

Part IV - Items of General Interest

Settlement Initiative for Employees of Foreign Embassies, Foreign Consular Offices and International Organizations in the United States

Announcement 2006-95

Section 1. Overview and Purpose of the Settlement Initiative

This announcement provides a two-part settlement initiative offered by the Internal Revenue Service (IRS) under which current and former employees of foreign embassies, foreign consular offices or international organizations (as defined in I.R.C. § 7701(a)(18)) in the United States (U.S.) can: (1) resolve income tax matters related to their employment at a foreign embassy, foreign consular office or international organization; and (2) unwind their participation in Simplified Employee Pension/Individual Retirement Account (SEP/IRA) plans, which they erroneously established. Section 2 describes eligibility requirements to participate in this settlement initiative. Section 3 describes the settlement terms. Section 4 sets out the settlement procedures and Section 5 states how ineligible and non-participating taxpayers will be treated. Taxpayers have until February 20, 2007, to notify the Service of their intent to participate in this settlement initiative.

The IRS has determined that a significant number of U.S. citizens and lawful permanent residents (“LPRs” also referred to as “green cardholders”) employed at

foreign embassies, foreign consular offices and international organizations in the U.S. have failed to fulfill their U.S. income tax responsibilities. Some have failed to timely file U.S. tax returns. Others have failed to accurately report the tax due by underreporting income, claiming deductions for unallowable expenses, and/or failing to pay self-employment taxes. See Section 3(a) of this announcement for the settlement terms of the income tax part of the settlement initiative.

U.S. citizens and LPRs who perform services in the United States as common law employees of foreign governments are not considered to be self-employed for purposes of I.R.C. §§ 401 and 408. These individuals are common law employees and, thus, may not contribute to SEP/IRA plans based on their employment with foreign embassies, foreign consular offices and international organizations. Many U.S. citizens and LPRs employed by foreign embassies, foreign consular offices and international organizations have erroneously established SEP/IRA plans, claimed deductions for contributions to the plans and used the plans as part of their retirement planning. See Section 3(b) of this announcement for the terms of the settlement of the SEP/IRA part of the settlement initiative.

Section 2. Eligibility Requirements

(1) This settlement initiative is limited to employees and former employees of foreign embassies, foreign consular offices or international organizations who are either currently employed or were employed as such in the United States. The initiative is limited to taxation issues relating to their employment at a foreign embassy, foreign consular office or international organization for taxable years 2003, 2004, and 2005.

(2) To be eligible to participate, taxpayers who contributed to SEP/IRA plans based on their employment with foreign embassies, foreign consular offices and international organizations, must comply, where applicable, with all requirements of both parts of the settlement initiative (Sections 3(a) and 3(b)).

(3) To be eligible to participate, taxpayers who are LPRs must represent that they have signed and filed a U.S. Citizenship and Immigration Services (USCIS) Form I-508 (Waiver of Rights, Privileges, Exemptions and Immunities under Section 274(b) of the Immigration and Nationality Act).

(4) Persons under criminal investigation. A person under tax-related criminal investigation by the IRS or the Department of Justice, or a person that has been notified, before the date on which a Notice of Election is filed pursuant to Section 4 of this announcement, that the IRS or the Department of Justice intends to commence a tax-related criminal investigation of that person is ineligible to participate in this settlement initiative.

(5) Taxpayers agree to cooperate and provide information to the IRS as required in this settlement initiative.

Section 3. Settlement Terms

(a) Income Tax Part

(1) Taxpayers will submit correct original returns or amend their previously filed tax returns for 2003, 2004, and 2005 to correctly report their tax liability.

(2) Taxpayers will pay all taxes and applicable statutory interest with respect to their correct tax liabilities for taxable years 2003, 2004, and 2005. Taxpayers will pay

penalties and/or additions to tax as described in subsection (7) below. Taxpayers will not claim refunds of any amounts paid under this initiative. Taxpayers will not file claims for interest abatement with respect to taxable years 2003, 2004, and 2005.

(3) Taxpayers will provide an official statement from their employer to verify the correct amount of gross income received for taxable years 2003, 2004, and 2005.

Gross income includes, but is not limited to, wages, taxable benefits, contributions to qualified retirement plans made on an after tax basis, pension distributions, and taxes paid by employers.

(4) Taxpayers will provide verification of payment and entitlement for all deductions and foreign tax credits claimed on their original and amended tax returns for taxable years 2003, 2004, and 2005, which are related to their employment at a foreign embassy, foreign consular office or international organization.

