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JENNIE CHERRY, RASHAD
WAREH



IRS announces 2011 Offshore Voluntary Disclosure Initiative

Kozusko Harris Duncan | Private Client & Offshore Services - USA



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The Internal Revenue Service (IRS) has announced a 2011 Offshore Voluntary Disclosure Initiative, available until August 31 2011. The previous initiative closed on October 15 2009 with 15,000 voluntary disclosures reported by the IRS. Since then, more than 3,000 taxpayers have come forward to disclose foreign bank accounts. The new initiative is again designed to enable taxpayers to bring offshore money into the US tax system and to help those taxpayers to become compliant with their US tax and reporting obligations.

Voluntary disclosure overview

The IRS has a regular voluntary disclosure practice that permits taxpayers to pay their tax liabilities and minimise the chance of criminal prosecution. The IRS will not recommend criminal prosecution to the Department of Justice where a taxpayer has truthfully, timely and completely complied with all provisions of the IRS voluntary disclosure practice. The 2011 initiative is a counterpart to this voluntary disclosure practice that defines the number of tax years covered and details the penalties that will apply.

The IRS is actively engaged in determining the identities of taxpayers with undisclosed foreign accounts. Non-compliant taxpayers run the risk of IRS detection, the imposition of substantial penalties and criminal prosecution. The 2011 initiative enables the taxpayer to weigh the cost of resolving unreported offshore money issues, with a reasonable degree of certainty. Information on non-compliant taxpayers continues to be made available to the IRS under tax treaties and through whistleblower submissions. Even more information will become available as the new reporting provisions of the 2010 HIRE Act become effective (for further details please see "Tax Relief Act, reporting requirements and planning for use of trust property" and "Reporting of offshore investments - proposed regulations and the HIRE Act").

Terms of the initiative

The disclosure period for the 2011 initiative encompasses an eight-year period - tax years 2003 to 2010 inclusive - in which the taxpayer had undisclosed foreign accounts or undisclosed foreign entities, in contrast to the six-year period covered by the previous initiative. In order to enter the programme, all amended tax returns and information returns must be filed, and all taxes, penalties and interest must be paid, by August 31 2011 (previously only a letter with identifying information and a description of the offshore tax issues was required to enter the programme). The increased submission requirements may make it extremely difficult for taxpayers to meet the August 31 2011 deadline.

All taxpayers wishing to take advantage of the 2011 initiative must:

- provide copies of previously filed original (and, if applicable, previously filed amended) federal income tax returns for the disclosure period;
- provide complete and accurate amended federal income tax returns for the disclosure period, with applicable schedules detailing the amount and type of previously unreported income from the account or entity;
- file complete and accurate original or amended offshore-related information returns and foreign bank account reports (FBARs)⁽¹⁾ for the disclosure period;

- cooperate in the voluntary disclosure process, including providing information on offshore financial accounts, institutions and facilitators, and signing agreements to extend the period of time for assessing tax and penalties;
- pay 20% accuracy-related penalties on the full amount of the underpayments of tax for all years;
- pay failure-to-file penalties of 5% for each month that the tax return is late, up to a total maximum penalty of 25%, where applicable;
- pay failure-to-pay penalties of 0.5% for each month that the tax is not paid in full, up to 25% of the unpaid tax, where applicable;
- pay, in lieu of all other penalties that may apply, including FBAR and offshore-related information return penalties, a penalty equal to 25% (or in limited cases 12.5% or 5%) of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the disclosure period;
- submit full payment of all tax, interest, accuracy-related penalties and, if applicable, the failure-to-file and failure-to-pay penalties with the required submissions, or make good-faith arrangements with the IRS to pay in full the tax, interest and these penalties; and
- execute a closing agreement on final determination covering specific matters.⁽²⁾

Benefits of participating

Although the 2011 initiative has a higher penalty rate (25%) than the previous 2009 initiative (20%), it includes alternate penalty categories. A 12.5% penalty is applicable to smaller offshore accounts - a taxpayer whose offshore accounts or assets did not exceed \$75,000 in any calendar year covered by the 2011 initiative will qualify for this lower rate. There is also a 5% penalty rate which may be applied in certain limited circumstances, such as certain foreign residents who were unaware that they were US citizens. The 2011 initiative also offers a modified mark-to-market election for taxpayers with interests in passive foreign investment companies.

Under the initiative, the IRS forgoes other potentially applicable penalties, including the 75% civil fraud penalty on unpaid tax and the individual penalties imposed for failure to file various information returns such as FBARs, the reporting of foreign trusts and foreign gifts,⁽³⁾ and the reporting of foreign corporations and foreign partnerships.⁽⁴⁾ Penalties related to FBARs alone can be as high as the greater of \$100,000 or 50% of the total balance of the foreign account per violation. Where foreign trusts are involved, the reporting requirement can be an annual one, causing increased penalties.

Taxpayers making use of the initiative also mitigate their risk of criminal prosecution. Possible criminal charges related to tax returns include:

- tax evasion, with a possible prison term of up to five years and a fine of up to \$250,000;
- filing a false return, with a possible prison term of up to three years and a fine of up to \$250,000; and
- failure to file an income tax return, with a possible prison term of up to one year and a fine of up to \$100,000.

Wilfully failing to file an FBAR or wilfully filing a false FBAR subjects a person to a prison term of up to 10 years and criminal penalties of up to \$500,000.

Comment

A new section on the IRS website⁽⁵⁾ sets forth the terms and conditions of the 2011 initiative and information on the voluntary disclosure procedure, along with forms and a penalty computation worksheet. A detailed set of frequently asked questions and answers is available on the site to assist taxpayers and their tax advisers.

Even with this support, the disclosure process will be time consuming and costly. Nonetheless, it offers a straightforward way for a US taxpayer to become compliant and remove the fear of detection and criminal prosecution.

For further information on this topic please contact Jennie Cherry or Rashad Wareh at Kozusko Harris Vetter Wareh LLP by telephone (+1 212 980 0010), fax (+1 212 202 4484) or email (jcherry@kozlaw.com or

rwareh@kozlaw.com).

Endnotes

(1) Form TD F 90-22.1.

(2) Form 906.

(3) Forms 3520 and 3520-A.

(4) Forms 5471, 5472, 926 and 8865.

(5) www.irs.gov/newsroom/article/0,,id=235584,00.html.