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IRS Increases Focus on Offshore Tax Matters Kozusko Harris Duncan | Private Client & Offshore Services - USA

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The Internal Revenue Service (IRS) is making offshore tax matters a top priority, targeting non-US bank and other financial accounts along with offshore structures. Furthermore, the federal government is considering additional legislation to deter US taxpayers from holding assets in accounts of financial institutions located in so-called tax havens without disclosing the existence of those accounts to the IRS, and to address perceived abuses of offshore tax planning.

Voluntary Disclosure Programme Announced

The IRS is conducting a voluntary disclosure programme for US persons who have not properly reported their non-US bank and other financial accounts and offshore structures, such as foreign trusts and companies controlled by US persons. The programme will end on September 23 2009.

US taxpayers who have failed to file tax returns and pay US tax on income earned in offshore accounts, or to file information returns related to such accounts, such as the recently revised Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (for further details please see "IRS Releases Revised Foreign Bank Account Reporting Form"), may use this programme to make disclosure to the IRS and pay or make arrangements

to pay the taxes due. Disclosures must first pass an initial screening with the IRS Criminal Investigation Division. They will then be forwarded to an offshore identification unit for civil processing.

The voluntary disclosure programme does not guarantee immunity from prosecution. It sets forth a penalty framework to be applied to all voluntary disclosure requests containing offshore issues. Taxpayers will be required to file or amend all returns for the past six years. The IRS will then assess all taxes and interest for the applicable period, plus either an accuracy penalty (20% of the understatement of tax) or a delinquency penalty (up to 25% of the net tax required to be shown on the tax return), with no application of the reasonable cause exception.

In addition to all other penalties that may apply, the IRS will assess a penalty equal to 20% of the amount in foreign bank accounts or entities in the year with the highest aggregate account or asset value. This penalty will be reduced to 5% in the case of certain inherited accounts if:

- the taxpayer did not open or cause the account to be opened;
- there has been no activity in the account (eg, deposits or withdrawals during the period it has been under the taxpayer's control); and
- all applicable US taxes have been paid on the funds deposited in the account, except for taxes on income or earnings of the account.

On May 16 2009 the IRS posted answers to frequently asked questions about the voluntary disclosure programme, including an example of the penalty framework (www.irs.gov/pub/irs-news/faqs.pdf).

Proposed Stop Tax Haven Abuse Act

Under the USA Patriot Act, the Department of the Treasury has the authority to impose financial penalties on foreign jurisdictions, financial institutions or transactions found to be of "primary money laundering concern". Two recently introduced bills, both called the Stop Tax Havens Abuse Tax Act (Senate Bill 506 and House Bill 1265), propose to impose the same penalties if the Treasury finds the entity or transaction to be "impeding US tax enforcement". These bills are in committee, the first step of the legislative process, where they will be deliberated, investigated and

revised before they go to general debate. They illustrate the continued focus on offshore tax matters and efforts to identify and collect unpaid taxes, interest and penalties.

The proposed act provides an initial list of 34 offshore secrecy jurisdictions, including:

- the Bahamas;
- Bermuda;
- the Cayman Islands;
- the British Virgin Islands;
- the Channel Islands;
- Luxembourg;
- Panama;
- Singapore; and
- Switzerland.

The Treasury secretary would be authorized to add or remove countries from the list. These jurisdictions are viewed as having secrecy laws or practices that unreasonably restrict US tax authorities from obtaining necessary information, unless the jurisdiction has information exchange practices that effectively overcome those secrecy barriers.

The proposed act also contains provisions that would cause certain non-US corporations that are managed and controlled from within the United States to be treated as domestic corporations for US income tax purposes, causing them to become subject to US corporate income tax. In addition, withholding tax would be required on payments with respect to the stock of US corporations to non-US persons of dividend equivalent amounts and substituted dividends, which arguably are not currently subject to the 30% withholding tax on dividends paid to non-US investors. US persons would also be subject to increased requirements to report to the IRS a variety of relationships they have with passive foreign investment corporations.

Comment

Following the close of the Voluntary Disclosure Programme in September, non-compliant taxpayers will risk potential criminal prosecution and significantly greater penalties. IRS Commissioner Douglas Shulman has stated that the IRS draws a clear line between those individual taxpayers with offshore accounts who voluntarily come forward and those who continue to fail to meet their tax obligations. Congress is likely to introduce additional legislation focusing on increased tax reporting requirements in order to identify US persons who may be using tax haven jurisdictions to avoid US taxation. Regardless, a stated objective of the IRS Strategy Plan 2009 to 2013 is to meet the challenges of international tax administration by training employees to identify and understand issues in a complex and cross-border international environment.

The IRS is not alone in making offshore tax matters a priority. It is working with other nations to coordinate and cooperate on enforcement issues, including joining with its counterparts in the United Kingdom, Australia, Canada and Japan to establish the Joint International Tax Shelter Information Centre, which conducts bilateral exchanges of information on potentially abusive tax shelter transactions. Advisers to international families serve their clients best by acknowledging that we practise in an age of tax transparency and international cooperation in tax matters.

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