

# Corporate Business Taxation Monthly IRS Amnesty to Offshore Tax Evaders—The Last, Last Chance?, (May. 1, 2009)

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IRS Amnesty to Offshore Tax Evaders—The Last, Last Chance?

Ronald Marini explains the IRS's recent announcement of a penalty structure for voluntary disclosures that gives taxpayers the chance to avoid criminal prosecution, the civil fraud penalty and other penalties.

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The Internal Revenue Service (IRS) announced on March 26, 2009, that it has put a new penalty structure in place. The IRS designed the new penalty structure to encourage taxpayers with offshore assets to come into its voluntary disclosure program. The IRS offered those taxpayers who comply with requirements the chance to avoid criminal prosecution, the civil fraud penalty and a battery of additional penalties. This penalty structure for voluntary disclosures is only available for six months, or until September 23, 2009.

Under the voluntary disclosure guidelines, IRS will look back six years and taxpayers must pay taxes, interest, and an accuracy or delinquency penalty for all years. Taxpayers will also incur a penalty of up to 20 percent on the highest aggregate balance held in the account during the six-year period. Certain taxpayers may qualify for a reduced penalty of five percent on the highest aggregate balance in the foreign account.

The agency unveiled a set of memorandums it sent to the highest officials in the Large and Mid-Size Business Division, the Small Business and Self-Employed Division, and Criminal Investigation. The IRS emphasized a heightened focus on audits of offshore issues as well as the new structure.

On May 6, 2009, the IRS unveiled a set of comprehensive, frequently asked questions and answers (FAQ) as to this new penalty structure, intended to encourage taxpayers to voluntarily disclose U.S. assets held offshore. The 12-page FAQ addressed a host of questions, including various stages at which taxpayers can come into the disclosure program, the issue of so-called quiet disclosures, explanation of the six-month time frame for the current program, and whether taxpayers will face penalties for certain failures to file Forms TD F 90-22.1, *Report of Foreign Bank and Financial Accounts*, FBARs.

## Background—The Perfect Storm Offshore

While the laws dealing with the disclosure of foreign banks or financial accounts took effect in 1970, nearly four decades ago, only recently has the U.S. government taken steps to publicly express its concerns in the area of tax compliance by U.S. citizens who have or who use foreign bank accounts.

In 2003, in an effort to raise the FBAR compliance rate (estimated to be *less than 20 percent* in the year 2001),<sup>1</sup> the Financial Crimes Enforcement Network (FinCEN) delegated its enforcement authority for the FBAR to the IRS by means of a Memorandum of Agreement between FinCEN and the IRS.<sup>2</sup> The agreement marked a significant step in the IRS's efforts to seek out people with undisclosed overseas accounts. Included among the reasons cited for the delegation of enforcement authority were greater resources available to the IRS to enforce FBAR compliance.

During 2006, German intelligence services paid nearly €5 million for confidential banking data to an informant, a former employee of the LGT Group, a Liechtenstein bank. Later, the British authorities paid money to the same person for data on British subjects who had sheltered money in Liechtenstein, and they are investigating about 100 people in Britain. Australia, Canada, France, Italy, the Netherlands, New Zealand and Sweden are also looking into tax evasion by their citizens in Liechtenstein. The IRS began enforcement action against more than 100 U.S. taxpayers on suspicion of evading taxes through investments in Liechtenstein.<sup>3</sup>

On June 19, 2008, the Justice Department announced the guilty plea of former UBS banker Bradley Birkenfeld to charges that he had conspired to defraud the IRS by assisting UBS clients in evading U.S. reporting requirements on income in Swiss bank accounts.<sup>4</sup>

On June 30, 2008, the Justice Department announced that it had filed papers seeking an order from a federal court in Miami, Florida, authorizing the IRS to request information from Zurich, Switzerland-based UBS AG about U.S. taxpayers who may be using Swiss bank accounts to evade federal income taxes.<sup>5</sup>

On July 1, 2008, the U.S. District Court in Florida approved the John Doe summons and authorized the IRS to issue summons to UBS for the production of records identifying U.S. taxpayers with accounts at UBS in Switzerland who elected to have their accounts remain hidden from the IRS.<sup>6</sup> Later it was asserted that there are some 52,000 unreported accounts held by or on behalf of U.S. persons in UBS alone.

