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The Rise and Fall of Malta Pensions: Taxpayer Positions, IRS Enforcement, and Remaining Solutions

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In this article, Sheppard examines how U.S. tax treatment of foreign pensions has changed recently in an effort to tackle alleged abuse of Maltese retirement plans, and he outlines resolution options still available to taxpayers.

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Imagine a world where you can create a personal retirement plan in a foreign country with which you have no affiliation, contribute cash or appreciated property to the plan without triggering immediate taxation, face no limitations on contribution amounts or sources, defer taxes on the passive income accumulating inside the plan, start taking distributions as early as age 50, and completely avoid tax on most plan distributions. Sounds good, right? Well, many U.S. taxpayers, relying on flexible interpretations of the Malta-U.S. tax treaty, did just that for several years. The IRS put its proverbial foot down in December 2021, announcing that taxpayers were misconstruing the treaty and that its civil and criminal divisions are committed to pursuing those who participated in or promoted abuses.

This article explains the general U.S. tax treatment of foreign pensions, key aspects of the treaty and Maltese law, the recent competent authority arrangement (CAA) to halt future activity, IRS enforcement actions, and options for affected taxpayers.[1]

I. U.S. Treatment of Foreign Retirement Plans

A. Generally

The rules regarding U.S. treatment of foreign retirement plans are complex, obscure, and inconsistent. A recent study by the Government Accountability Office (GAO-18-19) concludes as much and criticizes the IRS for allowing that to occur.[2]

The GAO report explains that in the United States, contributions by employees and employers to a "qualified" retirement plan, as well as passive earnings (such as interest, dividends, and capital gains) in a plan, generally are not taxed until the

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[1] *See* IRS, "United States, Malta Sign a Competent Authority Arrangement Confirming Pension Fund Meaning" (IR-2021-253) (Dec. 21, 2021).

[2] *See also* Veena K. Murthy, "Selected Cross-Border Equity and Deferred Compensation Issues With Fund Foreign Plans," 42 *Compensation Plan. J.* 67 (Apr. 2014); Lawrence J. Chastang and Steve Yeager, "Foreign Pensions and Florida Practitioners," *Florida CPA Today* (May/June 2013); Cynthia Blum, "Migrants With Retirement Plans: The Challenge of Harmonizing Tax Rules," 17(1) *Fla. Tax Rev.* (2015).

taxpayer receives distributions. The IRC ordinarily does not consider foreign retirement plans to be qualified plans. Accordingly, depending on the characteristics of the plan, local law, and terms of any applicable treaty, U.S. individuals who participate in foreign retirement plans might be currently taxed on plan contributions, accrued-but-undistributed earnings, and distributions not actually received (such as transfers of assets between foreign plans).

The GAO report acknowledges that the IRS has provided limited guidance about foreign retirement plans, such as the International Tax Gap Series and Publication 54, "Tax Guide for U.S. Citizens and Resident Aliens Abroad." However, it points out that neither item describes how taxpayers are to determine whether their foreign plans are eligible for tax-deferred status, or how to account for contributions, earnings, or distributions on their U.S. tax returns, "particularly whether and when contributions and earnings should be taxed as income."

The GAO report confirms the IRS's position that foreign retirement plans generally are not considered qualified plans for U.S. tax purposes and thus are not entitled to the corresponding tax-deferral benefits. It says that is true even if the plans are considered tax-deferred in the country where they were established and are similar in nature and purpose to IRC section 401(k) plans.

Lack of clarity from the IRS has created disagreement among U.S. tax practitioners about how to treat foreign plans. According to the GAO report, practitioners advise their clients to report the plans as passive foreign investment companies, disclose them as foreign financial accounts, characterize them as foreign financial assets, or treat them as foreign trusts.

The GAO report also explains that the IRS sticks to its mantra for international tax issues: that taxpayers are ultimately liable for getting things right, despite issue complexity, lack of guidance, and confusion among tax professionals about how to treat foreign plans. The IRS told the GAO that "taxpayers are responsible for understanding their filing requirements and for determining how to correctly file their tax returns, regardless of whether they live in a foreign country or the United States."

B. Treaty Benefits

As explained above, U.S. tax treatment of retirement plans in foreign countries without favorable treaties is often detrimental to U.S. persons. Things were different when it came to Malta, at least until recently.

