

IRS Announces 2011 Voluntary Disclosure Program

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The IRS has announced a second offshore voluntary disclosure initiative intended to bring more taxpayers into compliance with the tax rules and bring offshore money back into the U.S. tax system. The 2011 Voluntary Disclosure Program changes and clarifies some of the rules of the previous disclosure initiative, provides guidance to taxpayers and IRS examiners about how the guidelines are to be applied to the additional disclosures and presents a further disclosure opportunity for United States taxpayers with undisclosed foreign accounts.

On February 8, 2011, the Internal Revenue Service (IRS) announced a second offshore voluntary disclosure initiative (hereinafter, the "2011 Voluntary Disclosure Program") intended to bring more taxpayers into compliance with the tax rules and bring offshore money back into the U.S. tax system. The first offshore voluntary disclosure initiative was announced in 2009 (hereinafter, the "2009 Voluntary Disclosure Program") and ended on October 15, 2009. The 2009 Voluntary Disclosure Program was applicable for the 2003 through 2008 calendar years and, based on government announcements, resulted in approximately 15,000 disclosures. Since October 15, 2009, the IRS has received more than 3,000 additional disclosures. The 2011 Voluntary Disclosure Program, which changes and clarifies some of the rules in the 2009 Voluntary Disclosure Program, is available through August 31, 2011, and is applicable for the 2003 through 2010 calendar years. It provides guidance to taxpayers and IRS examiners about how the guidelines are to be applied to the 3,000 additional disclosures and presents a further disclosure opportunity for United States taxpayers with undisclosed foreign accounts.

Filing Requirements for Offshore Accounts

Each United States person who has a financial interest in or signature or other authority over any foreign financial accounts, if the aggregate value of the accounts exceed \$10,000, must report that relationship for each calendar year by filing a Form TD F 90-22.1 with the Department of the Treasury on or before June 30 of the succeeding year. Additionally, the United States person must indicate on line 7a of Schedule B of Form 1040 whether he or she has an interest in or signature or other authority over a foreign financial account. The 2009 Voluntary Disclosure Program and the 2011 Voluntary Disclosure Program allow taxpayers who are not in compliance with these rules to "turn themselves in" to the IRS in exchange for reduced penalties. Without the 2009 and 2011 Voluntary Disclosure Programs, the taxpayer could face severe civil and/or criminal penalties.

Penalty Structure

The penalty structure for the 2011 Voluntary Disclosure Program is somewhat higher than the penalty structure that was provided by the 2009 Voluntary Disclosure Program, but the 2011 Voluntary Disclosure Program provides some new features. A participant under the 2011 Voluntary Disclosure Program faces a 25 percent penalty on the highest aggregate balance of the account for the 2003 through 2010 calendar years, versus a 20 percent penalty under the 2009 Voluntary Disclosure Program. Additionally, because the 2011 Voluntary Disclosure Program applies for the 2003 through 2010 calendar years, the taxpayer faces penalties for the eight-year period, versus the six-year period under the 2009 Voluntary Disclosure Program. The 2011 Voluntary Disclosure Program, however, creates a new penalty category of 12.5 percent for taxpayers whose offshore accounts do not have more than \$75,000 in assets. The 2011 Voluntary Disclosure Program also clarifies when a taxpayer can qualify for a 5 percent reduced penalty. These two new penalty provisions are available to taxpayers who participated in the 2009 Voluntary Disclosure Program. Thus, a taxpayer who participated in the 2009 Voluntary Disclosure Program and would qualify for the 12.5 percent penalty under the 2011 Voluntary Disclosure Program can seek to have the reduced penalty imposed, even if a Form 906 closing agreement has been signed.

Additional Guidance

Additionally, the 2011 Voluntary Disclosure Program explains how the IRS will treat passive foreign investment income (PFIC). The treatment of investments held in the foreign accounts was somewhat confusing and was widely discussed by taxpayers. Taxpayers encountered disparate treatment by IRS examiners not familiar with the complicated PFIC rules. On September 13, 2010, the IRS provided for mark-to-market treatment for PFIC investments. The 2011 Voluntary Disclosure Program guidance is essentially the same.

The 2011 Voluntary Disclosure Program also provides guidance for taxpayers who attempted to make a “quiet” disclosure by filing amended returns, reporting their unreported income, but without making a voluntary disclosure. The 2011 Voluntary Disclosure Program strongly encourages those taxpayers to come forward under the 2011 Voluntary Disclosure Program and warns those taxpayers that they may be examined and criminally prosecuted. For taxpayers who properly reported all taxable income but that were unaware of the requirement to file the Forms TD F 90-22.1, the 2011 Voluntary Disclosure Program provides that the taxpayer does not have to use the voluntary disclosure process. The taxpayer simply has to file the delinquent Forms TD F 90-22.1. The 2011 Voluntary Disclosure Program also warns that if the IRS receives information under a John Doe summons that provides evidence of a specific taxpayer’s noncompliance, that particular taxpayer may become ineligible for the 2011 Voluntary Disclosure Program.

Interim Filers

Since the 2009 Voluntary Disclosure Program ended on October 15, 2009, more than 3,000 taxpayers attempted to voluntarily disclose an offshore account and have been waiting to hear what will happen to their cases. These taxpayers are now eligible for the 2011 Voluntary Disclosure Program, but it is unclear whether they will have to resubmit their information.

Conclusion

The 2011 Voluntary Disclosure Program has been generally well-received. It attempts to strike a balance of allowing more taxpayers to disclose their offshore accounts, while not rewarding them for waiting until after the 2009 Voluntary Disclosure Program deadline passed. After August 31, 2011, it is unknown whether another Voluntary Disclosure Program will be announced, but taxpayers who face potential criminal risk should not count on a third initiative. Therefore, taxpayers should take advantage of this opportunity while it lasts.

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