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Expanded Streamlined Offshore Voluntary Disclosure Procedures

Getting right with the Lord

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On Wednesday, June 18, 2014, the Internal Revenue Service released new procedures regarding their offshore voluntary disclosure program (OVDP). This is

an important development for taxpayers who've fallen into non-compliance not out of willfulness, but instead through lack of care or attention or through simple ignorance.

The procedures announced on Wednesday are the new streamlined compliance procedures (SCP) and the new OVDP. Those new procedures together represent a substantial change to the current voluntary disclosure program, and the new SCP, in particular, may provide a more favorable method for certain taxpayers to "get right with the Lord" by lowering the bar and reducing the pain of making voluntary disclosures to the IRS.

It should be noted that both the new OVDP and the new SCP take effect on July 1, 2014.

The New SCP

The new SCP are limited to those taxpayers whose non-compliance with U.S. tax laws was "non-willful," and is further divided into two categories: (1) procedures for non-resident U.S. taxpayers² and (2) procedures for resident U.S. taxpayers.³ Taxpayers in either category are required to file:

- amended/missing tax returns and information returns for the past three years and foreign account reporting forms (FBARS) (or Form 8938 for Foreign Account Tax Compliance Act purposes as applicable) for the past six years (not including returns that aren't due yet); and
- a certification of non-willful conduct.

Accordingly, the first threshold is whether a taxpayer is able and willing to sign a certification of non-willfulness regarding the reasons for either non-reporting or incorrect reporting of income related to the foreign financial accounts at issue. That certification is signed under penalties of perjury, like income tax returns, and will

include a statement setting forth, among other things, the specific circumstances of the non-reported income that indicate non-willfulness.⁴ Taxpayers must carefully consider whether they can and should sign the certification of non-willfulness because doing so in bad faith is itself a crime.

Those non-resident U.S. taxpayers eligible for the streamlined procedure will have to pay only additional tax due and interest—no other penalties will be applied. Similarly, those resident U.S. taxpayers who are eligible for the streamlined procedure will have to pay any additional tax due and interest, but in addition, an offshore penalty equal to 5 percent of the highest aggregate value of unreported foreign financial assets (that is, assets that were required to be, but in fact weren't, reported on either the FBAR or Form 8938)⁵ for any year in the relevant disclosure period (calculated at the end of each year).

Importantly, the new streamlined procedures don't provide for a full clearance from the IRS, either from criminal tax prosecution or civil tax liability. Unlike the OVDP (whether the old or the new), under the new SCP, no closing agreement will be entered into with respect to any of the taxable years for which returns are submitted (or for any prior years for which returns have been either filed or not filed). Thus, any of those years is subject to further audit by the IRS (assuming that the relevant statute of limitations hasn't expired).⁶ However, the IRS has indicated that audits of returns submitted under the new streamlined procedures won't be automatic, but will be based on audit standards it will develop. In other words, there will remain a risk of audit for all years at issue for a non-compliant taxpayer, regardless of whether their non-compliance dates back only three years or in many cases further, if the taxpayer chooses to pursue the SCP.

The New OVDP

The new OVDP is essentially the old OVDP, with two significant revisions. The biggest change in the new OVDP is that, effective as of Aug. 4, 2014, a new offshore

penalty of 50 percent of the unreported foreign financial assets will be applied if any of the relevant accounts are at institutions (or were facilitated by parties) that have been publicly identified as being under U.S. government investigation or are cooperating with a U.S. government investigation (that is, “bad banks” or “bad actors”).⁷ Otherwise, the current 27.5 percent offshore penalty continues to apply.⁸ In addition, under the new OVDP, the offshore penalty, which previously was paid at the end of the OVDP process, now must be made within 90 days of the date of the tentative acceptance letter from the IRS, along with the other documents required at that time, such as the taxpayer’s amended returns, check for tax, interest and other penalties, and unfiled informational returns.⁹ The current 8-year look back period will remain in effect under the new OVDP, and there may also be some additional reporting requirements of a relatively minor nature.

Switching Between Procedures

Taxpayers who are in the old OVDP (that is, taxpayers who’ve filed their initial OVDP application documents) by June 30, 2014 may be able to use the new SCP, but only with respect to a reduction in the offshore penalty. In other words, if eligible, the taxpayer would receive the benefit of either no offshore penalty (in the case of a non-resident U.S. taxpayer) or a 5 percent offshore penalty (in the case of a resident U.S. taxpayer); however, the 8-year look back period would still apply, and other applicable penalties (that is, failure to file, failure to pay and accuracy penalties) would still apply.

