

## SECOND (AND LIKELY FINAL) IRS OFFSHORE ACCOUNT DISCLOSURE INITIATIVE

### Action required by August 31, 2011

By Christopher J. Loughran

#### OVERVIEW

The IRS recently announced another “amnesty” type of program, available until August 31, 2011, for people with previously unreported offshore accounts. The prior disclosure program, which we summarized in our July 2009 tax bulletin, expired in the fall of 2009. The new program may best be summarized as more punitive than the 2009 program, but participation is likely to obtain a better result as compared with the result if a taxpayer is caught by the IRS without being in full compliance. “Being in full compliance” would mean that offshore accounts have been timely disclosed annually to the IRS on all required forms, all related income was fully reported on the appropriate U.S. income tax return, and all related tax was fully paid. More detail regarding participation is provided below, but anyone who determines the disclosure program may be appropriate for their circumstances should obtain legal counsel before contacting the IRS, since disclosure involves the IRS Criminal Investigation Division, which is not obligated to accept taxpayers into the program depending on the facts submitted.

Also noted below for taxpayers who have merely failed to file certain information returns (but have paid all tax on all offshore accounts), is helpful clarification from the IRS that these forms can also be filed without penalty up to August 31, 2011. Such filings are not technically part of the disclosure program, as explained more fully below.

The new disclosure program is officially referred to by the IRS as the “2011 Offshore Voluntary Disclosure Initiative (OVDI)”. Full details of the program including related forms are available at the IRS website at [www.irs.gov](http://www.irs.gov).

The 2009 (expired) program included penalties of only 20 percent of the late paid tax relating to the offshore accounts, as well as 20 percent of the highest balance in the offshore accounts not reported over the prior 6 years. If all tax had been timely paid, but the taxpayer merely failed to file timely annual Reports of Foreign

Bank and Financial Accounts (commonly referred to as “FBARs”), the 2009 program waived all penalties for the taxpayer merely getting caught up on the FBAR filing requirement.

The 2011 program penalties will generally be more severe than those applicable in the 2009 program. Each participant in the 2011 program would be required to do the following if they have not previously properly reported and paid U.S. tax on all offshore accounts:

- File amended income tax returns if required for 2003-2010 and pay all tax and interest on previously unreported income;
- File accurate original or amended FBAR reports for 2003-2010;
- Pay a 20 percent accuracy-related penalty for all underpaid tax pursuant to section 6662(a);
- If applicable, pay the failure to file penalty or failure to pay tax penalty (section 6651(a)) of up to 25 percent of the tax due;
- In lieu of all other penalties that could apply (including FBAR or other offshore information return penalties), pay a penalty equal to 25 percent of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets. In certain cases the penalty rate may be limited to 12.5 percent or 5 percent. The 12.5 percent penalty will apply if the highest aggregate foreign balance in all OVDI years is less than \$75,000. The 5 percent penalty rate is limited to two scenarios: 1.) taxpayers who are foreign residents who can establish that they were unaware they were U.S. citizens, and 2.) certain offshore accounts, such as inherited offshore accounts, the taxpayer did not open or cause to be opened, have had limited contact with, have withdrawn not more than \$1,000 per year from, and can establish that U.S. tax was paid on all funds deposited into the account (i.e., only offshore earnings have escaped U.S. taxation).

While the penalties for participating in the 2011 OVDI program are significant, before dismissing participation, any eligible party with an undisclosed offshore account must seriously weigh the cost of program participation against the serious risks associated with nonparticipation and subsequent detection. A host of civil and criminal penalties can apply to nondisclosure or inadequate disclosure of offshore accounts. While this list is not all inclusive, such nondisclosure could result in the following penalties (which can be avoided through proper participation in the 2011 OVDI program):

- For any year for which an FBAR was required to be filed but was “willfully” not filed (generally required when the aggregate value of all foreign accounts exceeds \$10,000 at any time in a given year), the failure to file penalty can be as high as the greater of \$100,000 or 50 percent of the foreign account value (i.e. the penalty can exceed the account

value) – per violation. If the taxpayer can show the failure was not willful, the penalty may be limited to \$10,000 per violation.