While it is impossible to precisely quantify how much offshore income is unreported, IRS Commissioner Doug Shulman has publicly stated his belief that [o]ffshore accounts harbor billions of dollars, and people should take notice that the secrecy surrounding these deals is rapidly fading.<sup>7</sup>

On February 18, 2009, the Justice Department announced that as part of a deferred prosecution agreement and in an unprecedented move, UBS, has agreed to immediately provide the U.S. government with the identities of, and account information for, certain U.S. customers of UBS's cross-border business. As part of the deferred prosecution agreement, UBS has further agreed to pay \$780 million in fines, penalties, interest and restitution.<sup>8</sup>

On April 15, 2009, The Department of Justice asked a federal court in Denver to approve service of a John Doe summons on First Data Corporation. The information expected in response to the summons will help the IRS identify merchants who use offshore accounts to evade their U.S. tax liabilities. Some United States taxpayers are evading billions of dollars per year in United States taxes through the use of offshore accounts.<sup>9</sup>

Also during April 2009, Daniel Reeves, an IRS agent in charge of the tax agency's Offshore Compliance Initiative detailed the IRS initiative at the Financial Due Diligence Conference in Miami Beach, Florida. Reeves, a key agent in the UBS case, said, We have identified other offshore banks that promote tax avoidance and we are developing additional John Doe summonses on some of those banks.

In addition to these IRS initiatives:

- President Obama has stated that that he supports ending the use of tax havens as a vehicle for avoiding U.S. tax.
- The U.S. Congress has introduced the Stop Tax Haven Abuse Act.<sup>10</sup>
- At the G-20 Meeting in April 2009, the OECD had obtained commitments from tax haven countries to exchange information, in order that these countries not to be blacklisted.

From the perspective of the offshore environment, it certainly appears that the above-mentioned elements combine to form the perfect storm against the continued use of offshore jurisdictions to avoid or evade U.S. and other foreign jurisdictions taxes.

## **The New Voluntary Disclosure Program for Undeclared Foreign Accounts**

The IRS released the following three memoranda on March 23, 2009, related to the new Initiative:

- Memorandum for Commissioner, LMSB and SB/SE, from Deputy Commissioner for Services and Enforcement Linda E. Stiff, Authorization to Apply Penalty Framework for Voluntary Disclosure Request regarding Unreported Offshore Accounts and Entities (Penalty Memorandum)<sup>11</sup>
- Memorandum for SB/SE EXAMINATION AREA DIRECTORS LMSB INDUSTRY DIRECTORS from Deputy Commissioner Barry B. Shott, LMSB and Deputy Commissioner Faris R. Fink, SB/SE, Emphasis on Proper Development of Offshore Examination Cases, Managerial Review, and Revocation of Last Chance Compliance Initiative (Case Development Memorandum)<sup>12</sup>

- Memorandum for SB/SE EXAMINATION AREA DIRECTORS LMSB INDUSTRY DIRECTORS and CI DIRECTORS OF FIELD OPERATIONS from Deputy Commissioner Barry B. Shott, LMSB, Deputy Commissioner Faris R. Fink, SB/SE and Deputy Chief Victor Song, CI, Routing of Voluntary Disclosure Cases (Routing Memorandum)<sup>13</sup>

On March 26, 2009, Commissioner Shulman stated:

We recently provided guidance to our examination personnel who are addressing voluntary disclosure requests involving unreported offshore income. We believe the guidance represents a firm but fair resolution of these cases and will provide consistent treatment for taxpayers. We have instructed our agents to resolve these taxpayers' cases in a uniform, consistent manner.

Those who truly come in voluntarily will pay back taxes, interest and a significant penalty, but can avoid criminal prosecution. Our guidance to the field is for the next six months only, after which we will re-evaluate our options.

For taxpayers who continue to hide their head in the sand, the situation will only become more dire.<sup>14</sup>

## Penalty Memorandum

The Penalty Memorandum explains the penalty framework for voluntary disclosure requests containing offshore issues, noting that the framework will be applied to all requests that have been submitted to IRS and are not yet resolved. The guidance will remain in effect for six months starting March 23, 2009, and ending September 23, 2009. The Penalty Memorandum stresses that all voluntary disclosure requests are mandatory work.

The Criminal Investigations unit will make preliminary determinations that taxpayers are eligible to seek voluntary disclosure and forward their requests to the Philadelphia Offshore Identification Unit (POIU) for civil processing by examiners who specialize in offshore examinations.

Once these examiners have completed their review, the Deputy Commissioners are authorized to enter into closing agreements resolving the taxpayer liabilities provided the resolution includes the following:

- The filing of six years of amended or delinquent tax returns, including informational returns and the FBAR; plus the assessment of all associates taxes and interest due
- The mandatory assessment of either a 20-percent accuracy penalty under [Code Sec. 6662](#) for income previously omitted from a tax return or the 25-percent delinquency penalty under [Code Sec. 6651](#), for each year involved, with no reasonable cause exception allowed
- The payment of a one-time 20-percent penalty in the year with the highest aggregate account balance, including all offshore accounts. This penalty is in lieu of all other available penalties, including the penalty for not filing the FBAR and various penalties for the nonfiling of Information Returns.