In addition, if a taxpayer is already in the old OVDP by June 30, 2014, whether a taxpayer will be allowed to use the SCP is determined initially at the discretion of the IRS examiner, followed by a final review and determination by an IRS central review committee whose decision isn’t appealable. Nevertheless, the taxpayer may still opt-out of the OVDP at that point if desired and proceed to civil examination.

After June 30, a taxpayer must choose between using the new SCP or pursuing the comprehensive, new OVDP. Of course, the taxpayer may still opt-out of the OVDP at any time.

Certain Observations

As noted above, the new SCP (assuming all eligibility requirements are met) present the simplest and cheapest option, but don't provide full protection from either criminal tax prosecution or civil tax liability in the event of a later IRS audit. In contrast, the OVDP (both the old and new) provides a full clearance from both criminal prosecution and civil tax liability at the cost of a longer look back period and greater burdens and penalties. Indeed, the new streamlined procedures are quite helpful for certain taxpayers. However, more helpful would have been a streamlined procedure, with reduced penalties, for the full 8-year period covered by OVDP because there may be taxpayers whose non-compliance was non-willful and prior to the 3-year period of the streamlined procedures, but who deserve nevertheless to participate in a process that's streamlined relative to OVDP. Taxpayers in that situation face a very difficult decision.

In addition, as a practitioner, it would have been helpful to be given more than eight business days to review these changes with clients. These clients, who aren't intentional tax cheats, by nature have complicated lives, often straddling two or more countries, or else most of them wouldn't be in this situation in the first place. While the new procedures are a very welcome addition to the options available to clients, a modest amount of additional time would have been well received and appreciated.

Ultimately, taxpayers "who want to get right with the Lord" now face the difficult decision of how much they're willing to pay and how much burden they're willing to endure, to sleep at night, free of worry of the IRS. Unlike many decisions for which a

client's lawyer can provide guidance, this decision must come entirely from the client.

Endnotes

1. I make no attempt to review the old (that is, 2012) offshore voluntary disclosure program (OVDP) process in this article, given the volume of materials already written on that topic.
2. For this purpose, a non-resident U.S. taxpayer is defined as: (1) a U.S. citizen or green card holder who, for any one of the most recent three years for which a U.S. tax return was due: (a) didn't have a US "abode," and (b) was physically outside the United States for at least 330 days; or (2) a non-U.S. citizen or non-green card holder who doesn't meet the "substantial presence test" for that same period.
3. For this purpose, a U.S. resident taxpayer is defined, in essence, as a U.S. taxpayer who doesn't meet the requirements for the streamlined foreign offshore program and who has filed a U.S tax return for each of the most recent three years for which a return was due (that is, the streamlined domestic procedure apparently doesn't apply when U.S. returns haven't been filed for each of the most recent three years).
4. In that regard, a determination of willfulness is made on the specific facts and circumstances of each case. In general, however, an initial requirement of willfulness is either specific knowledge, or deliberate ignorance, of a legal duty that's then followed by a violation of that duty. Willfulness isn't established by behavior that would be considered inadvertent, negligent or due to misplaced reliance on informed professional advisors.
5. The requirements and nuances of filing a foreign account reporting form or 8938 (that is, Foreign Account Take Compliance Act) form are beyond the scope of

this article but are quite detailed and in many areas unclear.

6. Historically, failure to file informational reporting forms (such as a Form 3520) generally caused the statute of limitations to remain open indefinitely as to the items that would have been reported on those forms if filed.

7. At this point, whether an account at a bad bank or facilitated by a bad actor must currently exist to trigger this 50 percent penalty is unclear. For example, if a taxpayer who had a financial account at a bad bank several years ago but the account is now closed, does the taxpayer need to be in OVDP by Aug. 4 to avoid this increased penalty? The guidance issued on the 18th suggests otherwise, but it's not a model of clarity.

8. Financial institutions currently on that list are:

UBS AG

Credit Suisse AG, Credit Suisse Fides, and Clariden Leu Ltd.

Wegelin & Co.

Liechtensteinische Landesbank AG

Zurcher Kantonalbank

swisspartners Investment Network AG, swisspartners Wealth Management AG, swisspartners Insurance Company SPC Ltd., and swisspartners Versicherung AG

CIBC FirstCaribbean International Bank Limited, its predecessors, subsidiaries, and affiliates

Stanford International Bank, Ltd., Stanford Group Company, and Stanford Trust Company, Ltd.

The Hong Kong and Shanghai Banking Corporation Limited in India (HSBC India)

The Bank of N.T. Butterfield & Son Limited (also known as Butterfield Bank and Bank of Butterfield), its predecessors, subsidiaries, and affiliates

9. A taxpayer may still opt-out of the OVDP into a full civil examination if the taxpayer believes that would be more advantageous (for example, she's confident that the 27.5 percent default penalty is unjustified).

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