

Tax Litigation Issues

Expert Analysis

Offshore Accounts: The Beat Goes On

The Internal Revenue Service's battle against offshore accounts continues. In its seventh year and fourth iteration, the Offshore Voluntary Disclosure Program (OVDP) remains the best opportunity for taxpayers who intentionally evaded their tax and reporting obligations to bring themselves into compliance and avoid criminal prosecution, albeit at a significant financial cost. However, not every current or former offshore account holder who failed to comply with their tax and reporting obligations acted with a culpable state of mind, and the IRS has come to recognize the inequity of treating taxpayers who made good-faith mistakes as harshly as those who acted willfully.

Over the past year, the IRS has offered taxpayers whose prior non-compliance was unintentional the ability to correct their past violations at a cost that reflects their relative lack of culpability. Taxpayers taking advantage of these alternatives do not get the protection from criminal prosecution that comes with the OVDP, and lawyers and accountants need to carefully advise their clients regarding the costs and benefits of the various options available to them.

Voluntary Programs

The IRS announced the first OVDP in March 2009 (the 2009 OVDP), in the wake

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of publicity surrounding its investigation of the Swiss banking giant, UBS AG. The 2009 OVDP, which attracted approximately 14,700 taxpayers before it expired in early October 2009,¹ was succeeded in February 2011 by the Offshore Voluntary Disclosure Initiative (the 2011 OVDI), which attracted another

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18,300 participants.² In June 2012, recognizing that many eligible taxpayers had not yet come forward, the IRS offered a third program (the 2012 OVDP).³

Participation in the 2012 OVDP was bolstered significantly by the Department of Justice's Program for Non-Prosecution Agreements or Non-Target letters for Swiss Banks (the Swiss Bank Program), which was announced on Aug. 29, 2013. The Swiss Bank Program offered banks that were not already under criminal investigation the opportunity to resolve their potential criminal exposure in exchange for substantial penalties and information regarding certain U.S.-related

accounts.⁴ The Swiss Bank Program incentivized participating banks to persuade their former clients to disclose their accounts,⁵ which led many banks to push those former clients to participate in the 2012 OVDP. The 2012 OVDP had attracted another 12,000 taxpayers, and in June 2014, the IRS revised the program yet again (the 2014 OVDP).⁶

Taxpayers are eligible to make a voluntary disclosure any time before the IRS receives information regarding their non-compliance: Eligibility is unrelated to the size of the account in question, the amount of taxes evaded or the sophistication of the scheme. Each of the OVDPs required participants to provide information regarding their offshore accounts, including the individuals and entities that assisted them in establishing and using those accounts. In addition, participants are required to (a) file amended tax returns, amended or delinquent Reports of Foreign Bank and Financial Accounts (FBARs), and other information returns for an eight-year period; (b) pay back taxes, interest and a 20 percent accuracy penalty on any previously unreported income; and (c) pay a penalty on the highest balance of the previously unreported accounts (the FBAR Penalty).

Over the past six years, the IRS has exacted increasing financial penalties from taxpayers who failed to come forward sooner: The FBAR Penalty went from 20 percent of the highest balance in the undeclared account(s) during the 2009 OVDP to 25 percent in the 2011 OVDI and 27.5 percent in the 2012 OVDP. In the 2014 OVDP, the IRS has increased the

FBAR Penalty paid by taxpayers disclosing accounts at specific financial institutions to 50 percent of the maximum value of all of their undisclosed accounts.⁷

Through the various voluntary disclosure programs, over 45,000 taxpayers have obtained the peace of mind that they have effectively eliminated their criminal exposure. In addition, for taxpayers who intentionally concealed their offshore accounts, the financial terms of the various voluntary disclosure programs were (and continue to be) less onerous than the maximum penalties that could be imposed if their accounts are discovered through a civil audit.⁸

Reduced Penalty Options

While the OVDP will always be the safest course for people who willfully failed to disclose offshore accounts, the IRS has recognized that the “one-size-fits-all” approach of the voluntary disclosure programs can yield draconian results in some cases. Thus, the 2011 OVDI and 2012 OVDP offered reduced FBAR Penalties to certain U.S. citizens living abroad, to taxpayers with smaller accounts, and to individuals who had minimal contact with their accounts.⁹

Moreover, since 2011, the IRS has offered taxpayers the opportunity to reap the benefits of the criminal protection offered by the various voluntary disclosure programs while “opting out” of the civil settlement structure. Individuals who pursue this option will have their civil liability resolved through the regular audit process, and can do either better or worse than if they had accepted the civil settlement structure available through the OVDP.¹⁰

