

# TAX ALERT

February 2011

## OFFSHORE VOLUNTARY DISCLOSURE INITIATIVE

### **THE 2011 OFFSHORE VOLUNTARY DISCLOSURE INITIATIVE—TAXPAYERS “LAST, BEST CHANCE” FOR DISCLOSURE WITHOUT CRIMINAL PROSECUTION**

*On February 8, 2011, the Internal Revenue Service (the “IRS”) announced a second, special voluntary disclosure initiative for taxpayers with unreported income from foreign accounts or assets during the 2003-2010 taxable years. The new initiative, which is intended to enable taxpayers with undisclosed foreign income to become compliant with the U.S. tax system, will only be available through August 31, 2011. The IRS warns that taxpayers who decide not to participate in the new initiative face a high risk of detection by the IRS, the imposition of substantial civil penalties, and an increased probability of criminal prosecution.*

#### **BACKGROUND – 2009 OFFSHORE DISCLOSURE PROGRAM**

In the wake of the U.S. government’s multi-agency effort against UBS to obtain information regarding U.S. taxpayers with “secret” or “undeclared” Swiss bank accounts, in March of 2009, the IRS announced a voluntary disclosure program for taxpayers who voluntarily reported undisclosed offshore income for the 2003 through 2008 taxable years. This program amounted to one of the largest and most significant tax amnesty programs in U.S. tax history.

Under the initial voluntary disclosure program, taxpayers who made a timely disclosure of their unreported foreign income were required to pay back-taxes and interest for the 2003 through 2008 period and either an accuracy or delinquency penalty on the back-taxes due for each year. In addition, disclosing taxpayers were required to pay a one-time 20% penalty on the highest aggregate account balance of any amounts held in undisclosed foreign bank accounts. In exchange, the IRS agreed not to pursue criminal prosecution of any taxpayers making a timely disclosure. The initial program expired on October 15, 2009.

The initial voluntary disclosure program resulted in disclosures by approximately 17,000 U.S. taxpayers with foreign accounts held in more than 60 countries worldwide. In addition, since the expiration of the initial voluntary disclosure program, more than 3,000 U.S. taxpayers have come forward to disclose undeclared foreign income and accounts. As a result of these additional, late disclosures, the IRS decided to offer taxpayers a formal last chance at disclosure.

#### **2011 OFFSHORE VOLUNTARY DISCLOSURE INITIATIVE**

As noted above, the 2011 Offshore Voluntary Disclosure Initiative (the “OVDI”) was announced by the IRS on February 8, 2011, and is intended to offer U.S. taxpayers a final opportunity to disclose undeclared foreign income and accounts without the threat of criminal prosecution. According to IRS Commissioner Doug Schulman, “[a]s we [the IRS] continue to amass more information and pursue more people internationally, the risk to individuals hiding assets offshore is increasing. This new effort gives those hiding money in foreign accounts a tough, fair way to resolve their tax problems once and for all. And it gives people a chance to come in before we find them.”

Although similar to the initial voluntary disclosure program, the OVDI differs in certain material respects.

**1. Terms and Details of the OVDI.** The details of the OVDI were released by the IRS in the form of 53 frequently asked questions (“FAQs”) and the IRS’s detailed responses. Pursuant to the FAQs, taxpayers who make a timely disclosure under the OVDI will avoid criminal prosecution and will be able to calculate, with reasonable certainty, the total cost of resolving all of their offshore tax issues. Similar to the initial voluntary disclosure program, taxpayers who participate in the OVDI will be required to pay back-taxes and interest on any undisclosed income for the 2003-2010 taxable years and a 20% accuracy related penalty (in addition to any applicable failure to pay or failure to file penalties) on the unreported income. In addition, taxpayers participating in the OVDI will be required to

pay a one-time 25% penalty on the highest aggregate account balance of any amounts held in undisclosed foreign bank accounts. The 25% penalty under the OVDI is 5% higher than the penalty imposed under the initial voluntary disclosure program.

**2. Complying with the OVDI.** In order to take advantage of the OVDI, taxpayers are required to submit a number of documents to the IRS on or before August 31, 2011, including:

- Copies of previously filed original and amended federal income tax returns for the 2003 through 2010 taxable years;
- Complete and accurate amended federal income tax returns for the 2003 through 2010 taxable years, which include any unreported foreign income, along with schedules detailing the amount and type of previously unreported income;
- Complete and accurate original or amended offshore-related information returns and Forms T.D. F 90-22.1 (the “FBAR”) for the 2003 through 2010 taxable years;
- A completed Foreign Account or Asset Statement for each previously undisclosed foreign account or asset;
- For accounts with a highest aggregate balance of \$1 million or more, a completed Foreign Financial Institution Statement;
- Full payment of the total amount of tax, interest, and penalties due or, if the taxpayer is unable to pay, a proposed payment arrangement and a completed Collection Information Statement;
- Copies of offshore financial account statements reflecting all account activity for the 2003 through 2010 taxable years; and
- Properly completed and executed agreements to extend the applicable statute of limitations for the assessment of tax and FBAR penalties.

One notable difference between the initial voluntary disclosure program and the OVDI is the requirement that taxpayers submit amended tax returns and financial information along with the initial voluntary disclosure. Under the initial program, these documents could be submitted after the taxpayer’s acceptance into the

voluntary disclosure program. Under the OVDI, the preparation and submission of these documents is a precondition to acceptance.

**3. Opportunities for Penalty Reduction.** For certain qualifying taxpayers, the 25% penalty on the highest aggregate account balance of any undisclosed foreign accounts can be reduced to 12.5% or 5%. These penalty reductions apply in cases in which the highest aggregate account balance is less than \$75,000 or if the taxpayer did not open the foreign account and had very minimal contact with the account during the 2003 through 2010 taxable years.

**4. Consequences of Failing to Participate in the OVDI.** Although the OVDI is only available to taxpayers who complete the voluntary disclosure process prior to August 31, 2011, the IRS’s regular voluntary disclosure procedures will still be available to taxpayers who wish to voluntarily disclose unreported offshore income after August 31, 2011. However, these taxpayers will not be eligible for the special penalty structure and terms of the OVDI and, instead, will be liable for all applicable civil penalties as well as the full FBAR penalty of 50% of the highest aggregate account balance. On the other hand, taxpayers who do not make a voluntary disclosure, either during or after the OVDI, will face both criminal prosecution and all applicable civil penalties if discovered by the IRS. Importantly, “quiet disclosures” (i.e., disclosures made by the mere filing of amended tax returns) will not be treated as voluntary disclosures in these cases. As a result, taxpayers making quiet disclosures will risk examination by the IRS and criminal prosecution for all applicable years.

The IRS’s intent to locate and prosecute taxpayers who fail to take advantage of the OVDI or the IRS’s general voluntary disclosure procedures is perhaps best summed up by IRS Commissioner Doug Schulman, who recently stated, “[c]ombating international tax evasion is a top priority for the IRS. We have additional cases and banks under review. The situation will just get worse in the months ahead for those hiding assets and income offshore. The new disclosure initiative is the last, best chance for people to get back in the system.”

Please be advised that this newsletter only provides brief descriptions of tax information of general interest and that any tax information contained herein was not intended and cannot be used for the purpose of: (1) avoiding penalties that may be imposed by the Internal Revenue Service; or (2) supporting, promoting, or marketing any transaction(s) or matter(s) addressed herein.

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