

June 10, 2011

Extension and New Guidance for the Voluntary Disclosure Initiative for Undisclosed Foreign Assets

On June 2, 2011, the IRS provided additional guidance regarding its 2011 offshore voluntary disclosure initiative (OVDI) in the form of revised frequently asked questions (FAQs).

The new guidance:

- allows taxpayers to request up to a 90-day extension to submit all necessary documentation under the program;
 - provides reduced FBAR penalties for certain U.S. taxpayers who reside in foreign countries and have been compliant with such countries' tax obligations; and
 - provides examples and procedures for taxpayers to opt out of the civil settlement structure of the OVDI program.
1. Under the OVDI program, a taxpayer is required to submit all necessary documentation and statements prior to August 31, 2011. New FAQ 25.1 allows a taxpayer who is in the program to request an extension of up to 90 days to comply with such requirement. However, the taxpayer must be able to demonstrate his good faith attempt to comply with the August 31 deadline. In the extension request, the taxpayer must include a list of those items that are missing, the reasons why they are not included and the steps taken to secure them. The taxpayer also must include agreements to extend the period of time to assess tax (including tax penalties) and to assess FBAR penalties.
 2. Under the OVDI program, taxpayers generally are assessed a special penalty (the FBAR penalty), in lieu of the statutory FBAR and certain other penalties, equal to 25% of the highest yearly aggregate value of the taxpayer's offshore accounts and other offshore assets in any year included in the period covered by the OVDI program. Revised FAQ 52 provides a new category of taxpayers that will be subject to a reduced 5% FBAR penalty and limits the scope of such penalty so that it is not imposed on non-financial assets purchased with funds for which the taxpayer can establish that all applicable taxes have been paid, either in the United States or in the country of residence. In order to qualify for the reduced penalty, a taxpayer who is a foreign resident must meet all three of the following conditions for all of the years of his voluntary disclosure: (a) taxpayer resides in a foreign country; (b) taxpayer has made a good faith showing that he has timely complied with all tax reporting and payment requirements in the country of residency; and (c) taxpayer has \$10,000 or less of U.S.-source income each year. This rule only applies if the income tax returns filed with the foreign tax authority included the offshore-related taxable income that was not reported on the U.S. tax return.

If you have any questions or inquiries regarding the OVDI and the new guidance, please contact your Katten Muchin Rosenman LLP attorney, or any of the following attorneys.

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3. Taxpayers who believe their tax and FBAR penalties under the regular tax rules would be less than the penalties provided under the OVDI may opt out of the civil settlement structure of the program. Revised FAQ 51 provides examples as to when it would be beneficial for a taxpayer to opt out of the civil settlement provided by the OVDI and the procedure for taxpayers electing to opt out. However, such taxpayers will undergo a full examination by the IRS. Depending on the results of such examination, a taxpayer may be assessed civil fraud and other penalties and, if the taxpayer is found to have any unreported income that was not disclosed in the voluntary application, risks criminal prosecution.

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