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IRS Announces Second Special Voluntary Disclosure Initiative for Taxpayers With Undisclosed Offshore Accounts

The Internal Revenue Service announced on February 8, 2011 the creation of a second special voluntary disclosure initiative for U.S. taxpayers with undisclosed foreign bank and other financial accounts. This new program is a follow-on to the IRS' original voluntary disclosure initiative that closed on October 15, 2009. The 2009 program reportedly attracted some 15,000 voluntary disclosures by taxpayers with previously undisclosed offshore accounts, and has been viewed within the government as a success in getting taxpayers "back into the U.S. tax system" by offering them the ability to avoid or significantly mitigate various the criminal and civil penalties that would otherwise have potentially applied had their failure to disclose been discovered by the IRS on audit.

As background, U.S. persons are generally required to file an annual information statement with the IRS disclosing any beneficial interest in, or signatory authority over, bank or other financial accounts located outside the U.S. This information statement is filed on Form TD F 90-22.1, and is generally referred to as an "FBAR" (Foreign Bank Account Report"). From an accountholder perspective the failure to file FBARs as required can potentially lead to a large array of both civil and criminal penalties – including monetary penalties of up to 50% of the unreported account balance (per year) and criminal penalties if the failure to file was willful.

The new 2011 program represents a second chance for taxpayers who did not take advantage of the original 2009 voluntary disclosure program. While the penalty structure offered by the IRS this time around is slightly less favorable than under the original 2009 program, it still offers taxpayers an opportunity to significantly reduce their penalty exposure. Highlights of the new 2011 program include the following:

- The program covers the years 2003 through 2010.

- There is an August 31, 2011 deadline to submit all required information to the IRS, including delinquent or corrected FBARs and amended income tax returns reporting any previously unreported income.

- In lieu of the normal 50% per year penalty, a participating taxpayer must pay a 25% penalty on the highest aggregate account balance in the undisclosed offshore account during the period covered by the voluntary disclosure. In limited cases, this 25% penalty may be reduced to 12.5% or 5%.

- Participating taxpayers must pay all delinquent taxes relating to any unreported offshore income, together with applicable interest and a 20% accuracy-related penalty.

- Participating taxpayers must pay any other applicable civil penalties associated with a failure to file returns or failure to pay taxes during the period covered by the voluntary disclosure.

- The program includes a generally favorable alternative resolution procedure to enable participating taxpayers to calculate their tax liability associated with investments that may have been made in "passive foreign investment companies" (e.g., foreign mutual funds) through their undisclosed offshore accounts.

- Participating taxpayers must fully cooperate with the IRS in providing information on offshore financial accounts, institutions and facilitators.

- The IRS will not initiate criminal prosecution of taxpayers who fully comply with the terms of the program.

The IRS remains focused on the potential evasion of U.S. income tax that is facilitated by hiding funds in offshore accounts, and has been increasingly aggressive in pursuing U.S. taxpayers who have failed to properly file FBARs and pay taxes on offshore income. As offshore financial secrecy continues to erode, the IRS has become increasingly able to obtain information relating to U.S. taxpayers directly from foreign banks. As a result, taxpayers with undisclosed offshore accounts that did not previously take advantage of the 2009 voluntary disclosure program may wish to consider the potential advantages of participating in this new 2011 program.

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