These rules are subject to two limitations:

- If the foreign account was opened or a foreign entity was created within the six-year period, then taxes, interest and all penalties will begin from the date the account was opened (or the date on which the foreign entity was acquired or formed).
- There is a reduction of the 20-percent penalty to five percent of the highest aggregate balance where the taxpayer:
  - did not open or create the foreign account (or entity);
  - has never withdrawn money from the foreign account or added money to the foreign account (or there was no activity in any entity); and
  - has paid all U.S. taxes on the funds, which were deposited into the account (or the entity).<sup>15</sup>

The only noncompliance that may exist on the part of the taxpayer is not reporting the income earned on the foreign account (or in the foreign entity). Of course, the third requirement may be the most difficult to satisfy, since it only applies to persons who either inherited a foreign account or received a foreign account as a gift or inheritance.

If a taxpayer received a gift or inheritance of the principle of the account or the actual account (or entity) from a foreign relative, it is likely that no U.S. taxes would have been imposed; but the U.S. taxpayer is still required to report the receipt of the foreign gift or inheritance on a Form 3520.

If a taxpayer received a gift or inheritance from a U.S. relative, a determination needs to be made as to whether US gift or estate taxes were paid on the funds contributed to the account. This leaves open the issue of whether the utilization of a gift tax exclusion or an estate tax exclusion; would qualify these funds as previously taxed and thus meet the third requirement? I believe that where there is a specific tax provision for the nonpayment of taxes (gift or inheritance from foreign person, utilization of a gift or estate tax exclusion, etc.), this third requirement would be met.

## Case Development Memorandum

The Case Development Memorandum explains that Offshore cases sent to the field are to be considered the highest priority. Examiners should be alert to the badges of fraud and consult with Fraud Technical Advisors in developing cases for criminal referrals or the assertion of the civil fraud penalty. Counsel is available to assist SBSE and LMSB personnel as needed.

The Case Development Memorandum encourages Examiners to utilize the full range of information gathering tools in properly developing offshore issues, with special emphasis on detecting unreported income. This includes the following:

- Interviewing taxpayers
- Making third-party contacts
- Timely issuing summonses to taxpayers and third parties

In particular, examiners should request foreign-based information through exchange of information under applicable treaties and tax information exchange agreements (TIEAs) in any cases where the taxpayers have accounts or transactions in countries with such agreements.

The Case Development Memorandum contains an Attachment 1, which provides a brief summary of potential foreign information reporting requirements and civil penalties that could apply to a taxpayer depending on his/her particular facts and circumstances (as shown below).<sup>16</sup>

## Potential Reporting Requirements and Civil Penalties

The following summary of potential reporting requirements and civil penalties is not necessarily all encompassing, and it is unlikely that any one taxpayer would be subject to all of the reporting obligations or penalties listed below:

- (1) Penalties for failure to comply with the Bank Secrecy Act<sup>17</sup> requirement that U.S. persons report their financial interest in, or authority over, financial accounts located in a foreign country. U.S. citizens, residents and certain other persons must annually report their financial interest in, or signature authority (or other authority that is comparable to signature authority) over, a financial account (such as a bank or investment account) that is maintained with a financial institution located in a foreign country if, for any calendar year, the aggregate value of all foreign accounts exceeded \$10,000 at any time during the year. This reporting requirement is met by filing *Form TD F 90-22.1* (Report of Foreign Bank and Financial Accounts, commonly known as an FBAR) FBARs are filed with a Department of the Treasury facility located in Detroit and are not to be filed with tax returns; the filing date for FBARs is June 30. The requirement to file FBARs is in the regulations under 31 USC §5314 (which is a provision of the Bank Secrecy Act) Generally, the civil penalty for willfully failing to file an FBAR can be as high as the greater of \$100,000 or 50 percent of the total balance of the foreign account. Criminal penalties may also apply. Refer to IRM 4.26.16.4 for additional FBAR penalty considerations.
- (2) Fraud Penalties ([Code Secs. 6651\(f\)](#) and 6663). Where an underpayment of tax or a failure to file a tax return is due to fraud, the taxpayer is liable for penalties that, although calculated differently, essentially amount to 75 percent of the unpaid tax.

- (3) Failure to File Tax Return ([Code Sec. 6651](#)). When a taxpayer is required to file a tax return and does not do so on or before the due date of the return, [Code Sec. 6651\(a\)](#) (1) imposes a penalty of five percent of the net tax amount required to be shown on the tax return for each month (or fraction of a month) that the return is late. The maximum penalty is 25 percent. This penalty is increased to 15 percent with a maximum of 75 percent, if the taxpayer's failure to file is fraudulent.
- (4) Failure to Pay Tax Penalties ([Code Sec. 6651\(a\)](#) (2) and(3)). When a taxpayer fails to timely pay the amount of tax shown on the return, [Code Sec. 6651\(a\)\(2\)](#) imposes a late payment penalty equal to 0.5 percent of the late payment for each month (or part of a month) that the payment is late. The maximum penalty is 25 percent.

