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Part IV - Items of General Interest

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

Announcement [XXXX-XX]

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 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 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. See Section 3(a) 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 sections 401 and 408 of the Internal Revenue Code (Code). 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) 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.

(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 participate in 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 the Election is filed, 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 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 agreement. Taxpayers will not file claims for interest abatement in any of the 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 each year. 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, which are related to their employment at a foreign embassy, foreign consular office or international organization.

(5) Taxpayers must agree to report all future income they receive related to their employment at a foreign embassy, foreign consular office or international organization. No penalties will be waived for any future years after 2005 as part of this agreement.

(6) Taxpayers will agree not to claim tax benefits in future years from positions taken on prior year returns to which they would otherwise not be entitled. For example, a taxpayer failing to report after tax contributions to a qualified retirement plan as described in Code § 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 <u>for only one</u> of the 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 years 2003, 2004, and 2005.

(8) The IRS will assess the taxes, penalties, additions to tax, and statutory interest determined under this agreement for 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 make such contributions in the future.

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

(3) 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 following paragraph. In accordance with Code § 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.

(4) The IRS will allow taxpayers to move funds from their erroneously established SEP/IRA accounts to other tax-favored retirement plans that would have been available to them for the years in which improper SEP/IRA contributions were made. The amount moved will not be considered to be a taxable distribution from the SEP/IRA and is

limited to the amount of the contribution which could have been made to an allowable tax-favored retirement plan plus the earnings, as determined by the IRS, on the allowable contributions.

(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)(l) 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 related to income tax as provided in Section 3(a)(7) above.

(9) No penalties will be waived in future years as part of this agreement.

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

(5) Include original delinquent or amended tax returns for 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-xxxx.

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, 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 xxxxx hours. The estimated annual burden per respondent varies from 3 to 7 hours, depending on individual circumstances, with an estimated average of xxx hours. The estimated number of respondents is xxx. 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

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.