Opting out is not for the faint of heart. If a taxpayer can demonstrate that his failure to disclose an account or to report income was non-willful, he can substantially reduce his penalties outside the OVDP. However, taxpayers who opt out of the OVDP are subject to a full examination of their returns and, if the revenue agent auditing these returns concludes that the reporting lapses

were intentional or the result of conscious avoidance, the taxpayer will be exposed to an FBAR Penalty of up to 50 percent of the account balance for each year the account was open as well as a civil fraud penalty on any unreported income.¹¹

Streamlined Procedures

Taxpayers taking advantage of the reduced penalties offered in the 2011 OVDI and 2102 OVDP and individuals who opt out of the civil settlement structure do not forgo the criminal protection offered by the voluntary disclosure programs. However, not all taxpayers with offshore account issues have criminal exposure. Thus, in September 2012, the IRS initiated the Streamlined Filing Compliance Procedures, which were available to a narrow class of taxpayers residing

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outside the United States who owed relatively little taxes and met certain compliance risk factors.

Last June, the IRS significantly expanded the streamlined procedures for non-residents and initiated a separate process for U.S. residents whose failure to comply with their reporting obligations was unintentional.¹² Participants in the current Streamlined Procedures must (a) file original or amended tax returns for the most recent three years; (b) pay back taxes (with interest) on any previously unreported income; and (c) file either delinquent or amended FBARs and/or other information reports for the past six years.

While taxpayers residing outside the United States will not be subject to an FBAR Penalty, U.S. residents availing themselves

of the Streamlined Procedures must pay a 5 percent penalty on the highest balance of the previously unreported accounts over the six-year period.

To qualify for the Streamlined Procedures, taxpayers must certify that their failure to disclose offshore accounts and to report income attributable to such accounts was “non-willful,” which is defined as having been “due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.” While prospective clients will be anxious to reap the financial savings associated with the Streamlined Procedures, practitioners need to highlight the risks associated with pursuing that course of action.

Significantly, at a recent conference,¹³ Nanette L. Davis, a senior litigation counsel in the Tax Division, noted that the Department of Justice will look to prosecute taxpayers who submit false certifications of non-willfulness. In other words, taxpayers who unsuccessfully attempt to qualify for the Streamlined Procedures will not only forgo the protection for criminal prosecution available through the OVDP, but may actually expose themselves to charges if their certifications are deemed to be fraudulent.

Delinquent Submission

The IRS has also recognized that some individuals who failed to comply with their offshore account reporting obligations will not have any unreported income or owe any taxes. In the first three voluntary disclosure programs, these individuals were directed to file delinquent (or amended) FBARs and other information reports outside of the OVDP.¹⁴ In connection with the 2014 OVDP, however, the IRS developed the Delinquent FBAR Submission Procedures (for individuals who failed to file FBARs, but do not have unreported income or unpaid taxes), and the Delinquent International Information Return Submission Procedures (for individuals who failed to file other information returns).¹⁵ Qualifying taxpayers can use these proce-

dures to file delinquent or amended FBARs or other information returns without subjecting themselves to any penalties.

As with the Streamlined Procedures, however, participants in the Delinquent Filing Procedures must provide an explanation for their failure to file the FBARs or other information returns on a timely basis, and do not get any protection from criminal prosecution.

Alternative Approaches

Two additional options available to clients with previously undisclosed accounts warrant consideration: filing amended tax returns, FBARs and information returns outside of the OVDP (also known as making a quiet disclosure) or complying with filing obligations on a going-forward basis without addressing historical violations. While neither of these alternatives provide any protection against criminal charges and the IRS affirmatively discourages taxpayers from making “quiet disclosures,” they should be considered when the facts and circumstances surrounding the past non-compliance do not give rise to concern regarding prosecution.

Indeed, in guidance issued on May 13, 2015, the IRS noted that, in most cases, the maximum FBAR Penalty imposed in connection with an audit will be 50 percent of the highest value of the previously undisclosed account. Assuming that criminal prosecution is not at issue, the IRS’s guidance has reduced the financial risk associated with these options. However, to the extent the client’s conduct was truly non-willful, the Streamlined Procedures provide the opportunity to be proactive, as opposed to taking a “wait-and-see” approach.

Conclusion

After seven years of voluntary disclosure programs, the IRS continues to offer non-compliant taxpayers a variety of options

to cure their historical violations. Practitioners counseling individuals with undisclosed accounts need to weigh the available choices, being mindful of the need to address potential criminal exposure and urge their clients not to be penny-wise and pound-foolish.



1. See Jeremy Temkin, “One Last Chance for Offshore Account Holders,” *New York Law Journal* (May 14, 2009); Alison Bennett, “Shulman Says About 14,700 Taxpayers Voluntarily Disclosed Offshore Assets,” *BNA Daily Report for Executives*, 220 DER GG-2 (Nov. 18, 2009).