1. Relevant Treaty Provisions

The key to the Malta situation was twofold. First, the treaty contains aspects that U.S. individuals have chosen to interpret in a highly favorable manner. Second, applicable Maltese law is beneficial to persons participating in local pensions.

Most readers probably dread the thought of digging into a dense tax treaty, but it is necessary to understand the controversy surrounding Maltese pensions. This article addresses only the most pivotal treaty aspects.

a. Definitions

Article 3 of the treaty explains that the term "pension fund" encompasses (i) any person (including a trust, partnership, or company) established in Malta (ii) that is a licensed fund or scheme subject to tax only on income from immovable property in Malta and (iii) operated principally to administer or provide pension or retirement benefits or earn income for the benefit of at least one arrangement like that.

b. Private Pensions

Article 17 states that distributions from pensions beneficially owned by a U.S. or Malta resident can be taxed only by the country where the beneficiary resides. The U.S. Treasury's technical explanation to the treaty clarifies that the phrase "pensions and other similar remuneration" covers both lump-sum and periodic payments. It also indicates that the distributions must be "in consideration of past employment," although as explained below, taxpayers seemed to have disregarded that.

An exception to that rule provides that any amount arising in a contracting state that would be exempt from tax in that state if the beneficiary were a resident there will also be exempt in the other contracting state where the beneficiary is a resident. The technical explanation offers an illustration:

> A distribution from a U.S. "Roth IRA" to a resident of Malta would be exempt from tax in Malta to the same extent the distribution would be exempt from tax in the United States if it were distributed to a U.S. resident. . . . Similarly, if the distribution were not subject to tax when it was "rolled over" into another U.S. IRA . . . then the distribution would be exempt from tax in Malta.

The so-called savings clause in the treaty does not prevent avoidance of taxation on some distributions from a Maltese pension fund. The technical explanation confirms that, saying the United States will not tax U.S. citizens and residents on distributions from Maltese pensions even if those amounts would otherwise be subject to tax under U.S. law.[3]

c. Pension Funds

Article 18 of the treaty provides that when an individual resident of Malta or the United States is a member of, beneficiary of, or participant in a pension fund that is a resident of the other country, the income earned by the fund may be taxed only when and to the extent it is paid from the fund to the individual or for her benefit, not transferred to another pension fund in the other country.

The technical explanation unpacks that language. If a Malta or U.S. resident participates in a pension fund established in the other country, the country of residence will not tax the appreciation within the pension fund until the individual receives a distribution. It provides the following example:

> If a U.S. citizen contributes to a U.S. qualified plan while working in the United States and then establishes residence in Malta, [article 18] prevents Malta from taxing currently the plan's earnings and accretions with respect to that individual. When the resident receives a distribution from the pension fund, that distribution may be subject to tax in Malta, subject to . . . Article 17.

[3] *See also* S. Exec. Rpt. 111-3 (June 30, 2010), at 3-4.

The ability to defer taxation on appreciation within a pension fund is not undermined by the savings clause in the treaty.

2. Maltese Pension Law

This article does not comprehensively analyze Malta's laws on pensions. It summarizes tax positions previously taken by U.S. taxpayers, which requires a look to local law.

Practitioners with self-professed expertise in this area have highlighted several notable characteristics of Maltese pension law. First, contributions to a pension fund are not required to derive from a participant's salary or other earned income. Second, contributions do not need to be in cash; they can be essentially any property, including appreciated capital assets, such as securities. Third, because a pension fund is treated as a foreign grantor trust for U.S. tax purposes, the contribution of assets, even appreciated ones, does not trigger immediate capital gain for the participant. Fourth, there is no cap on the amount of contributions a participant can make to a pension fund, either annually or overall. Fifth, appreciation within the pension fund is tax deferred, so no taxation occurs until a distribution is made. Finally, even when distributions occur, only a portion is taxed.

On the last point, Maltese law allows a participant to take distributions from a pension fund as early as age 50, when he can take a lump-sum payment of up to 30 percent of the total value tax free. He can enjoy the same tax exemption on similar payments if he receives them at least three years after the initial one. Required periodic payments are taxable in Malta — and thus in the United States — but they are linked to a minimum wage and are generally insignificant.[4]

