

Offshore Voluntary Disclosure Program: The Survivor's Manual

a. What years are included in the OVDP disclosure period?

- (1) The voluntary disclosure period is the most recent *eight tax* years for which the due date (or properly extended due date) has already passed. For example, assume that Kate submits a voluntary disclosure *prior* to April 15, 2014 (or other 2013 due date under extension). The disclosure period includes each of the years 2006 through 2013 in which she had undisclosed OVDP assets.
- (2) The eight-year voluntary disclosure period does not include fully tax compliant years. For taxpayers who began filing timely, original, compliant returns that fully reported previously undisclosed OVDP assets before making the voluntary disclosure, the voluntary disclosure period will begin with the eighth year preceding the most recent year for which the return filing due date has not yet passed, but will not include the compliant years. Consider the following example. Henry opened up a securities account in Country A back in 2005. He has continually filed income tax returns in which he omitted income from that account. However, Henry subsequently began reporting the income on his timely, original tax returns for 2009 through 2012. He files a voluntary disclosure in January 2014. The voluntary disclosure period will be 2005 through 2008.

b. How does the miscellaneous offshore penalty framework work?

- (1) General rule: Unlike FBAR penalties that can be asserted for multiple years (up to six under the six-year statute of limitations for FBARs), the miscellaneous offshore penalty is a one-time penalty. The values of foreign accounts and other foreign assets are aggregated for each year and the penalty is calculated at 27.5 percent of the highest year's aggregate maximum balance during the period covered by the voluntary disclosure.
- (2) *Exception:*
 - a. Effective August 4, 2014, taxpayers who have not applied to the OVDP and who have an offshore bank account with a foreign financial institution which has been publicly identified as being under investigation, or is cooperating with a U.S. government investigation will face an increased offshore penalty of 50%.
 - b. The IRS has published a list of those foreign financial institutions or facilitators.

- c. The IRS reserves the right to add new financial institutions to this list at any time, in

which case entire groups of taxpayers will be subject to the 50% penalty without any prior notice.

(3) What other penalties (and interest) apply within the offshore program?

- Of course, taxpayers must pay the tax deficiency for each year during the disclosure period and interest on the deficiency.
- Information-return penalties such as the Failure to File penalty for the respective tax years.
- A 20% accuracy-related penalty under IRC § 6662(a) on the full amount of offshore-related underpayments of tax for the respective tax years.
- Under OVDP, the civil fraud penalty generally does *not* apply.

(4) Below is an example of how the offshore penalty is calculated:

Assume that Jack holds the following amounts listed in the chart below in a foreign account over the period covered by his voluntary disclosure. He files a return but does not include the foreign account or the interest income on his return. Nor does he file a FBAR. Jack decides to apply to the voluntary disclosure program. Assume further (1) that Jack deposited the \$ 500,000 in his account before 2003, properly reporting it; (2) that Jack's voluntary disclosure is accepted by the IRS; and (3) that Jack is in a 35-percent income tax bracket.

Year	Amount on Deposit	Interest Income	Account Balance
2003	\$ 500,000	\$ 25,000	\$ 525,000
2004		\$ 25,000	\$ 550,000
2005		\$ 25,000	\$ 575,000
2006		\$ 25,000	\$ 600,000
2007		\$ 25,000	\$ 625,000
2008		\$ 25,000	\$ 650,000
2009		\$ 25,000	\$ 675,000
2010		\$ 25,000	\$ 700,000

Because the highest account balance was in 2010, the base for the offshore penalty will be \$ 700,000. Therefore, the offshore penalty is \$ 192,500 (i.e., \$ 700,000 x 27.5%).

Within the OVDP framework, Jack would pay \$ 276,500. This includes:

- Tax of \$ 70,000 (8 years at \$ 8,750/year) plus interest;
- An accuracy-related penalty of \$ 14,000 (i.e., \$ 70,000 x 20%); and
- A miscellaneous offshore penalty, in lieu of the FBAR penalty, of \$ 192,500.

If Jack didn't come forward and the IRS discovered his offshore activities, he would have had to pay substantially more in penalties. He would also have been liable for interest and possibly additional penalties. And if this doomsday scenario came to fruition, he could potentially be prosecuted.

