

## By-Lined Article

# THE SECOND COMING OF THE VOLUNTARY DISCLOSURE PROGRAM FOR UNDISCLOSED FOREIGN ACCOUNTS

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Due to the success of the Internal Revenue Service's (IRS) previous voluntary-disclosure program for undisclosed foreign accounts that resulted in 14,700 submissions by the end-date of October 15, 2009, and another 3,000 submissions after that date, on February 8, 2011, the IRS announced a second initiative for the disclosure of unreported foreign accounts in exchange for reduced penalties. According to the IRS, this initiative — *2011 Offshore Voluntary Disclosure Initiative* (2011 OVDI) — is designed "to bring offshore money back into the U.S. tax system and help people with undisclosed income from hidden offshore accounts get current with their taxes" with certainty as to how their cases will be handled. IRS Commissioner Douglas Shulman said that this initiative "gives people a chance to come in before the IRS finds them" through widening IRS investigations of foreign banks, information from whistleblower disclosures, as well as from information obtained through the recently enacted Foreign Account Tax Compliance Act and the Foreign Financing Asset Reporting requirements.

## Frequently Asked Questions

To assist taxpayers, the IRS published at the same time as announcing 2011 OVDI a list of frequently asked questions (FAQs) to explain the new penalty structure, new pre-clearance procedure and to reflect some of the solutions to problems that arose in the 2009 program. Although no reasonable-cause relief is provided in the FAQs, the IRS has stressed that under no circumstances will taxpayers incur penalties greater than what they would have otherwise been liable for under the maximum existing statutory penalties. To ensure this point, the amount due under the 2011 OVDI will be compared to the maximum tax, interest and penalties without mitigating circumstances that a taxpayer would owe for all open years in the absence of the 2011 initiative and the lesser amount will be assessed.

## Timeliness of Disclosure

Timely disclosure is key to participating in the 2011 OVDI. August 31, 2011 is the last date by which all documents and supporting materials have to be submitted to the IRS. As forewarned, Commissioner Shulman said, "Start now, not in August."

## Eligibility

To be eligible for 2011 OVDI, the taxpayer must not be under either civil or criminal audit.

## Penalties Under the 2011 Initiative

The penalty structure under 2011 OVDI is higher than the penalty structure under the 2009 program and covers two additional years. In contrast to the 2009 program, the 2011 OVDI imposes a penalty of 25 percent, rather than the prior program's penalty of 20 percent, of the highest account balance in the foreign bank accounts from 2003 to 2011.

In addition to the 25-percent asset-based penalty, taxpayers will also be responsible for the income taxes and interest as a result of the unreported income plus the 20-percent accuracy-related penalty and if applicable, the failure to file and pay penalties on previously unreported foreign income.

Not only will the 25-percent penalty apply to unreported foreign financial accounts, but also to offshore assets acquired with funds that were not taxed.

Under certain circumstances the 25-percent penalty may be reduced to 12.5 percent or 5 percent. The 12.5-percent penalty will apply to taxpayers whose highest aggregate asset account balance for each of the eight years covered by the program did not exceed \$75,000. There is even a lower penalty of five percent for taxpayers who did not open the account, unless the bank required them to open a new account, had minimal contact with the account, did not withdraw more than \$1,000 in any year covered by the initiative and can establish that all U.S. taxes have been paid on the funds in the account and for taxpayers who are foreign residents and were not aware that they were U.S. citizens. Taxpayers who participated in the 2009 program and who would qualify for reduced penalties under 2011 OVDI can reopen their cases and have the lower penalty applied.

### **Pre-clearance Screening Process**

Taxpayers can submit to pre-clearance screening to determine whether they are eligible for 2011 OVDI. Pre-clearing screening can be obtained by faxing to the Criminal Investigation Lead Development Center in Philadelphia the taxpayer's identifying information, e.g. name, date of birth, Social Security number and address, executed power of attorney if represented and a request for pre-clearance before making an offshore voluntary disclosure. Criminal Investigation will then inform the taxpayer or the taxpayer's representative whether or not they are cleared to make the disclosure. Taxpayers who are cleared will have 30 days from receipt of notification to make their voluntary disclosure by submitting an Offshore Voluntary Disclosure letter to the Offshore Voluntary Disclosure Coordinator in Philadelphia, a centralized voluntary disclosure management office. The Voluntary Disclosure Letter can be found on the [IRS website](#). Criminal Investigation will review the submission and will notify the taxpayer whether the offshore voluntary disclosure has been preliminarily accepted or declined. If accepted the taxpayer will be instructed to submit the full voluntary disclosure package of information as set forth on the IRS website.

### **Sham Entities and Information Returns**

Many taxpayers held offshore unreported accounts through controlled foreign entities that had no other purpose than to conceal the ownership of the accounts. As a result, these taxpayers were obligated to file information returns for those foreign entities, whether or not the form of the entity was honored by the taxpayers in dealing with the accounts. Under 2011 OVDI, the IRS will waive the requirement for filing delinquent information returns for such entities and the penalties, if the taxpayer dissolves the entity and submits a statement signed under penalties of perjury that the sole purpose of the entity was to conceal the taxpayer's ownership of the accounts.

### **Simplified PIFC Treatment**

The 2011 OVDI offers to taxpayers the same simplified method of valuing investments in passive investment foreign companies (PIFC) that was used in the 2009 program. In doing so, the IRS recognizes the difficulty that taxpayers would have in preparing statutory PIFC computations without historical information on cost basis and holding period and that the IRS would have in verifying them. The 2011 OVDI offers taxpayers the use of the mark-to-market methodology authorized by the Internal Revenue Code (IRC) without having to reconstruct historical data. Under the

mark-to-market method, the IRS will apply a 20-percent tax rate to mark-to-market gains, net gains and gains from all PFIC dispositions during the eight-year period covered by the initiative. In addition, seven percent of such gains computed under the mark-to-market method for the first year of the initiative will be added to the tax for that year.

## **Conclusion**

As noted in the announcement of 2011 OVDI, "tax secrecy continues to erode" and for those hiding cash or assets offshore, the "risk of being caught will only increase." 2011 OVDI offers clear benefits to encourage taxpayers to make a submission, rather than risk detection with higher penalties and possible criminal prosecution. In light of the August 31, 2011, deadline for submitting required documents and material, taxpayers should start now to take advantage of the initiative. There is no reason to believe that there will be a third coming of a voluntary disclosure program for taxpayers hiding assets offshore. As said by Commissioner Shulman, this is the "last, best chance for people to get back into the system. . ."

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