[4] *See, e.g.*, Gerald Nowotny, "Maltcoin — Using Malta Pension Plans to Manage Bitcoin and Crypto Currency Investments," JDSupra, Aug. 22, 2019; Nowotny, "Parts Unknown! The Benefits of Malta Pension Schemes for U.S. Taxpayers," 36 *J. Tax'n Investments* 25 (Winter 2019); Jeffrey L. Rubinger, "Will Malta Become the 'New' Ireland in International Tax Planning?" 85 *Fla. Bar J.* 32 (Mar. 2011); Rubinger and Summer Ayers LePree, "Using Income Tax Treaties to Convert Taxable Income Into Nontaxable Distributions," 92(1) *Fla. Bar J.* 49 (Jan. 2018); William D. Lipkind and Adam Buchwalter, "Benefits for U.S. Retirement Plan Participants in the Malta-U.S. Tax Treaty," *Tax Notes Int'l*, Oct. 26, 2020, p. 517; and Robert Goulder, "Maltese Pension Plans: The Impermanence of Clever Things," *Tax Notes Int'l*, Feb. 7, 2022, p. 741.

3. Applying the Treaty and Maltese Law

Perhaps the best way to show the benefits that U.S. individuals were claiming under the treaty is through illustrations. A few scenarios provided by practitioners are featured below.

The first scenario is general in nature:

> A U.S. resident with a highly appreciated capital asset contributes it to a qualified Maltese fund, which is neither taxable nor deductible. The fund, in turn, would sell or exchange the asset in a transaction that would normally trigger capital gains, but does not because the treaty says that the IRS can't tax the gain unless Malta is prepared to tax it, and Malta won't be taxing it under the local rules that permit an exemption.[5]

The next scenario underscores the supposed benefits of contributing appreciated cryptocurrency to a Maltese pension fund:

> Bob Smith, age 50, began buying Bitcoin in 2010. He is a resident of California and would be subject to a combined federal and marginal tax on the capital income in the sale of his cryptocurrency portfolio. He purchased 10,000 coins in 2010 for $1,000. The current value of the coins is $101.1 million. As the stability and price has begun to stabilize, Bob has concluded that it might be prudent to realize some of the gains within the portfolio. Bob creates a Malta Pension Plan administered by Acme Trust in Malta. The plan is a single-participant plan. Bob transfers his entire portfolio to the plan on a tax-free basis. The portfolio is held within a Delaware LLC that is wholly owned within the plan. The manager of the LLC is Bob's best friend and CPA. The LLC's "wallet" is the same "wallet" that he has had for the last nine years. The entire portfolio is sold, and Bob recognized gain on approximately $101 million. Due to the tax treaty benefits, Bob is able to claim treaty benefits for the entire gain on IRS Form 8833. The proceeds are reinvested without taxation. The investment income and gains will remain tax-deferred. Bob is able to take a lump-sum distribution of $30 million at age 50 which is non-taxable for both Malta and U.S. purposes.[6]

Another scenario focuses on contributing valuable stocks, as opposed to cryptocurrency whose value has skyrocketed:

> Enterprising Johnny (age 45) has a direct investment of $1 million in a technology company that undergoes an inital public offering [IPO]. The expectation is that the value of Johnny's shares will appreciate to $11 million following the IPO. Following the IPO, Johnny plans to sell the shares for $11 million. Once that's done, Johnny would like to reinvest his proceeds in a managed account. He is a U.S. citizen, a resident of New York City, and is married with two children. To accomplish his goal, Johnny transfers the shares to the [Maltese Pension] Plan, tax free. Following the IPO, the shares are sold, and the resulting proceeds are reinvested in the Plan. Johnny's Plan account achieves a 7.5 percent return (net of fees) for a 10-year period. The Plan account has grown to $19 million when, at age 55, Johnny decides to begin distributions from the Plan. The Plan account is made up of three components: (1) the initial contribution ($1 million); (2) the untaxed sales proceeds ($10 million); and (3) $8 million of untaxed portfolio gains from the date of the sale. Johnny is eligible to take 30 percent of the account value ($5.7 million) as a tax-free distribution. The balance of the funds remain available to provide periodic retirement payments of $465,000 per year. In this situation, $35,000 is treated as a return of principal, and the balance of each payment, $430,000, is taxable at ordinary income rates for Malta and U.S. purposes. Beginning in Year 4, Johnny is able to take additional lump-sum distributions equal to 50 percent of the excess value above the

[5]Goulder, *supra* note 4.

[6]Nowotny, "Maltcoin," *supra* note 4.