Below is the doomsday scenario. Outside of the offshore voluntary program, Jack's civil liability includes:

- Tax, accuracy-related penalties, and, if applicable, the failure to file and failure to pay penalties, plus interest;
- FBAR penalties totaling up to \$ 2,450,000 for the *willful* failure to file complete and correct FBARs:
 - (1) **2003**: \$ 262,500 (.5 x \$ 525,000);
 - (2) **2004**: \$ 275,000 (.5 x \$ 550,000);
 - (3) **2005**: \$ 287,500 (.5 x \$ 575,000),
 - (4) **2006**: \$ 300,000 (.5 x \$ 600,000),
 - (5) **2007**: \$ 312,500 (.5 x \$ 625,000),
 - (6) **2008**: \$ 325,000 (.5 x \$ 650,000),
 - (7) **2009**: \$ 337,500 (.5 x \$ 675,000),
 - (8) **2010**: \$ 350,000 (.5 x \$ 700,000).
- A potential fraud penalty of 75%; and

- Substantial additional information return penalties if the foreign account is held through a foreign entity such as a trust or corporation and required information returns were not filed.

Had Jack's noncompliance started *before* 2003 and he decided not to enter the program, the IRS may even examine tax years prior to 2003.

(5) What Type of Assets Does the Offshore Penalty Apply To?

The offshore penalty applies to:

- (1) All assets *directly* or *indirectly* owned by the taxpayer including (i) financial accounts holding cash, securities or other custodial assets; (ii) tangible assets such as real estate or art; and (iii) intangible assets such as patents or stocks or other interests in a U.S. or foreign business.
- (2) For assets that are *indirectly* held or controlled by the taxpayer through an entity, the penalty may be applied to the taxpayer's interest in the entity. But if the entity is an alter ego of the taxpayer, then the penalty may be applied to the taxpayer's interest in the underlying assets.

Note well: Tax noncompliance includes not only the failure to report gross income from the assets, but also the failure to pay U.S. tax that was due with respect to the funds used to *acquire* the asset.

c. Answers to Important Questions Pertaining to OVDP

- i. **When determining the highest amount in each undisclosed foreign account for each year or the highest value of each OVDP asset for each year, what exchange rate applies?**

The foreign currency exchange rate at the end of the year, regardless of when during the year the highest value was reached.

- ii. **I have an interest in a PFIC (passive foreign investment company). What are my options?**

Within OVDP, the IRS offers taxpayers an alternative to the statutory PFIC computation. The purpose of this alternative is to resolve PFIC issues on a basis that is consistent with the Mark to Market (MTM) methodology authorized in I.R.C. § 1296 without requiring a complete reconstruction of historical data.

iii. I'm currently under examination. Can I still come in under "the tent" of voluntary disclosure?

No. If the IRS has already initiated a civil examination against you, then it's too late. In other words, "The fat lady [has sung]." And this is true regardless of whether the examination relates specifically to undisclosed foreign accounts or undisclosed foreign assets. Similarly, taxpayers under criminal investigation by CI are also ineligible.

iv. Assume that Jack decides to make a "quiet disclosure" and file amended returns and delinquent FBARs for 2006-2013. However, he suddenly has a change of heart and decides to apply to the OVDP. Is Jack still eligible?

The IRS is aware that some taxpayers have made "quiet" disclosures by filing amended returns and delinquent FBARs and paying any related tax and interest for previously unreported offshore income, without notifying the IRS. Taxpayers who have already made "quiet" disclosures are still eligible to participate in the OVDP. To do so, they must submit an application, along with copies of their previously filed returns – original and amended – and all other required documents and information to the IRS's voluntary disclosure coordinator.

Those taxpayers making "quiet" disclosures should be aware that they are not protected from criminal prosecution and are subject to civil examination and the imposition of penalties.

v. If I make a quiet disclosure, will the IRS audit me? If so, will I still be eligible for OVDP?

The IRS is reviewing amended returns and could select any amended return for examination. It has identified and will continue to identify amended tax returns reporting increases in income.

The IRS will closely review these returns to determine whether enforcement action is appropriate. If a return is selected for examination, the taxpayer will no longer be eligible for OVDP.

vi. What if I cannot afford to pay the total amount of tax, interest, offshore penalty, and other penalties?

You may be qualify for special payment arrangements. However, before that can happen, the IRS must determine that your inability to pay is genuine. As such, you must submit a proposed payment plan to the IRS, along with a completed Collection Information Statement (Form 433-A, Collection Information Statement for Wage Earners and Self-employed individuals, or Form 433-B, Collection Information Statement for Businesses).

This information must be sent to the Austin campus: IRS 3651 S. I H 35 Stop 1919 AUSC Austin, TX 78741 (ATTN: OVDP).

vii. I have two offshore accounts. No FBARs were filed. I reported all income from one account, but not the other. How do I report this?