When a taxpayer fails to pay a tax that is required to be (but was not) shown on a return within 21 days after the date of the IRS's notice and demand for that tax, [Code Sec. 6651\(a\)\(3\)](#) imposes a penalty of 0.5 percent for each month (or part thereof) that the assessment remains unpaid. The maximum penalty is 25 percent.

- (5) Accuracy-Related Penalty ([Code Sec. 6662](#)). The accuracy-related penalty for underpayments is imposed at the rate of 20 percent on the portion of any underpayment of tax required to be shown on a return attributable to negligence, a substantial understatement of tax, a substantial overstatement of pension liabilities or a substantial estate of gift tax valuation understatement. The accuracy-related penalty with respect to a substantial valuation misstatement can be as high as 40 percent.
- (6) Penalties for failure to file certain information returns (Code [Secs. 6035](#), [6038](#), [6038A](#), [6038B](#), [6038C](#), [6039F](#), [6046](#), [6046A](#) and [6048](#))
  - *Form 5471. Information Return of U.S. Persons With Respect To Certain Foreign Corporations.* U.S. persons who are officers, directors or shareholders in certain foreign corporations (including, for example, an International Business Corporation used in an offshore scheme) report information required by [Code Secs. 6035](#), [6038](#) and [6046](#) and compute income from controlled foreign corporations under [Code Secs. 951–964](#). The penalty for failing to file each one of these information returns is 10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return.
  - *Form 5472. Information Return of a 25-Percent Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business.* Reports transactions between a 25-percent foreign-owned domestic corporation or a foreign corporation engaged in a trade or business in the United States and a related party as required by [Code Secs. 6038A](#) and [6038C](#). The penalty for failing to file each one of these information returns, or to keep certain records regarding reportable transactions, is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return.
  - *Form 926. Return by a U.S. Transferor of Property to a Foreign Corporation.* Reports transfers of property to a foreign corporation and to report information under [Code Sec. 6038B](#). The penalty for failing to file each one of these information returns is 10 percent of the value of the property transferred, up to a maximum of \$100,000 per return, with no limit if the failure to report the transfer was intentional.
  - *Form 3520. Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts.* Report various transactions involving foreign trusts, including creation of a foreign trust by a U.S. person, transfers of property from a U.S. person to a foreign trust and receipt of distributions from foreign trusts under [Code Sec. 6048](#). This return also reports the receipt of gifts from foreign entities under [Code Sec. 6039F](#). The penalty for failing to file each one of these information returns, or for filing an incomplete return, is 35 percent of the gross reportable amount, except for returns reporting gifts, where the penalty is five percent of the gift per month, up to a maximum penalty of 25 percent of the gift.
  - *Form 3520-A. Annual Information Return of Foreign Trust with a U.S. Owner.* Reports ownership interests in foreign trusts, by U.S. persons with various interests in and powers over such trusts under [Code Sec. 6048\(b\)](#). The penalty for failing to file each one of these

information returns, or for filing an incomplete return, is five percent of the gross value of invested assets determined to be owned by the U.S. person.

- *Form 8865. Return of U.S. Persons With Respect to Certain Foreign Partnerships.* U.S. persons with certain interests in foreign partnerships use this form to report interests in and transactions of the foreign partnerships, transfers of property to the foreign partnerships, and acquisitions, dispositions and changes in foreign partnership interests under [Code Secs. 6038](#), 6038B and 6046A. Penalties include \$10,000 for failure to file each return, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum \$50,000 per return, and 10 percent of the value of any transferred property that is not reported, subject to a \$100,000 limit.

## Revocation of Last Chance Compliance Initiative

The Case Development Memorandum explains that effective as of March 23, 2009, the IRS will no longer afford taxpayers the opportunity to minimize their exposure to penalties through the terms of the Last Chance Compliance Initiative (LCCI). On any currently open examinations where the LCCI terms have already been offered, taxpayers will be afforded the opportunity to resolve their cases under LCCI if they respond to the examiner within 15 days of their prior notification.

The Initiative is now the only official method for resolving offshore noncompliance by U.S. taxpayers. Taxpayers who either do not come forward during the six-month period or who come out better, based upon their factual circumstances, making a voluntary disclosure (not pursuant to this initiative) with a reasonable basis argument for the nonapplication of penalties; can forgo the certainty provided by this initiative and take their chances on the assertion of criminal penalties and multiple civil penalties (see above).