> lump-sum value necessary to provide periodic payments. The projected value of the amount necessary to provide the annual annuity is $10.1 million. The excess amount is $8.9 million. Fifty percent of the excess eligible amount for tax-free treatment is $4.45 million. The total amount of tax-free distributions in the example is $10.15 million.[7]

The last scenario involves the contribution of both real property and securities to a Maltese pension fund:

> Assume Cristina, a 49-year-old U.S. citizen, owns both highly appreciated U.S. real estate and founders shares of a valuable start-up that is about to go public. In combination, the interests are worth approximately $200 million, and the aggregate tax basis of the assets is $5 million. As part of her retirement planning, Cristina decides to contribute these assets to a Maltese pension fund. Assume that in the same tax year, the real estate is sold for fair market value and the start-up has its IPO (further assume Cristina is subject to a six-month lock-up period before the shares may be sold). During the same tax year, after her lock-up period expires, Cristina sells her shares for fair market value, leaving her portion of the pension plan holding proceeds of $200 million. The following year, when Cristina is at least 50 years of age, assuming the terms of the pension plan permit her to begin withdrawing assets at age 50, Cristina can receive a distribution during that tax year of $60 million from the pension without the imposition of any income tax, either in Malta or the United States. Cristina then waits until year four, at which time she can make additional tax-free distributions. To calculate how much can be distributed free of tax, it is necessary to first determine whether the pension holds "sufficient retirement income." This amount, in turn, is based under Maltese law on the "annual national minimum wage" in the jurisdiction in which the member is a resident. To the extent the pension plan balance exceeds the member's "sufficient retirement income" (computed on a lifetime basis), 50 percent of the excess can be withdrawn tax-free each year. Assuming the $140 million remaining assets (after accounting for the initial lump-sum distribution) had increased in value to $160 million by year four, and further assuming it was determined that the individual needed $1 million as her sufficient retirement income, 50 percent of the $159 million excess, or $79.5 million, could be distributed to Cristina that year free of tax. Such calculations could likewise be performed in each succeeding tax year, with 50 percent of the excess being available for tax-free receipt by the beneficiary each year. Consequently, while it is not possible to distribute 100 percent of the proceeds of the pension tax-free, a very substantial portion of any income generated in the pension (including gains realized by the pension and attributable to appreciation accrued prior to contribution of assets to the pension) can be distributed without any Maltese or U.S. federal income tax liability.[8]

II. IRS Actions

A. The Party Is Over

The IRS recently acted to halt supposed abuse of the treaty as it applies to Maltese pensions. For starters, it featured the matter in its "Dirty Dozen" list for 2021.[9] However, the agency did not fully condemn the practice at that time, explaining that it was "evaluating the issue to determine the validity of these arrangements and whether treaty benefits should be available in such instances"

[7] Nowotny, "Parts Unknown!" *supra* note 4.

[8] Rubinger and LePree, *supra* note 4.

[9] IRS, "IRS Wraps Up Its 2021 Dirty Dozen Scams List With Warning About Promoted Abusive Arrangements," IR-2021-144 (July 1, 2021).

and that it might challenge the associated tax treatment.[10]

The IRS did not stew on the questions for long. About six months after its initial warning, the IRS announced that U.S. and Maltese officials had signed the CAA confirming their mutual understanding of the meaning of the term "pension fund" for treaty purposes.[11]

How could the countries do that? Well, the treaty expressly empowers the competent authorities of both countries to resolve "any difficulties or doubts as to the interpretation or application" of the treaty, including the meaning of any treaty term. The technical explanation adds that (i) agreements reached by the competent authorities are not required to conform to U.S. or Maltese law, (ii) the intent is to permit the competent authorities to implement the treaty consistently with its general purpose, and (iii) the competent authorities are empowered to address cases that are within the spirit of the treaty but not specifically covered.

The CAA makes several important points. For instance, it explains that a fund, scheme, or other arrangement established in Malta that can accept from a participant contributions of something other than cash or does not limit contributions by reference to income earned by a participant is not "operated principally to administer or provide pension or retirement benefits" under article 3 of the treaty. It therefore does not meet the definition of a pension fund and cannot provide tax-deferral benefits under article 18. The CAA also says that distributions from that type of fund, scheme, or arrangement are not pensions or other similar remuneration made in consideration of past employment under article 17. Because personal retirement plans established in Malta by U.S. persons do not satisfy treaty articles 3, 17, and 18, they cannot be used to access treaty benefits.

Importantly, the CAA says those interpretations by the competent authorities "reflect the original intent" of the United States and Malta — presumably going back approximately 15 years to when the treaty was signed.

