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2011 Offshore Voluntary Disclosure Initiative – Mainly Good News But Some Bad News Too

On February 8, 2011, the IRS Commissioner announced a second offshore voluntary disclosure initiative (the "2011 OVDI") for U.S. taxpayers who still have unreported foreign accounts. The 2011 OVDI follows the IRS's hugely successful 2009 Offshore Voluntary Disclosure Program (the "2009 OVDP"). The 2011 OVDI largely continues the practices of the 2009 OVDP, but it imposes higher penalties and taxes. The good news is that the penalty was only increased from 20% to 25% and that criminal prosecution will not be recommended for complying participants; the bad news is that taxes, tax penalties, and interest have to be paid for an 8-year period rather than a 6-year period.

It should be noted at the outset that it is entirely legitimate for U.S. taxpayers to have foreign accounts and offshore corporations, trusts, etc.; however, subject to limited exceptions, U.S. taxpayers must report foreign accounts and offshore corporations, trusts, etc. to the U.S. Treasury on the Form 90-22.1 (often referred to as the "FBAR") and must pay tax on any income earned from those accounts.

Under the 2011 OVDI taxpayers will have to file tax returns for years 2003 through 2010, and pay any unpaid taxes, interest and tax penalties. In addition, the 2011 OVDI imposes a 25% penalty on the highest balance in the account(s) during that same 8 year period. Although the 25% penalty imposed under the 2011 OVDI is more severe than the 20% penalty imposed under the 2009 OVDP, in most cases it is still significantly less severe than the substantial civil, and in some cases criminal, penalties which may otherwise be imposed on a U.S. taxpayer for each year the taxpayer failed to accurately disclose a foreign financial account or offshore corporation or trust, etc. on an FBAR, etc.

A lower 12.5% penalty may apply where the accounts are less than \$75,000. Furthermore, a 5% penalty may apply where the taxpayer did not open the account, had minimal contact with the account, made annual withdrawals of less than \$1,000 and can show that tax was paid on the income from the account. This "tax paid" requirement will prevent many taxpayers from otherwise qualifying for the 5% penalty.

Taxpayers who participated in the 2009 OVDP and paid the 20% penalty, but who would qualify for the 5% penalty under the 2011 OVDI can reopen their case and apply for the reduced 5% penalty.

The 2009 OVDP ended on October 15, 2009; however, some estimated 3,000 taxpayers have applied to participate in the regular IRS voluntary disclosure program since that date. Those taxpayers can elect to roll into and participate in the 2011 OVDI.

Unlike the 2009 OVDP, the 2011 OVDI requires that participating taxpayers submit their amended tax returns, including all previously unfiled information returns and FBARs, and pay the taxes, interest and penalties **on or before** August 31, 2011. This requirement was intended to simplify the processing of the information by the IRS, but will make it difficult for many taxpayers to comply. It has been our experience that since the UBS summons was withdrawn last year, it has been increasingly difficult to obtain old bank statements from many foreign banks. Taxpayers who plan on participating in the 2011 OVDI should begin the process as soon as possible to comply with the August 31, 2011 deadline.

The IRS has released a 28-page FAQ which provides additional information on the application process, how to deal with Passive Foreign Investment Company ("PFIC") issues, how to qualify for the 5% penalty, etc. As expected, the FAQ strongly suggests that taxpayers who have made "quiet disclosures" should participate in the 2011 OVDI, and provides that if the "quietly filed" amended tax returns are audited, the IRS could seek to impose criminal sanctions as well as examine years before 2003.

Another piece of good news is that the IRS will not impose penalties for failure to file Forms 5471 or 3520, for example, if such forms are filed before August 31, 2011 **and** there are otherwise no unreported tax liabilities.

Given that the new reporting requirements enacted by the HIRE Act will take effect shortly, the 2011 OVDI may represent the last window of opportunity for taxpayers with unreported foreign accounts to come forward and clean up their filing obligations. Considering that the IRS has now given non-compliant taxpayers two opportunities to come forward voluntarily, those taxpayers who choose not to do so will likely face significant additional penalties should they be caught by the IRS. In this era of Wikileaks and whistleblowers, and the IRS's ongoing focus on identifying non-compliant taxpayers, we strongly caution non-compliant taxpayers against assuming that they will not be caught by the IRS.

For additional information, please contact the authors or any member of the [Venable Tax Group](#).

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