THE IRS'S OFFSHORE VOLUNTARY DISCLOSURE PROGRAM AND RELATED PROCEDURES

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Today's Program

- History and Context of the Offshore Voluntary Disclosure Program (OVDP) and the IRS's voluntary disclosure practice
- Various Offshore Programs and Procedures
- The OVDP Process
- Practical Pointers

The Offshore Voluntary Disclosure Program ("OVDP")

- The OVDP is an IRS program that provides a uniform penalty structure and process for taxpayers who come forward voluntarily and report their previously undisclosed foreign accounts and assets.
- The program allows taxpayers to report and correct past noncompliance with respect to reporting of foreign income and/or foreign assets.
- The OVDP requires that the taxpayer pay the additional tax liability, plus certain tax penalties and interest, as well as an OVDP penalty.
- In exchange, the IRS agrees not to seek additional penalties or to recommend the taxpayer for criminal prosecution.

Illustrating the Problem

Assume that a taxpayer had the following amounts and activity in a foreign financial account:

Year	Amount on Deposit	Interest Income	Account Balance
2007	$1,000,000	$50,000	$1,050,000
2008		$50,000	$1,100,000
2009		$50,000	$1,150,000
2010		$50,000	$1,200,000
2011		$50,000	$1,250,000
2012		$50,000	$1,300,000
2013		$50,000	$1,350,000
2014		$50,000	$1,400,000

Further assume that the taxpayer willfully failed to report any income on this foreign financial account or to file FBARs or any foreign informational returns during any years. Taxpayer's marginal tax rate is 35%.

Illustrating the Problem *(cont.)*

- If the taxpayer in the above example comes forward and his/her voluntary disclosure is accepted by the IRS, he/she faces the following potential scenario under the OVDP:
  - He would pay $553,000 plus interest. This includes:
    - Tax of $140,000 (8 years at $17,500) plus interest,
    - An accuracy-related penalty of $28,000 (i.e., $140,000 x 20%), and
    - A miscellaneous offshore penalty of $385,000 (i.e., $1,400,000 x 27.5%).
  - Most importantly, the IRS effectively grants criminal amnesty, agreeing not to refer the taxpayer for criminal prosecution.

Illustrating the Problem *(cont.)*

- If the taxpayer does not come forward, he/she faces significant civil tax and criminal exposure.
- Statutes authorize potential fines of over $4,000,000 plus applicable interest, as well as any fines related to required information return penalties.
- The civil liabilities potentially include:
  - The tax, accuracy-related penalties, and, if applicable, the failure-to-file and failure-to-pay penalties, plus interest;
  - FBAR penalties totaling up to $3,825,000 for willful failures to file complete and correct FBARs (2009 - $575,000, 2010 - $600,000, 2011 - $625,000, 2012 - $650,000, and 2013 - $675,000, and 2014 - $700,000) (***but see*** recent IRS guidance on FBAR penalty assessment);
  - A potential fraud penalty (75%); and
  - Potential substantial additional information return penalties if the foreign financial account is held through a foreign entity such as a trust or corporation and required information returns were not filed.
- In addition, if the taxpayer is not in the OVDP and the foreign noncompliance started before 2007, the Service may examine tax years prior to 2007.
- Most importantly, the taxpayer faces severe criminal exposure.

Various Offshore Programs and Procedures

- History of programs
- Major changes to the 2014 program (current)
- Requirements to be accepted
- When is the OVDP the right choice?

History of the Voluntary Disclosure Programs

- Background – program specifically designed for taxpayers with exposure to criminal/civil penalties due to willful failure to report foreign financial asset and pay all taxes due in respect to those assets
- 2009 OVDP
- 2011 OVDI
- 2012 OVDP
- 2014 OVDP

Major Changes in the 2014 Program

- Disclosure of additional (potentially self-incriminating) information in preclearance process
- Disclosure of entity information
- 50-percent penalty
- Upfront payment
- Changes related to new streamlined program

Requirements to Be Accepted into the OVDP

- Taxpayers who have legal source funds invested in undisclosed OVDP assets and meet the requirements of IRM 9.5.11.9 are eligible to apply for the OVDP.
  - Note: The Voluntary Disclosure Practice does **not** apply to illegal source income.
  - Individuals who facilitated the tax noncompliance of others are **not** eligible to participate in OVDP.
  - If the IRS has initiated a civil examination for any year, regardless of whether it relates to undisclosed OVDP assets, the taxpayer will not be eligible to participate in the OVDP. A taxpayer under criminal investigation by CI is also ineligible.
- Entities are eligible to participate in the OVDP.

OVDP Process

- Preclearance
- The voluntary disclosure letter
- The voluntary disclosure package
- Opt-out (if applicable)
- Finishing the process

Step 1: Preclearance

- Purpose
  - Is the taxpayer “cleared” to make a voluntary disclosure?
  - In other words, does the IRS already have the taxpayer’s name/information?
    - How might the IRS already have the taxpayer’s name/information?
- Process
  - A one-page fax request to IRS CI
  - Under the new 2014 program, requires providing certain incriminating information
  - How long does it take?