B. Enforcement Is Coming

In announcing the CAA, the IRS warned U.S. taxpayers that it was coming for them. It said it had put taxpayers on notice in mid-2021 about potential noncompliance associated with Maltese pension funds, was "actively examining taxpayers who have set up these arrangements," and expected taxpayers to "get things right, now and for past years." It directed taxpayers to consult independent tax advisers before filing their 2021 tax returns and to take appropriate corrective actions on prior filings.

The IRS further noted that taxpayers might also be taking advantage of arrangements with other countries containing similar language regarding pension funds. It cautioned taxpayers "against entering into any substantially similar arrangements that would seek to misconstrue the provisions of a bilateral income tax treaty." It also warned that its civil and criminal divisions would pursue people who participated in, or in any way promoted, the abusive application of a treaty.

III. Potential Problems for Taxpayers

Taxpayers who took aggressive positions under the treaty might have committed various types of violations, at least from the IRS's perspective. This section discusses common duties and penalties.

A. Income Taxes

U.S. persons, including U.S. citizens and residents, generally must pay federal income tax on all income, regardless of where it originates. In other words, U.S. persons face worldwide taxation, which requires them to declare all income, no matter where earned, obtained, received, or accrued.

B. Tax-Related Penalties

Taxpayers who omit foreign income face U.S. tax liabilities and sizable penalties. Examples

[10] *See also* Michael Smith, "U.S. Cracking Down on Maltese Pension Schemes," *Tax Notes Int'l*, Jan. 3, 2022, p. 104.

[11] *See also supra* note 1.

include negligence penalties equal to 20 percent of the tax debt that can rise to 40 percent in situations involving undisclosed foreign financial assets and to 75 percent if the IRS can prove civil fraud.

C. Information Reporting Penalties

In addition to reporting all income and paying the corresponding taxes, individual taxpayers ordinarily must take several actions when they have assets, activities, or income abroad, including:

- disclosing on Form 1040, Schedule B, the existence and location of foreign accounts, as well as various links to foreign trusts;
- electronically filing a Financial Crimes Enforcement Network Form 114 (foreign bank account report, or FBAR) to provide more details about foreign accounts;
- reporting foreign financial assets on Form 8938;
- filing a Form 8833 if claiming that the application of a treaty between the United States and another country modifies normal treatment; and
- if they own or have specific links to foreign entities, reporting that on one of several forms determined by the type of foreign entity involved.

Penalties for failing to meet those requirements include large sanctions for unfiled, late, inaccurate, or incomplete FBARs. Congress was concerned about widespread FBAR problems for many years, so it enacted stringent penalties as part of the American Jobs Creation Act of 2004. Non-willful violations carry a maximum penalty of $10,000 per violation. Higher penalties apply if willfulness exists: the larger of $100,000 or 50 percent of the balance in the undisclosed account at the time of the violation.

If a taxpayer fails to file a proper Form 8938, the IRS generally will assert a penalty of $10,000 per violation — which increases to a maximum of $50,000 if the taxpayer does not quickly rectify the problem after contact from the IRS.

Holding an interest in a foreign corporation triggers even more complications. Several categories of U.S. persons who are officers, directors, or shareholders of specific types of foreign corporations ordinarily must file a Form 5471. If a person neglects to do so, the IRS may assert a penalty of $10,000 per violation, per year. The IRS can assert larger penalties for other unreported or improperly reported entities, such as foreign trusts.

The penalties described above are significant, even when considered separately. They can become untenable when the IRS decides to stack them by asserting several in connection with the same foreign item. A U.S. district court recently held that neither U.S. law nor the Constitution prohibits some types of IRS penalty stacking.[12]

D. Expanded Assessment Periods

For nearly all international information returns, failure to file not only triggers substantial penalties but also gives the IRS more time to audit. Below are two techniques at the agency's disposal for expanding assessment periods to the detriment of taxpayers.

The general rule is that the IRS has three years from the time of filing to identify a tax return as problematic, conduct an audit, offer all required administrative procedures, and issue a final notice proposing adjustments. There are various exceptions to that rule, including that if a taxpayer does not file a required international information return, the assessment period never starts to run. The IRS thus has an endless opportunity to audit not only the unfiled international information returns but also the tax returns to which they should have been attached in the first place. That rule essentially prevents taxpayers with international noncompliance from running out the clock for an IRS audit.