## Is This the Last, Last Chance Compliance Initiative?

The Penalty Memorandum states that the Initiative will remain in effect for six months from March 23, 2009, through September 23, 2009. The IRS will re-evaluate its options after this six month period.<sup>18</sup>

What the IRS will do at the end of the six-month period is anybody's guess, but you can try to guesstimate what they will do, by looking at other recent settlement initiatives:

- For example, on January 14, 2003, the IRS introduced the Offshore Voluntary Compliance Initiative, which ended on April 15, 2003. There were no extensions for taxpayers to come forward subsequent to the deadline. However, subsequent to the deadline, practitioners made reference to the provisions of the Offshore Voluntary Compliance Initiative, as persuasive authority, when making a voluntary disclosure after April 15, 2003.<sup>19</sup>
- Alternatively, on November 17, 2006, the IRS introduced a settlement for U.S.-based employees and former employees of foreign embassies, foreign consular offices and international organizations to resolve outstanding U.S. tax matters related to their employment. When the Embassy Settlement was introduced, the deadline was February 20, 2007, but it was later extended to June 30, 2007.<sup>20</sup>

The only thing that you can say for sure regarding this Last, Last Chance Compliance Initiative is that until September 23, 2009, it provides certainty for U.S. taxpayers who have unreported foreign source income. Even though the penalties under the Initiative are significant, it allows taxpayers to avoid criminal prosecution and also allows taxpayers to avoid all of the potential penalties contained in Attachment 1 of The Case Development Memorandum. (See above.)

As if avoiding the imposition of the above penalties is not a significant enough benefit for taxpayers; they should understand that the situation will not get any better. IRS agents have been instructed by Commissioner Shulman that if the taxpayer did not self-report through a voluntary disclosure, they are to fully develop these cases, pursuing both civil and criminal avenues, and consider all available penalties including the maximum penalty for the willful failure to file the FBAR report and the fraud penalty.<sup>21</sup> The success or failure of the federal criminal prosecution of Steven Michael Rubinstein, a Boca Raton, Florida, accountant,

accused of filing a false income tax return and failing to report the money in his financial account at UBS; may also the impact the IRS's strategy for dealing with offshore noncompliance.

We expect that this prosecution is just the first of the prosecutions that will be brought, as we continue to review the information we have received from all sources, said Acting Assistant Attorney General John A. DiCicco of the Justice Department's tax division. The IRS also used the opportunity to encourage other tax evaders to turn themselves in. Anyone in this situation needs to immediately come in through our voluntary disclosure process before it's too late, came the ominous warning from IRS Commissioner Doug Shulman. The IRS is committed to pursuing people hiding income offshore.

It's better to come clean now instead of waiting and facing a heavier price later, he said.<sup>22</sup>

Furthermore, the Case Development Memorandum states that the IRS Strategic Plan for 2009-2013 is focused on international tax administration and allocating the resources necessary to focus on both existing and emergency risk areas.<sup>23</sup>

So for all of you doubters out there, please be advised that this is not just going to go away. If a U.S. taxpayer was ever thinking of doing something to correct his/her nonreporting of foreign income; this may very well be his/her *last, last chance*.

## Routing Memorandum

### Voluntary Disclosure

When determining if a taxpayer's voluntary disclosure submission qualifies for the Initiative, the Routing Memorandum instructs CI to refer to IRM Section 9.5.11.9. for questions pertaining to taxpayer eligibility.

Taxpayers need to be aware that not all voluntary disclosure submissions will automatically qualify for the Initiative and criminal prosecution is a potential outcome from a disclosure, which does not qualify for the Initiative.<sup>24</sup> Cases involving illegal source income will not qualify.<sup>25</sup> Taxpayers who are currently under examination, regardless of whether it relates to undisclosed foreign accounts or undisclosed foreign entities, do not qualify for this voluntary disclosure initiative.<sup>26</sup>

The IRS's Web site states that [t]he IRS stresses that the acceptance into a voluntary disclosure agreement depends on the individual's facts and circumstances involved in each case. Taxpayers cannot rely on the fact that other similarly situated taxpayers may not have been recommended for criminal prosecution.<sup>27</sup>

The Internal Revenue Manual defines a voluntary disclosure as having taken place when the taxpayer's communication is truthful, timely and complete. These terms require that the taxpayer show a willingness to cooperate (and does in fact cooperate) with the IRS in determining his/her correct tax liability, and the taxpayer makes good faith arrangements with the IRS to pay in full, the tax, interest and any penalties determined by the IRS to be applicable.<sup>28</sup>

Disclosures are timely if they are received before the following:

- (1) The IRS has initiated a civil examination or criminal investigation of the taxpayer, or has notified the taxpayer that it intends to commence such an examination or investigation.
- (2) The IRS has received information from a third party (e.g., informant, other governmental agency or the media) alerting the IRS to the specific taxpayer's noncompliance.
- (3) The IRS has initiated a civil examination or criminal investigation that is directly related to the specific liability of the taxpayer.
- (4) The IRS has acquired information directly related to the specific liability of the taxpayer from a criminal enforcement action (e.g., search warrant, grand jury subpoena).<sup>29</sup>

However, based upon informal comments from Commissioner Shulman and Eileen Mayer, Chief of the IRS's Criminal Investigation Division, indicating that UBS Clients, whose names have already been requested by the IRS pursuant to John Doe summonses, qualify for a voluntary disclosure; it appears that this Last, Last Chance Initiative provides some flexibility to the timely requirements contained in requirements of IRM Section 9.5.11.9.4.ENDNOTE30

## POUI for Processing

The Routing Memorandum provides that voluntary disclosure requests containing offshore issues, where CI has preliminarily determine taxpayer eligibility, will now be forwarded by CI to the Philadelphia Offshore Identification Unit (POUI) for civil processing. Additionally, any voluntary disclosures with offshore issues that are currently in areas/industry case inventories, should also be forwarded to the POUI.