2. Internal Revenue Service, Press Release IR-2011-14, “Second Special Voluntary Disclosure Initiative Opens; Those Hiding Assets Offshore Face Aug. 31 Deadline” (Feb. 8, 2011) (available at <http://www.irs.gov/newsroom/article/0,,id=235695,00.html>); Jeremy Temkin, “Voluntary Disclosure of Offshore Accounts: Yet Another ‘Last’ Chance,” *New York Law Journal* (Feb. 17, 2011).

3. Internal Revenue Service, Press Release IR-2012-64, “IRS Says Offshore Effort Tops \$5 Billion, Announces New Details on the Voluntary Disclosure Program and Closing of Offshore Loophole” (June 26, 2012) (available at [http://www.irs.gov/uac/IRS-Says-Offshore-Effort-Tops-\\$5-Billion,-Announces-New-Details-on-the-Voluntary-Disclosure-Program-and-Closing-of-Offshore-Loophole](http://www.irs.gov/uac/IRS-Says-Offshore-Effort-Tops-$5-Billion,-Announces-New-Details-on-the-Voluntary-Disclosure-Program-and-Closing-of-Offshore-Loophole)).

4. See U.S. Department of Justice, “United States and Switzerland Issue Joint Statement Regarding Tax Evasion Investigations,” (Aug. 29, 2013) (available at <http://www.justice.gov/opa/pr/united-states-and-switzerland-issue-joint-statement-regarding-tax-evasion-investigations>); Jeremy Temkin, “New Justice Department-Swiss Bank Program Announced,” *New York Law Journal* (Oct. 28, 2013).

5. See Department of Justice, Program for Non-Prosecution Agreements or Non-Target letters for Swiss Banks, ¶II.H.

6. Internal Revenue Service, Press Release IR-2014-73, “IRS Makes Changes to Offshore Programs; Revisions Ease Burden and Help More Taxpayers Come into Compliance” (June 18, 2014) (available at <http://www.irs.gov/uac/Newsroom/IRS-Makes-Changes-to-Offshore-Programs;-Revisions-Ease-Burden-and-Help-More-Taxpayers-Come-into-Compliance>).

7. See Internal Revenue Service, “2014 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers” (2014 FAQ), Q.7.2 (available at <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised>). The 50 percent penalty is imposed on taxpayers who had undisclosed accounts at financial institutions that are publicly identified as being under investigation, cooperating with the government or the subject of a John Doe Summons. The IRS regu-

larly updates the list of financial institutions whose clients are subject to this 50 percent penalty. See Foreign Financial Institutions or Facilitators (available at <http://www.irs.gov/Businesses/International-Businesses/Foreign-Financial-Institutions-or-Facilitators>).

8. Compare 2014 FAQ Q.8 (penalties within the OVDP) with 2014 FAQ Q.5 (potential penalties outside the OVDP).

9. See, e.g., Internal Revenue Service, “2012 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers” (“2012 FAQ”), Q.52, Q.53 (available at <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers>).

10. See, e.g., 2014 FAQ Q.51; Guidance for Opt Out and Removal from the Civil Settlement Structure of the [2009 OVDP] and the [2011 OVDI] (available at http://www.irs.gov/pub/newsroom/2011_ovdi_opt_out_and_removal_guide_and_memo_june_1_2011.pdf).

11. Prior to 2014, the IRS provided examples of circumstances under which a taxpayer might benefit or suffer from opting out. See, e.g., 2012 FAQ Q.51.1, Q.51.2. In an unpublished decision, the U.S. Court of Appeals for the Fourth Circuit held that the government can establish willfulness by demonstrating that the defendant consciously avoided learning of his reporting requirements. See *United States v. Williams*, 489 Fed. Appx. 655 (4th Cir. 2012); see also *McBride v. United States*, 908 F.Supp.2d 1186 (D. Utah 2012).

12. Details regarding the Streamlined Domestic Offshore Procedures can be found at <http://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-in-the-United-States> and <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures-for-U-S-Taxpayers-Residing-in-the-United-States-Frequently-Asked-Questions-and-Answers>, and details regarding the Streamlined Overseas Offshore Procedures can be found at <http://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-Outside-the-United-States> and <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures-for-U-S-Taxpayers-Residing-Outside-the-United-States-Frequently-Asked-Questions-and-Answers>.

13. 7th Annual NYU Tax Controversy Forum, held in New York, N.Y., on June 5, 2015.

14. See, e.g., 2012 FAQ Q.17, Q.18.

15. Details regarding the Delinquent FBAR Submission Procedures can be found at <http://www.irs.gov/Individuals/International-Taxpayers/Delinquent-FBAR-Submission-Procedures>, and details regarding the Delinquent International Information Return Submission Procedures can be found at <http://www.irs.gov/Individuals/International-Taxpayers/Delinquent-International-Information-Return-Submission-Procedures>.