The issue can be framed as follows: Must you report both accounts as a voluntary disclosure or should you bifurcate them such that there is a delinquent FBAR filing for the *reported* account and a voluntary disclosure for the *unreported* account?

Note well: An FBAR is a single form or report that discloses all foreign accounts meeting the reporting requirement. As such, it is not possible to separate the corrected filing. Instead, you should make a voluntary disclosure for the omitted income and include the delinquent FBARs for both accounts.

The rationale is that the account with no tax deficiency is unrelated to your tax noncompliance. Therefore, no penalty will be imposed with respect to that account.

viii. If the amount of income that I underreported from my foreign bank account is de minimis, should I still consider the program?

Yes. No amount of unreported income is considered de minimis for purposes of determining whether there has been tax non-compliance with respect to a foreign account or other OVDP asset.

ix. If the IRS serves a John Doe summons or makes a treaty request seeking information from my bank and identifies me as the holder of an undisclosed foreign account, does that disqualify me from making a voluntary disclosure under this program?

No. The mere fact that the IRS has served a John Doe summons, made a treaty request or has taken similar action does not automatically disqualify every member of the John Doe class or group identified in the treaty request from participating.

However, this comes with the following caveat. Once the IRS or DOJ obtains *information* under a John Doe Summons, treaty request or other similar action that provides evidence of a *specific taxpayer's noncompliance* with the tax laws, that particular taxpayer will be ineligible for OVDP.

The following are other ways in which a U.S. taxpayer can become a blacklisted insofar as OVDP is concerned and thus, ineligible from participating in OVDP:

- The IRS announces that certain taxpayer groups with accounts at certain foreign financial institutions will be ineligible;
- The IRS commences a civil or criminal examination or investigation of the taxpayer;
- The IRS commences a civil or criminal investigation that is directly related to the taxpayer's liability; or
- The IRS acquires information related to the taxpayer's liability from a criminal enforcement action such as a search warrant or grand jury subpoena.

x. If I apply to OVDP and am accepted, will my voluntary disclosure be subject to an examination?

Normally, no examination will be conducted once the taxpayer enters the offshore voluntary disclosure program. However, the IRS reserves the right to conduct an examination. The normal process is for the voluntary disclosure to be assigned to an examiner who is responsible for certifying its' accuracy and completeness. The certification process is less formal than an examination and does not carry with it all the rights and legal consequences of an examination.

However, the examiner has the right to ask any relevant questions, request any relevant documents, and even make contact with third parties. This is done to certify the accuracy of the amended returns.

- xi. If I transferred funds from one unreported foreign account to another during the voluntary disclosure period, must I pay a 27.5 percent offshore penalty on both accounts?**

No. If you can establish that funds were transferred from one account to another, you will only have to pay a 27.5 percent penalty on the highest balance in one account. However, the burden will be on you to establish the extent of the duplication.

- xii. Are entities, such as corporations, partnerships, and trusts eligible to make a voluntary disclosure?**

Yes.

- xiii. If a taxpayer fails to file an FBAR to report an account over which he has signature authority but no beneficial interest, will that foreign account be included in the base for calculating the taxpayer's offshore penalty?**

No. The account that the taxpayer has mere signature authority over is unrelated to the tax noncompliance that the taxpayer is voluntarily disclosing. He or she may cure this breach at any time by filing an FBAR with an explanation *prior* to being contacted by the IRS regarding an income tax examination or delinquent returns.

The answer might be radically different if one or more of the following conditions exist. In these cases, the taxpayer may have an OVDP asset to which the offshore penalty applies:

- (1) The account over which the taxpayer has signature authority is held in the name of a *related* person, such as a family member or an entity controlled by the taxpayer;
- (2) The account is held in the name of a foreign entity for which the taxpayer had a Title 26 reporting obligation; or
- (3) The account was related in some other way to the taxpayer's noncompliance (e.g., it was used as a conduit).

xiv. Parents have a jointly owned foreign account on which they have made their children signatories. As such, the children have an FBAR filing requirement but no income. How should the family correct this? How will the offshore penalty be applied?

Signatories with no ownership in the account, such as children, need only file delinquent FBARs with explanatory statements.

As for the parents, only one offshore penalty will be applied for the voluntary disclosures relating to the *same* foreign financial account. Here, this means that the parents must *jointly* pay a single offshore penalty – at the applicable offshore penalty rate of either 27.5% or 50% -- on the account.