## FAQs on Offshore Voluntary Compliance

On May 6, 2009 the IRS unveiled a set of comprehensive, frequently asked questions and answers on the Last, Last Chance Initiative:

- (1) Why did the IRS issue internal guidance regarding offshore activities now?
- (2) What is the objective of these steps?
- (3) Why should I make a voluntary disclosure?
- (4) What is the IRS's Voluntary Disclosure Practice?
- (5) How do I make a voluntary disclosure and where should I submit my voluntary disclosure?
- (6) What form should my voluntary disclosure take?
- (7) I'm currently under examination. Can I come in under voluntary disclosure?
- (8) I have an offshore merchant account upon which I have not reported all of the income. Can I come in under the IRS's voluntary disclosure practice?
- (9) I have properly reported all my taxable income but I only recently learned that I should have been filing FBARs in prior years to report my personal foreign bank account or to report the fact that I have signature authority over bank accounts owned by my employer. May I come forward under the voluntary disclosure practice to correct this?
- (10) What if the taxpayer has already filed amended returns reporting the additional unreported income, without making a voluntary disclosure (*i.e.*, quiet disclosure)?
- (11) Is a taxpayer who sought relief under the IRS's Voluntary Disclosure Practice before this internal guidance was issued eligible for the terms described in this internal guidance?
- (12) How does the penalty framework work? Can you give us an example?
- (13) What years are included in the six-year period?
- (14) What are some of the criminal charges I might face if I don't come in under voluntary disclosure and the IRS finds me?
- (15) What are some of the civil penalties that might apply if I don't come in under voluntary disclosure and the IRS finds me? How do they work?
- (16) Why did the IRS pick six months?
- (17) What happens at the end of six months? Will I get a better deal if I wait to see what the IRS does at the end of six months?
- (18) What should I do if I am having difficulty obtaining my records from overseas?
- (19) Are entities, such as corporations, partnerships and trusts eligible to make voluntary disclosures?
- (20) Does the twenty-percent penalty apply to entities? Does the twenty-percent penalty apply only to cash and securities held in foreign accounts or entities or to tangible and intangible assets as well?
- (21) Are taxpayers required to complete a questionnaire as part of the voluntary disclosure practice?
- (22) Is there a list of questions taxpayers are expected to answer as part of the voluntary disclosure process?
- (23) When determining the highest amount in each undisclosed foreign account for each year or the highest asset balance of all undisclosed foreign entities for each year, what exchange rate should be used?
- (24) Will I have to file or amend my old tax returns?
- (25) Besides federal income tax returns, what forms or other returns must be filed?
- (26) If I had an FBAR reporting obligation for years covered by the voluntary disclosure, what version of the Form TD F 90-22.1 should I use to report my interests in foreign accounts?
- (27) If I don't have the ability to full pay can I still participate in the IRS's Voluntary Disclosure Practice?
- (28) If the taxpayer and the IRS cannot agree to the terms of the closing agreement, will mediation with Appeals be an option respect to the terms of the closing agreement?

- (29) I have a client who may be eligible to make a voluntary disclosure. What are my responsibilities to my client under Circular 230?
- (30) Can I talk to the IRS without revealing my client's identity?

Some of the more noteworthy answers contained in this FAQ, include as listed below.

### **Properly Reported All My Taxable Income but Did Not File FBARs**

The IRS's answer #9 is that taxpayers who reported and paid tax on all their taxable income for prior years but did not file FBARs should file the delinquent FBAR reports according to the instructions and attach a statement explaining why the reports are filed late. The IRS will not impose a penalty for failure to file the FBARs.<sup>31</sup>

### **What About Filing Amended Returns Reporting the Additional Unreported Income, Without Making a Voluntary Disclosure (i.e., Quiet Disclosure)?**

The IRS's answer #10 provides that they are aware that some taxpayers have attempted so-called quiet disclosure by filing amended returns and paying any related tax and interest for previously unreported offshore income without otherwise notifying the IRS. These taxpayers can come forward under the voluntary disclosure practice to make timely, accurate and complete disclosures. Taxpayers making quiet disclosure should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years. The IRS has identified, and will continue to identify, amended returns reporting increases in income. The IRS closely reviewed these returns to determine whether enforcement action is appropriate.<sup>32</sup>

Taxpayers who have a reasonable basis for the nonassertion of the various penalties, may consider not making a voluntary disclosure and may instead make a quiet disclosure through the filing of amended returns, with their applicable service center, accompanied by an explanation of the taxpayer's reasonable basis for the nonassertion of the various penalties. The risk to these taxpayers who elect to make a quiet disclosure, is that they do not have the certainty of the nonassertion of criminal as well as the various civil penalties provided by the voluntary disclosure initiative. It's up to each tax advisor to adequately inform his clients of their alternatives and the risks associated with each alternative for dealing with their prior years unreported offshore income.

