

IRS Announces Second Special Voluntary Disclosure Initiative for Offshore Accounts

February 9, 2011

On February 8, the Internal Revenue Service (IRS) announced a new penalty framework allowing taxpayers to voluntarily disclose previously unreported offshore accounts and entities. The program generally provides for exemption from criminal prosecution and a significant reduction in civil penalty exposure for U.S. taxpayers who choose to voluntarily participate in the program.¹ The program is only applicable to those who **complete all requirements on or before August 31, 2011**. For those considering participating in this program, now is the time to act, as it will likely take several months to obtain all required foreign records and have tax returns completed. Any decision not to come forward at this time should be weighed against the potential for higher monetary penalties, the risk of criminal charges, and the likelihood that one or more foreign banks will have customer data turned over to the IRS in the next year.

The newly announced IRS program, titled the 2011 Offshore Voluntary Disclosure Initiative (2011 OVDI), requires participating taxpayers to file or submit amended tax and information returns, including Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR). Qualifying taxpayers must pay (i) all taxes and interest due from 2003 to 2010, (ii) either an accuracy or delinquency penalty for each year on the amount of additional tax due, and (iii) a penalty equal to 25% of the amount in the foreign bank accounts in the year with the highest aggregate account balance during the period from 2003 to 2010.² The 25% penalty may be reduced to 12.5% for taxpayers whose offshore accounts or assets did not surpass \$75,000 in any calendar year covered by the program, or to as low as 5% in a certain very limited class of cases.

The current program comes on the heels of the IRS's prior voluntary disclosure program, and demonstrates the U.S. government's continued focus on offshore accounts and tax evasion. The prior voluntary disclosure program attracted approximately 15,000 participants before it closed on October 15, 2009. After that program closed, more than 3,000 taxpayers came forward to make voluntary disclosures without the benefit of a set civil penalty program.³ Information related to the identity of those with undisclosed foreign accounts is increasingly available to the IRS under tax treaties and

1. Typically, when a voluntary disclosure is made, the IRS will not recommend criminal prosecution to the Department of Justice.

2. Taxpayers may also be required to pay failure to file and failure to pay penalties, if applicable.

3. See IR-2011-14, "Second Special Voluntary Disclosure Initiative Opens; Those Hiding Assets Offshore Face Aug. 31 Deadline."

information sharing agreements with foreign governments, and is expected to become more readily available as the result of recent legislation involving reporting by financial institutions and financial incentives to whistleblowers to come forward with information on tax noncompliance.

IRS Commissioner Douglas H. Shulman described the program as the “last, best chance” for taxpayers and as offering a “tough, fair way to resolve their tax problems once and for all.” He also stressed that participating in the program beats being discovered by the IRS and having to face the much stricter civil penalties and potential criminal penalties that would be pursued for those taxpayers who do not voluntarily come forward. Commissioner Shulman specifically stated that IRS investigators have been tracking the migration of assets from Europe into Asia, and taxpayers should expect new criminal investigations and prosecutions in the future. The 2011 program is expected to draw in many taxpayers with unreported accounts throughout Asia, specifically in Hong Kong and Singapore.

The 2011 OVDI process is complex and may not be appropriate or available in certain circumstances. Participation, in most cases, will require taxpayers to quickly gather all foreign account records and engage an accountant—preferably one with some international tax experience—who can efficiently prepare eight years of amended tax returns and supporting schedules. Given the August 31, 2011 deadline, we believe time is of the essence for taxpayers with undisclosed accounts. Although the civil penalty structure is higher than before, taxpayers who make *timely* voluntary disclosures may be able to avoid criminal prosecution and limit their potential civil penalty exposure. Taxpayers should consider the IRS’s disclosure program, contact attorneys with experience in handling these types of matters, and evaluate their potential liability under the program. Morgan Lewis’s Tax Controversy and Consulting Practice regularly assists clients with such voluntary disclosure processes.

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