Step 2: Voluntary Disclosure Letter

- Voluntary disclosure letter
  - IRS Form 14457, *Offshore Voluntary Disclosure Letter*
  - IRS Form 14454, *Attachment to Voluntary Disclosure Letter*
  - Each account requires a separate attachment
  - Signed under penalty of perjury
- "Preliminary acceptance"
  - Following successful CI background check and processing of voluntary disclosure letter and attachments

Step 3: Voluntary Disclosure Package

- Taxpayer must submit the “OVDP Package” for the required period
- OVDP package includes:
  - Original tax returns
  - Amended returns
    - Must include any previously omitted income, foreign or domestic
  - Copy of Offshore Voluntary Disclosure Letter
  - FBARs
  - SOL waiver
    - Form 872 and
    - FBAR
  - Foreign Account or Asset Statement
  - Penalty Calculation Worksheet
  - Payment of tax, interest, 20% accuracy penalty, and, if applicable, failure-to-file and failure-to-pay penalties
  - OVDP penalty (“in lieu of” penalty)
    - 27.5% (50%, if applicable)
  - Account Statements
  - Any required disclosure statements

Calculating the Penalty

- The penalty base
- Common issues
  - Currency conversion
  - Transfers between accounts
  - Valuation discounts for assets held through entities?
  - Co-ownership of OVDP assets issues

The 50-Percent Penalty

- Under the 2014 Program, taxpayers with an undisclosed foreign financial account are now subject to a 50-percent miscellaneous offshore penalty if, at the time of submitting the preclearance letter to IRS Criminal Investigation, an event has already occurred that constitutes a public disclosure that either:
  - The FFI where the account is held, or a facilitator who assisted in establishing or maintaining the taxpayer's offshore arrangement, is or has been under investigation by the IRS or the DOJ in connection with accounts beneficially owned by a U.S. person;
  - the FFI or other facilitator is cooperating with the IRS or the DOJ; or
  - the FFI or other facilitator has been identified in a court-approved issuance of a summons seeking information about U.S. taxpayers who may hold financial accounts (a "John Doe summons").

The 50-Percent Penalty *(cont.)*

- Once the 50-percent miscellaneous offshore penalty applies to any of the taxpayer's accounts or assets, it will apply to all of the taxpayer's assets subject to the penalty, including accounts held at another institution or established through another facilitator for which there have been no events constituting public disclosures. FAQ 7.2

List of “Bad” Banks

- The List is growing!
- Check it for each disclosure.

Opting Out

- An “Opt-out” is the election by a taxpayer to have his/her case handled under the standard audit procedure, rather than submit to the OVDP’s one-size-fits-all penalty structure.
- An “opt out” is distinct from a “removal” from the program.
- So long as the taxpayer continues to cooperate, he/she continues to receive protection against criminal referral.
- The decision to “opt out” is irrevocable.
- “Opt Outs” come with significant risks.
  - Those risks may be mitigated somewhat in light of recent IRS guidance.

Finishing the Process

- Revenue Agent assigned
- Possible IDRs
- Closing Agreement, Form 906

Common Questions

- How long does the process take?
- When does the client have to pay?
- Are penalties negotiable?
- Is a taxpayer still eligible for streamlined relief if the account was held at a 50% bank?
- Can the taxpayer just disclose some, but not all unreported accounts?
- When will the OVDP end?

The Changing Landscape

- FATCA Agreements Continued to be Signed

- Waves

Alternatives to the OVDP

- “Head in the sand” approach
- Quiet disclosures
- Streamlined relief
- Delinquent filing procedures

Head-in-the-Sand Approach

- Do nothing
- Presents serious risks
- Is there a legal obligation to file amended returns?

Quiet Disclosures

- A quiet disclosure involves filing amended returns and forms reporting the additional unreported income and assets without making a voluntary disclosure or otherwise notifying the IRS.

Delinquent FBAR Submission Procedure

- Available for taxpayers who do not need to use either the OVDP or the Streamlined Filing Compliance Procedures to file delinquent or amended tax returns to report and pay additional tax, but who:
  - have not filed a required Report of Foreign Bank and Financial Accounts (FBAR) (FinCEN Form 114),
  - are not under a civil examination or a criminal investigation by the IRS, and
  - have not already been contacted by the IRS about the delinquent FBARs
- Supersedes old FAQ 17

Streamlined Relief

- The streamlined filing procedures have been expanded and modified to accommodate a much broader group of U.S. taxpayers.
- Major changes to the streamlined procedures include:
  - Extension of eligibility to U.S. taxpayers residing in the U.S.;
  - Elimination of the $1,500 tax threshold; and
  - Elimination of the risk assessment process associated with the streamlined filing compliance procedure announced in 2012

Willful vs. Non-Willful

- What is “willful” and “non-willful” conduct?
- Willfulness: “a voluntary, intentional violation of a known legal duty.” IRM 4.26.16.4.5.3
- Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.
- What evidence is relevant?

Streamlined Relief

(cont.)

- Two New Streamlined Procedures
  - Streamlined Foreign Offshore Procedure (“SFOP”)
  - Streamlined Domestic Offshore Procedure (“SDOP”)
- Certification
  - Due to non-willful conduct
  - Taxpayer must certify that the failure to report foreign financial assets and report all tax due in respect of those assets did not result from willful conduct on their part.
- Not eligible if IRS started civil examination

How is the Streamlined Procedure Different from the OVDP?

- Except for certain “transitional” relief, the two programs are mutually exclusive.
- No protection against criminal referral
- Reduced penalties:
  - SFOP: Penalties are waived
  - SDOP: 5% penalty
  - Compare to OVDP Penalty of 27.5% (or 50%, if applicable)
- Requires certification of non-willfulness
- Tax returns are processed like any other return
- May be subject to audit, but not automatically
- No closing agreement

Risks Associated with Streamlined Program

- Once a streamlined submission is made, the taxpayer may *not* participate in the OVDP
- Non-willful certification
- No preclearance protection
- No protection against criminal referral or application of civil fraud penalties if IRS determines was “willful” violation

DISCLAIMER

The information included in these slides is for discussion purposes only and should not be relied on without seeking individual legal advice.