### **How Does the Penalty Framework Work? Can You Give Us an Example?**

The IRS's answer #12 provides an example of someone who had \$1 million on deposit in 2003 (assumed that \$1 million was reported for 2003) and who earned \$50,000 of interest per year, in an offshore bank account that was not reported. The example states that this taxpayer would pay \$386,000 plus interest under the voluntary compliance initiative and the same taxpayer could otherwise face up to \$2,306,000 in tax, accuracy-related penalties, FBAR penalties and an examination that could lead to criminal prosecution.

### **What Years Are Included in the Six-Year Period?**

The IRS's answer #13 is that taxpayers are expected to file corrected delinquent or amended tax returns for tax years 2003 through 2008. Therefore a taxpayer who has had unreported offshore income for 20 years, will only be required to report under this initiative the income for the last six tax years.

### **Besides Federal Income Tax Returns, What Forms or Other Returns Must Be Filed?**

The IRS's answer #25 lists the following returns:

- Copies of original and amended federal income tax returns for tax periods covered by the voluntary disclosure
- Complete and accurate amended federal income tax returns (or original returns, if not previously filed) of the taxpayer for all tax years covered by the voluntary disclosure

- An explanation of previously unreported or underreported income or incorrectly claimed deductions or credits related to undisclosed foreign accounts or undisclosed foreign entities, including the reason(s) for the error or omission
- If the taxpayer is a decedent's estate, or is an individual who participated in the failure to report the foreign account or foreign entity in a required gift or estate tax return, either as executor or advisor, complete and accurate amended estate or gift tax returns (original returns, if not previously filed) necessary to correct the underreporting of assets held in or transferred through undisclosed foreign accounts or foreign entities
- Complete and accurate amended information returns required to be filed by the taxpayer, including, but not limited to, Forms 3520, 3520-A, 5471, 5472, 926 and 8865 (or originals, if not previously filed) for all tax years covered by the voluntary disclosure, for which the taxpayer requests relief
- Complete and accurate Form TD F 90.22-1, *Report of Foreign Bank and Financial Accounts*, for foreign accounts maintained during calendar years covered by the voluntary disclosure

## Can I Talk to the IRS Without Revealing My Client's Identity?

The IRS's answer #30 indicates that you can talk to the IRS hypothetically; however, the IRS stresses that hypothetical situations present the potential for misunderstanding, when there is no assurance that the hypothetical contains all relevant facts. Posing a hypothetical situation does not constitute a voluntary disclosure. So if the IRS receives information about the taxpayer during the pendency of a determination regarding the hypothetical taxpayer's qualification for a voluntary disclosure; that taxpayer may become ineligible for a voluntary disclosure.

## Summary

The revelations of former Swiss and Liechtenstein bank employees, has ignited an outrage by governments around the world. These governments have responded by generating numerous initiatives, all which are aimed at ending the use of foreign tax havens to avoid paying taxes.

Here in the United States, we have a president who is committed to ending the use of offshore tax havens to evade paying U.S. taxes; we have a Congress waiting to pass some version of The Stop Tax Haven Abuse Act; we have the IRS litigating the John Doe summons sent to UBS, and among other things we also have the IRS proposing to issue John Doe summonses to other foreign banks where U.S. taxpayers may have accounts.

In this environment the IRS has announced this six-month voluntary disclosure procedure, which I like to refer to as the Last, Last Chance at Initiative. This initiative is designed to provide a predictable set of outcomes for taxpayers who desire to make a voluntary disclosure of their previously undeclared offshore income. The goal of this offshore initiative is to encourage as many U.S. taxpayers as possible to voluntarily disclose their previously undeclared offshore income, pay their associated taxes, interest and a significant penalty which is clearly set out in the penalty memorandum.

The fundamentals of this Last, Last Chance Initiative are clear:

- (1) The taxpayer must file corrected delinquent or amended tax returns for tax years 2003 through 2008.
- (2) The taxpayer must pay (or arrange for payment) of the associated taxes plus interest for tax years 2003 through 2008.
- (3) The taxpayer must pay a mandatory assessment of either a 20-percent accuracy penalty or a 25-percent delinquency penalty, for each year involved, with no reasonable cause exception allowed.
- (4) The taxpayer must pay a one time 20-percent penalty in the year with the highest aggregate account balance, including all offshore accounts. This penalty is in lieu of all other available penalties, including the penalty for not filing the FBAR and various penalties for the nonfiling of Information Returns.

