance for the OVDP. FAQ 443 states the following: “Will I be required to complete and sign agreements to extend the period of time to assess tax (including tax penalties) and to assess FBAR penalties for any years that are otherwise set to expire while my voluntary disclosure is being processed by the IRS? Yes. Properly completed and signed agreements to extend the period of time to assess tax (including tax penalties) and to assess FBAR penalties are required to be submitted as part of the voluntary disclosure package.”

XII. Conclusion

As this article demonstrates, long delays by the IRS in processing and concluding OVDP cases can be deadly for taxpayers, and then financially deadly for their estates after that. Given that hundreds of thousands of taxpayers applied for the OVDP, a large number of cases resulted in multi-year delays by the IRS, and many disclosures were made by elderly taxpayers, the events surrounding Accidental American Antonio cannot be singular. Taxpayers, estates, and advisors in similar situations might implement the strategies and legal theories addressed in this article, because being subjected to the U.S. estate tax, after pro-actively approaching the IRS to rectify past non-compliance and then immediately expatriate (on a tax-free basis), is a bitter pill to swallow.
DELAYS BY IRS IN PROCESSING INTERNATIONAL VOLUNTARY DISCLOSURE CASES


30 TIGTA Report 2016-30-030 (June 2, 2016).


30 Code Sec. 7701(b)(1)(A)(ii) and Code Sec. 7701(b)(3).

30 Code Secs. 877(a), 877(e)(2), and 877(g).

30 Code Secs. 877(a), 877(e)(2), and 877(g).

30 Code Sec. 877(g)(1)(B)(ii) and (II).

30 General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals, Department of Treasury, p. 282 (Feb. 2015).

30 General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals, Department of Treasury, p. 282 (Feb. 2015).

30 General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals, Department of Treasury, p. 283 (Feb. 2015).

30 General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals, Department of Treasury, p. 283 (Feb. 2015).

30 Code Sec. 6664(a).

30 Code Sec. 6664(a).

30 Reg. §301.6404-1(a).


30 Code Sec. 6640(e)(1)(A).


30 Reg. §301.6404-2(b)(2).


30 Notice 2009-85, 2009-45 IRB 598, Section 8 (A through C).

30 Reg. §301.9100-1(b).

30 Reg. §301.9100-3(b)(1).

30 Reg. §301.9100-3(b)(1).

30 Reg. §301.9100-3(b)(1).

30 Code Sec. 6664(c)(1), Reg. §301.6664-4(a).

30 Code Sec. 6664(c)(1), Reg. §301.6664-4(a).

30 Code Sec. 6664(c)(1), Reg. §301.6664-4(a).

30 Code Sec. 6664(c)(1), Reg. §301.6664-4(a).

30 Code Sec. 6664(c)(1), Reg. §301.6664-4(a).

30 Code Sec. 6664(c)(1), Reg. §301.6664-4(a).

30 Code Sec. 6664(c)(1), Reg. §301.6664-4(a).

30 Code Sec. 6664(c)(1), Reg. §301.6664-4(a).

30 Code Sec. 6664(c)(1), Reg. §301.6664-4(a).

30 Code Sec. 6664(c)(1), Reg. §301.6664-4(a).

30 Code Sec. 6664(c)(1), Reg. §301.6664-4(a).

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