(5) Taxpayers must agree to report all income they receive after 2005 related to their employment at a foreign embassy, foreign consular office or international organization. No penalties and/or additions to tax will be waived with respect to any taxable years after 2005 as part of this initiative.

(6) Taxpayers will agree not to claim tax benefits in taxable years after 2005 that are inconsistent with positions taken with respect to prior taxable years. For example, a taxpayer failing to report after tax contributions to a qualified retirement plan as

described in I.R.C. § 401(a) for any year cannot treat those contributions as constituting basis in those payments in a subsequent year.

(7) The IRS will assess an applicable accuracy penalty on underpayments under I.R.C. § 6662 and/or applicable additions to tax under I.R.C. § 6651 for failure to file and/or failure to pay for only one of the taxable years 2003, 2004, or 2005, the year to be determined by the IRS based on the year with the highest tax deficiency. No other penalties will be assessed for adjustments relating to foreign embassy, foreign consular office or international organization income for the taxable years 2003, 2004, and 2005.

(8) The IRS will assess the taxes, penalties, additions to tax, and statutory interest determined under this initiative for taxable years 2003, 2004, and 2005.

(b) SEP/IRA Part

(1) Taxpayers agree to the disallowance of deductions claimed on their 2003, 2004, and 2005 income tax returns for contributions to erroneously established SEP/IRA accounts relating to their employment at a foreign embassy, foreign consular office or international organization and will not claim deductions for such contributions after 2005.

(2) Taxpayers will pay all taxes and applicable statutory interest resulting from the disallowance of erroneous SEP/IRA contribution deductions for taxable years 2003, 2004, and 2005. Taxpayers will not claim refunds of any amounts paid under this initiative. Taxpayers will not file claims for interest abatement with respect to taxable years 2003, 2004, and 2005.

(3) The IRS will allow taxpayers to move funds from their erroneously established SEP/IRA accounts to other tax-favored retirement plans (i.e., I.R.C. § 401(a) plans and IRAs) that would have been available to them for the years in which improper SEP/IRA

contributions were made. The amount that may be moved will be limited to the amount of the contributions that could have been made to an allowable tax-favored retirement plan plus the earnings, as determined by the IRS, on the allowable contributions. To the extent the taxpayer would have been able to make pre-tax contributions to an I.R.C. § 401(k) plan or an I.R.C. § 408(a) IRA for the years in which the improper SEP/IRA contributions were made, the amount that is moved, plus the deemed earnings thereon, will not be treated as a taxable distribution from the SEP/IRA. To the extent the amount moved is not described in the preceding sentence, the amount moved will be treated as a taxable distribution from the SEP/IRA in the year the amount is moved and will be treated as investment in the contract for purposes of I.R.C. § 72.

(4) Taxpayers will arrange for distribution of all amounts in their erroneously established SEP/IRA accounts in excess of those allowed to be moved as provided in the preceding paragraph. In accordance with I.R.C. § 408(d)(1), taxpayers will report the amount of the distribution as ordinary income in the year the distribution is received, irrespective of the years in which the amounts were contributed.

(5) The taxpayers will advise the financial institution where the SEP/IRA account is established to withhold 20% of the taxable distribution from the erroneously established SEP/IRA account.

(6) The IRS will not assess the annual 6% excise tax under I.R.C. § 4973(a) on the excess contributions in the erroneously established SEP/IRA account.

(7) The IRS will not assess the 10% excise tax under I.R.C. § 72(t)(I) on the early distribution from the erroneously established SEP/IRA account.

(8) The IRS will not assess the accuracy penalty under I.R.C. § 6662 on underpayments relating to deductions to the erroneously established SEP/IRA account. Notwithstanding, the IRS will assess penalties and/or additions to tax related to income tax as provided in Section 3(a)(7) above.

(9) No penalties and/or additions to tax will be waived with respect to taxable years after 2005 as part of this initiative.

(10) The IRS will assess the taxes, penalties, additions to tax, and statutory interest determined under this initiative for taxable years 2003, 2004, and 2005.

