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National Taxpayer Advocate Charges IRS of Reneging Promise

Nancy Olson, the National Taxpayer Advocate which is the IRS watchdog service charged the IRS of reneging on its promise to cap penalties on taxpayers for offshore disclosures of their income. Accusing the IRS of “bait and switch”, Olsen said the IRS in its most recent Offshore Voluntary Disclosure program has seen scores of taxpayers participating in the program and paying more than what they were supposed to pay in taxes and fines. Such taxpayers are typically those who have inherited accounts or work overseas.

Olson warned that dissatisfaction in how the IRS is conducting the voluntary disclosure program might seriously undermine the trust in the IRS in future compliance programs. However, the IRS through its spokesman Dean Patterson strongly refuted Olson’s comments saying, “If at any time during the certification process, a taxpayer disagreed with the results provided for under the program the taxpayer could opt out of the program and make their case for lower penalties. This option is still available today.”

On Monday, the IRS announced the start of another Offshore Voluntary Disclosure program like the two held in 2009 and 2011 in which about \$4.4 billion was collected in taxes and fines from more than 33,000 US taxpayers who had taxable assets in overseas bank accounts.

In Olsen’s annual report to Congress, she wrote that the penalty on taxpayers for non-willful or accidental failure to file a record of foreign bank and financial accounts, or FBAR, was not to be above \$10,000. On the other hand, willful failure to file an FBAR would carry a draconian penalty, of 50% of the highest account balance for each year covered.

But in the Voluntary Disclosure program of 2009, the IRS said the maximum amount of penalty imposed would be 20%, whereas in 2011, the maximum amount was capped at 25%. Olson wrote that in what has come to be known as “FAQ 35” in tax circles, the IRS also said it would never assess a penalty greater than what the law would permit. However in February 2011, the IRS said it would no longer entertain arguments from taxpayers that their compliance was not willful.

So based on the IRS statement on "FAQ 35", many taxpayers especially those with Holocaust accounts they had inherited from ancestors made the claim that they were not willfully hiding their money to avoid taxes, assuming that they would not have to pay the 20 or 25% but instead would be fined the maximum of \$10,000. But this would be to no avail after the February 2011 statement by the IRS. In fact, since that time, IRS officers would even tell people that bringing up the non-willful argument is in effect opting out of the program and allowing the IRS to bring the full force of the law against the taxpayer.

In effect, this completely nullifies "FAQ 35" thus reneging on the promise the IRS made therein. Yet tax lawyers still view participation in the voluntary disclosure program as the best option if you have offshore taxable income.