Under the IRC, if a taxpayer omits from a tax return income that either (i) exceeds 25 percent of the gross income that the taxpayer actually reported on the tax return, or (ii) is more than $5,000 and is attributable to a foreign financial asset that must be disclosed on Form 8938, the IRS can assess taxes and penalties up to six years after

[12] Sheppard, "What *Garrity* Teaches About FBARs, Foreign Trusts, 'Stacking' of International Penalties, and Simultaneously Fighting the U.S. Government on Multiple Fronts," 20(6) *J. Tax Prac. & Proc.* 27 (2019).

the taxpayer files the relevant tax return.[13] The primary consequence of this provision is that relatively minor amounts of omitted income can keep the assessment period open a full six years instead of the normal three. It takes little to reach a threshold of $5,000 in today's economy. In guidance (SBSE-25-0312-022), the IRS provided several examples of instances in which taxpayers will be subject to scrutiny for six years, including the following:

> [The] taxpayer filed his 2005 federal income tax return on or before April 15, 2006. The return contains a more-than-25-percent omission of income, including an omission of more than $5,000 of income attributable to a foreign financial asset. Because the statute of limitations is six years from the filing date of the return for both the "more-than-25-percent omission of income" and the "omission of more than $5,000 of income attributable to a foreign financial asset," the statute of limitations will not expire before April 15, 2012.

IV. Taxpayer Options

Although the IRS has said it is pursuing taxpayers who took aggressive treaty positions regarding Maltese pension funds, staffing shortages, insufficient funding, and the COVID-19 pandemic have presented challenges that could infuse the IRS's announcement with a degree of puffery.

Even so, taxpayers should make some critical decisions, and fast. Perhaps the biggest decision for taxpayers is whether to be proactive to minimize the number of years scrutinized, taxes due, and penalties imposed or take no corrective action and simply hope that the IRS never finds them.

A. Stick-to-Your-Guns Approach

Some taxpayers who established Maltese pensions and claimed benefits under the treaty will do nothing in response to the CAA and the IRS's related enforcement threats. Taxpayers adopting that stance likely will consist of those with a high risk tolerance; misconception about the true reach of the IRS; firm belief that their treaty positions were correct and supportable; faith in their advisers; or insufficient funds to pay the IRS and settle matters, even if they wanted to.

Assume that those taxpayers claimed on their Forms 1040 that the contribution of appreciated assets to the Maltese pensions, the passive income accruing within the pensions, and specific distributions from the pensions benefited from deferred taxation or avoided U.S. taxes altogether thanks to the treaty. Further assume that they did not file all the necessary international information returns for the pensions — not a stretch, considering that the GAO report confirms that questions remain about whether foreign pensions should be treated for U.S. purposes as PFICs, foreign financial accounts, foreign financial assets, or foreign trusts.

In that scenario, one might expect the IRS to take one of several positions on audit. First, as stated in the CAA, the treaty does not, and never did, offer tax deferral or avoidance for U.S. persons holding Maltese pensions, so taxpayers owe taxes on all income previously omitted from Form 1040. Second, taxpayers should be sanctioned to the fullest extent for unfiled FBARs and other relevant forms, as applicable. Third, taxpayers who failed to disclose to the IRS their treaty position by filing a Form 8833 with their Form 1040 should be deprived of any benefits, period. Finally, taxpayers should be subject to taxes, penalties, and interest for many years, thanks to the IRC sections that keep the assessment period open beyond three years.

To make matters worse, if the IRS were to take the positions above, taxpayers could easily find themselves engaged in three different lawsuits at the same time, with all the expense, time, and risk that entails.[14]

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[13] *See also* U.S. Joint Committee on Taxation, "Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, The 'Hiring Incentives to Restore Employment Act,' Under Construction by the Senate," JCX-4-10, at 64-66 (Feb. 23, 2010); and Hiring Incentives to Restore Employment Act, section 513(d).

[14] Sheppard, "Lessons From an International Tax Dispute: Three Interrelated Cases, in Three Different Proceedings, Generating Three Separate Liabilities," 46(5) *Int'l Tax J.* 43 (2020).