Section 4. Required Procedures for Electing Participants

(a) Notice of Election

Taxpayers electing to participate in this initiative must notify the IRS of their election by sending a Notice of Election, as set out below, on or before Tuesday, **February 20, 2007**. The Notice of Election must be sent by certified mail or designated delivery service (within the meaning of I.R.C. § 7502(f)) to:

Internal Revenue Service
1111 Constitution Ave. NW – LE 4423
Washington, DC 20024
Attn: SE:LM:IN:C:FR:ELECTION

The Notice of Election must be signed and must:

(1) State that the taxpayer elects to participate in the Foreign Embassy/Foreign Consular Office/International Organization Employee Settlement Initiative;

(2) Include the taxpayer's name, taxpayer's legal status (U.S. citizen or LPR), taxpayer identification number (TIN), current address, and daytime telephone number.

If the taxpayer is under examination, in Appeals, or has filed a petition in Tax Court, the taxpayer must include the name, address, and daytime telephone number of the IRS examiner, IRS Appeals Officer or IRS Attorney. If a tax practitioner represents the taxpayer, the practitioner must provide a completed Form 2848 or other valid power of attorney specifying each taxable year and type of tax covered;

(3) Include copies of all tax returns previously filed with the IRS (with the notation "Copy" written across the top of each return) for the taxable years 2003, 2004, and 2005;

(4) Include an official statement from the foreign embassy, foreign consular office or international organization showing total gross income paid in taxable years 2003, 2004, and 2005; and

(5) Include original delinquent or amended tax returns for taxable years 2003, 2004, and 2005 reporting the correct income and claiming only the proper amount of deductions and foreign tax credits, which are related to their employment at a foreign embassy, foreign consular office or international organization.

A taxpayer who is under examination, in Appeals, or has filed a petition in Tax Court must send a copy of the Notice of Election to the IRS examiner, IRS Appeals Officer, or IRS Attorney assigned to the matter.

(b) Additional Information and Documentation

Upon receipt of an election to participate, the IRS may send a request for additional information and documentation. Taxpayer must submit all requested information under penalties of perjury to the IRS within 30 days of the date of mailing of

the request by the IRS. The IRS may grant an extension for good cause to a taxpayer who requests additional time within the 30-day period. The IRS will treat a taxpayer who fails to provide the requested information within the applicable time as having withdrawn from the initiative.

(c) Closing Agreement and Payment

After receiving the requested information the IRS will prepare a closing agreement under I.R.C. § 7121 reflecting the terms of the settlement. The closing agreement will provide that: (1) all information provided by the taxpayer as required by the settlement is considered material and providing inaccurate information is a misrepresentation of a material fact within the meaning of I.R.C. § 7121(b); and (2) taxpayer waives all defenses to the assessment and collection of the tax, penalties, additions to tax, and statutory interest determined under this initiative.

The IRS will mail the closing agreement to taxpayer who must sign and return it to the IRS within **30** days of the date of mailing by the IRS. The IRS may grant an extension for good cause to a taxpayer who requests additional time within the **30**-day period.

A taxpayer participating in this initiative must fully pay all taxes, additions to tax, penalties, and statutory interest due when the signed closing agreement is returned to the IRS. Any taxpayer unable to make full payment at that time must submit complete financial statements and agree to financial arrangements acceptable to the IRS before the IRS will execute the closing agreement. The IRS will not execute a closing agreement under this initiative with a taxpayer who is unable to reach acceptable

financial arrangements.

Section 5. Ineligible and Non-participating Taxpayers

For taxpayers ineligible or not participating in this initiative, the IRS may:

(a) conduct examinations; (b) determine the correct taxes, penalties, additions to tax; and, (c) issue a Notice of Deficiency.

Section 6. Paperwork Reduction Act

The collection of information contained in this announcement has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(c)) under control number 1545-2045.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB number.

The collection of information in this announcement is in Section 4 of this announcement, Required Procedures for Electing Participants. The information is required to apply the terms of the settlement and determine the amount of taxes, applicable statutory interest and penalties. Collecting information is required to obtain the benefit described in this announcement. The likely respondents are individuals.

The estimated total annual reporting burden is 11,000 hours. The estimated annual burden per respondent varies from 1 to 3 hours, depending on individual circumstances, with an estimated average of 2 hours. The estimated number of respondents is 5,500. The estimated frequency of responses is one time per respondent.

Books or records about a collection of information must be retained as long as their content may become material in administering any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. § 6103.

Section 7. Contact Information

Various personnel from the Office of Associate Chief Counsel (International) and Office of Division Counsel (Small Business/Self-Employed) participated in drafting this announcement. For further information regarding this announcement contact Brant Meadows with the Office of Deputy Commissioner, International at (202) 874-1789 (not a toll-free call) or send an e-mail to embassy@irs.gov.