- Penalty for failure to file Form 3520 – Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts. For each unfiled or incomplete return, a penalty of up to 35 percent of the gross reportable amounts.
- Penalty for failure to file Form 3520-A – Information Return of a Foreign Trust with U.S. Owner. For each unfiled or incomplete return, a penalty of 5 percent of trust assets owned by a U.S. person.
- Penalty for failure to file Form 5471 – Information Return of U.S. Persons with Respect to Certain Foreign Corporations. For each unfiled return, a penalty of \$10,000.
- Penalty for failure to file Form 5472 – Information Return of a 25% Foreign Owned U.S. Corporation. For each unfiled return, a penalty of \$10,000.
- Penalty for failure to file Form 926 – Return by a U.S. Transferor of Property to a Foreign Corporation. For each failure to file, a penalty of 10 percent of the value of the property transferred, up to \$100,000.
- Penalty for failure to file Form 8865 – Return of U.S. Persons with Respect to Certain Foreign Partnerships. For each failure to file, a penalty of \$10,000, plus an additional 10 percent of the value of any property transferred (such 10% being capped at \$100,000).
- Accuracy-related penalties under section 6662 of 20 percent or 40 percent of the unpaid tax.
- Failure to file return or pay tax penalties of up to 25 percent each.

Participation in the OVDI program can also avoid criminal charges that might otherwise be applied. Such criminal charges might include tax evasion (up to 5 years imprisonment and a fine up to \$250,000), filing a false income tax return (3 years/\$250,000), failure to file an income tax return (1 year/\$100,000), willful failure to file an FBAR or willfully filing a false FBAR (10 years/\$500,000).

In addition to individuals, others eligible for the 2011 OVDI program include corporations, partnerships and trusts.

The IRS indicates that taxpayers who are under examination, whether civil (such as a routine income tax examination) or criminal, are not eligible to participate in the 2011 OVDI, regardless of whether or not such examination is directed toward undisclosed foreign accounts or entities. It is not clear yet from IRS guidance whether this restriction only applies to the years under examination – but it appears it may preclude OVDI participation for any year as long as an examination is open.

The IRS has stated that so-called “quiet disclosures” (amended or late returns filed outside the OVDI program) will not be eligible for the benefits of the OVDI program if they are selected for examination.

### **Helpful Clarification for Taxpayers Who Have Only Failed to File FBARs (or other information returns)**

The IRS in the OVDI Frequently Asked Questions (FAQ) and Answers item 17 specifically states that taxpayers who have reported all income from offshore accounts and paid all related tax on previously filed returns, but merely failed to timely file the annual informational FBAR report, are not eligible for the 2011 OVDI program. The IRS directs such taxpayers to file any such delinquent FBAR for a tax year prior to 2010 per the instructions to Form TD F 90-22.1 (with an attached statement explaining why they are late), and states that if such FBARs are filed by August 31, 2011, the IRS will not impose FBAR late filing penalties if in fact there has been no underreported tax liability. The

IRS reiterates that FBARs for 2010 must be filed by the normal due date, June 30, 2011, in order to avoid late filing penalties.

In FAQ 18, the IRS goes on to state that for taxpayers who have merely failed to file other information returns (such as Form 5471 for controlled foreign corporations or Form 3520 for foreign trusts), but who have paid all tax on all taxable income that might be disclosed on or through these information returns, such taxpayers should file delinquent information returns with the appropriate IRS service center and attach a statement explaining why the information returns are being filed late (the Form 5471 would for example be submitted with a complete amended return, with no other change but the inclusion of the Form 5471 and related statement, assuming the return was otherwise correct as filed). In these cases, the IRS says it will not impose a penalty for failure to timely file the information returns if they are filed by August 31, 2011 and there is no underreported tax liability.

**We recommend that you seek assistance from a professional tax advisor before filing any late information returns mentioned above, and certainly if you believe there is reason for participation in the 2011 OVDI program (in which case legal counsel with experience in the area is highly recommended). If you would like to discuss your situation, please contact one of the Perkins tax shareholders noted on the back of this bulletin or your own tax advisor.**

# BULLETIN

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**For any questions or additional clarification, please contact your tax advisor or one of the Perkins & Co tax shareholders or managers:**

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