B. Hat-in-Hand Approach

There are several options for risk-averse taxpayers, the most relevant of which are discussed here.[15]

1. Quiet Disclosure

The IRS has warned taxpayers since it began introducing its recent wave of voluntary disclosure programs in 2009 not to circumvent those programs by making a so-called quiet disclosure. It repeatedly announced that it planned to identify and harshly sanction attempted quiet disclosures.[16]

However, with the introduction of its comprehensive voluntary disclosure program in 2018, the IRS completely changed course, telling taxpayers (LB&I-09-1118-014) that it is acceptable to make a quiet disclosure if there is no risk of criminality. It said taxpayers who did not commit any tax or tax-related crimes could correct violations by filing amended or past due returns.[17]

2. Streamlined Offshore Procedures

To be eligible for the IRS's streamlined foreign offshore procedure, a U.S. citizen must meet several criteria: (i) he was physically outside the United States for at least 330 days in one or more of the past three years; (ii) he did not have a U.S. abode during that time; (iii) he failed to report income from a foreign account and pay tax as required (he might have also failed to submit proper international information returns for a foreign financial account); (iv) his failures were the result of non-willful conduct; and (v) he is not under civil or criminal investigation by the IRS.

Eligible taxpayers generally must file all required returns for the past three years and FBARs for the past six years. They must pay all corresponding tax and interest but the IRS does not impose penalties.

The streamlined domestic offshore procedure is similar to the streamlined foreign procedure, with three critical distinctions: (i) participants do not meet the foreign residency requirement described above; (ii) participants previously filed all required U.S. tax returns for each of the three relevant years but failed to report income from a foreign financial asset and pay the corresponding taxes; and (iii) the IRS does not waive all penalties for taxpayers accepted into the streamlined domestic offshore program, imposing what it calls a "miscellaneous offshore penalty" equal to 5 percent of the highest total value of all noncompliant foreign assets during the relevant period.

V. Conclusion

Regardless of the validity of treaty positions U.S. taxpayers claimed for their Maltese pensions, some things are undeniable at this point. Importantly, the United States and Malta recently issued the CAA declaring that taxpayers were never entitled to defer or avoid U.S. taxes on pension contributions of appreciated assets, passive income accruing within pensions, or pension distributions. Based on that foundation, the IRS is now devoting civil and criminal resources to address the situation. Taxpayers who previously claimed treaty benefits have two main options: Do nothing and prepare for a lengthy fight with the IRS or approach the IRS before getting audited to settle matters under the most favorable disclosure program available. To avoid compounding their problems, prudent taxpayers will consult practitioners specializing in international tax and procedure, irrespective of which option they choose. ■

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[15] Logic dictates that taxpayers who relied on tax or legal professionals to take aggressive positions under the treaty and then disclosed those positions on their returns did not engage in willful or criminal behavior. Thus, they are not the type of taxpayers who would apply to resolve matters with the IRS through the updated voluntary disclosure program. For further discussion, see Sheppard, "IRS Announces Newest Version of Its Comprehensive Voluntary Disclosure Program: Analyzing Its Evolution of the First Five Years," *Int'l Tax J.* (forthcoming 2022); "IRS Issues New Form 14457 and Instructions Regarding Its Comprehensive Domestic and International Voluntary Disclosure Program: Analyzing Key Aspects," 46(4) *Int'l Tax J.* 41 (2020); and "IRS Amnesty Covers More Than Foreign Accounts: Analyzing the Updated Voluntary Disclosure Practice, New International Tax Withholding Procedure, and Guidelines for Late Returns by Foreign Corporations," 97(6) *Taxes — The Tax Magazine* 19 (2019).

[16] *See, e.g.*, Robert B. Stack and Doug Andre, "Expedited Opt-Out Needed for OVDI Participants Who Owe No Tax," *Tax Notes*, Jan. 30, 2012, p. 561; Goulder, "Quiet Disclosures Get No Love From IRS," *Tax Notes Int'l*, May 17, 2010, p. 518; Marie Sapirie, "First Criminal Charges Raise Quiet Disclosure Questions," *Tax Notes Int'l*, May 30, 2011, p. 694; and GAO, "IRS Has Collected Billions of Dollars, but May Be Missing Continued Evasion," GAO-13-318 (2013).

[17] An IRS official later confirmed to tax professionals suspicious of the IRS's drastic reversal that the agency had changed its earlier position and now condones quiet disclosure. *See* Andrew Velarde, "Noncooperation in Voluntary Disclosure Won't Blindside Taxpayer," *Tax Notes Int'l*, Mar. 18, 2019, p. 1225. *See also* Nathan J. Richman, "Revisions to IRS Voluntary Disclosure Program Underway," *Tax Notes Federal*, Nov. 1, 2021, p. 714.