While practitioners may take issue with many components of this Last, Last Chance Initiative (for example the nonallowance of a reasonable cause exception or the technical basis for many of the initiatives provisions) they should understand the IRS's position that if a taxpayer wants to avail themselves of this

certainty of noncriminal prosecution pursuant to this initiative and the certainty of the associated penalties provided by this initiative; then it's a package deal and they will not be negotiating with taxpayers or their representatives, any item contained in this Last, Last Chance Initiative, in order to ensure uniformity in its administration.

The taxpayer or his/her representative is not obligated to utilize this Last, Last Chance Initiative. The taxpayer or his representative may choose to do a voluntary disclosure pursuant to IRM Section 9.5.11.9., especially where the taxpayer has a reasonable basis for waving the various associated penalties for the unreported offshore income. Alternatively, the taxpayer or his representative may have attempted a so-called quiet disclosure by filing amended returns and paying any related tax and interest for previously unreported offshore income without otherwise notifying the IRS. However, the results of these two courses of action are less certain than the results currently being offered in Last, Last Chance Initiative.

Whatever decision a taxpayer and his/her representative make regarding the utilization or nonutilization of this Last, Last Chance Initiative: They need to also address the potential state tax issues and state tax assessments associated with any federal tax filing, including previously undeclared foreign source income.

Whatever decision a particular taxpayer makes regarding his/her desire to take advantage of this Last, Last Chance Initiative; this is an option that should not be dismissed without serious consideration. It would be a very, very serious error for a taxpayer to do nothing and hope that his/her potential IRS problems regarding unreported offshore income will just go away. They will not!

#### Footnotes

- 1 US Treasury Department, *A Report to Congress in Accordance With §361(B) of the USA PATRIOT Act* (Apr. 26, 2002) (Treasury Report), at 6. The report is available at [www.ustreas.gov/press/releases/reports/fbar.pdf](http://www.ustreas.gov/press/releases/reports/fbar.pdf). USA PATRIOT Act of 2001 (P.L. 107-56).
- 2 68 FR 26,468 (May 16, 2003) (codified at 31 CFR §103.56(g)).
- 3 Sarah Plass, *U.S. Among Countries Investigating Tax Evasion*, N.Y. TIMES, Feb. 27, 2008, at D1.
- 5 Department of Justice Press Release No. 08-584.
- 6 *Id.*
- 7 Department of Justice Press Release No. 08-579.
- 8 Department of Justice Press Release No. 09-136.
- 9 Department of Justice Press Release No. 09-349.
- 10 Stop Tax Haven Abuse Act (H.R. 1265).
- 11 IRS Memorandum: *Authorization to Apply Penalty Framework to Voluntary Disclosure Requests*, Mar. 23, 2009.
- 12 IRS Memorandum: *Emphasis on and Proper Development of Offshore Examination Cases*, Mar. 23, 2009.
- 13 IRS Memorandum: *Routing of Voluntary Disclosures*, Mar. 23, 2009.
- 14 Statement from IRS Commissioner Doug Shulman on Offshore Income, Mar. 26, 2009.
- 15 IRS Memorandum: *Authorization to Apply Penalty Framework to Voluntary Disclosure Requests*, Mar. 23, 2009.
- 16 IRS Memorandum: *Emphasis on and Proper Development of Offshore Examination Cases*, Mar. 23, 2009.
- 17 Bank Secrecy Act of 1970 (P.L. 91-508).
- 18 Statement from IRS Commissioner Doug Shulman on Offshore Income, Mar. 26, 2009.
- 19 [Rev. Proc. 2003-11](#), IRB 2003-4, 311; 2003-1 CB 311.
- 20 [Announcement 2006-95](#), IRB 2006-50, 1105; 2006-2 CB 110.
- 21 Statement from IRS Commissioner Doug Shulman on Offshore Income, Mar. 26, 2009.
- 22 Department of Justice Press Release No. 09-296.

- 23 IRS Memorandum: Emphasis on and Proper Development of Offshore Examination Cases, Mar. 23, 2009.
- 24 IRM 9.5.11.9.2
- 25 *Id.*
- 26 Alison Bennett, *Tax Havens: IRS Issues Comprehensive New FAQs On Offshore Voluntary Compliance Program*, BNA DAILY TAX REP., May 7, 2009, at 86 DTR G-6.
- 27 [www.irs.gov/irm/part9/ch05s13.html#d0e42500](http://www.irs.gov/irm/part9/ch05s13.html#d0e42500).
- 28 IRM 9.5.11.9.3
- 29 IRM 9.5.11.9.4
- 31 Alison Bennett, *Tax Havens: IRS Issues Comprehensive New FAQs On Offshore Voluntary Compliance Program*, BNA DAILY TAX REP., May 7, 2009, at 86 DTR G-6.
- 32 *Id.*