This can be satisfied by one parent paying the total offshore penalty or by each parent paying a portion thereof, at the taxpayer's option. However, any joint owner of a foreign financial account who does not make a voluntary disclosure may be examined and be subject to all applicable penalties.

xv. If multiple taxpayers are co-owners of a single OVDP asset, who will be liable for the offshore penalty?

In the case of co-owners, each taxpayer who makes a voluntary disclosure will be liable for the penalty on his percentage ownership of the highest value of the OVDP asset.

The burden will be on the disclosing taxpayer claiming ownership of less than 100 percent of the OVDP asset to establish the extent of the

ownership. His voluntary disclosure applies to his tax liability only. It does not cover the other co-owners.

The IRS may examine any co-owner who does not make a voluntary disclosure. Co-owners examined by the IRS will be subject to all applicable penalties.

xvi. If there are multiple individuals with signature authority over an OVDP asset held in the name of a trust, must everyone involved file delinquent FBARs? If so, must everyone pay the offshore penalty?

Only one offshore penalty applies with respect to voluntary disclosures relating to the same OVDP asset. The penalty may be allocated among the taxpayers with beneficial ownership making the voluntary disclosures in any way they choose. The reporting requirements for filing an FBAR, however, do not change. Therefore, every person who is required to file an FBAR must file one.

xvii. A taxpayer owns valuable land located in a foreign jurisdiction. This property produces no income and there were no reporting requirements regarding the property. Must the taxpayer report the land and pay the offshore penalty? What if the property produced income that the taxpayer failed to report?

The answer to the first question depends on whether the non-income producing land was acquired with funds that were not reported and not taxed. The offshore penalty targets offshore assets that are related to tax noncompliance. Thus, if offshore assets were acquired with funds that were subject to U.S. taxation but on which no such tax was paid, the offshore penalty would apply regardless of whether or not the assets produced income.

Assuming that the land was acquired with after-tax funds or with funds that were not subject to U.S. taxation, to the extent that the land has not yet produced any income, there has been no U.S. taxable event and no obligation to disclose exists.

The taxpayer need only report income from the property or gain from its sale at such time in the future as the income is realized. Because there is no tax noncompliance, the offshore penalty would not apply to the land.

In response to the second question, to the extent that the land produced income subject to U.S. taxation during the voluntary disclosure period that was *not* reported, the land would be included in the penalty computation regardless of whether the land was properly acquired with after-tax funds.

If the land was held in the name of an entity such as a trust or corporation, there would also have been an information return filing obligation that may need to be disclosed.

xviii. What should I do if I'm having trouble obtaining my bank records from my foreign financial institution?

Carefully document your attempts. For phone conversations, note the date, time and duration of the call. Note the name of the employee of the foreign financial institution with whom you spoke.

For written correspondence, photocopy all correspondence to and from the foreign bank.

Provide documentation relating to your attempts to obtain records to the examiner handling your case, or if your case is not yet assigned, contact the IRS OVDP hotline.

xix. How can the IRS propose adjustments to tax for more than three years without a statutory exception to the normal three-year statute of limitations for making adjustments?

Agreeing to assessment of tax and penalties for all voluntary disclosure years is required under OVDP. The taxpayer must agree to assessment of the liabilities for all years in order to get the benefit of the reduced penalty framework. It is an all or nothing proposition.

xx. Must I complete and sign agreements to extend the period of time to assess tax – including tax penalties – and to assess FBAR penalties for any years that are set to expire while my application is being processed?

Yes. Agreements to extend the period of time to assess tax (including tax penalties) and to assess FBAR penalties must be submitted as part of the voluntary disclosure package.

xxi. Does the examiner have any discretion to settle offshore voluntary disclosure cases for amounts less than the 27.5% (or where appropriate, 50%) offshore penalty?

No. Examiners have no authority to negotiate a different offshore penalty.

xxii. After making a voluntary disclosure, what if I disagree with the offshore penalty? What can I do?

Remember that the penalty framework for offshore voluntary disclosure and the agreement to limit tax exposure to eight years are mandatory terms. In other words, mediation with appeals is not an option.

The only option is for the taxpayer to withdraw from or “opt out” of the program. An “opt out” is an election made by a taxpayer to have his case handled under the standard audit process. Once made, this decision is irrevocable. Therefore, if the taxpayer wakes up the following morning with buyer’s remorse, it is too late.

xxiii. If I opt out, will my case be referred for audit?

The IRS will likely conduct a full examination. During that examination, the normal statute of limitations rules apply. If no exception to the normal three-year statute applies, the IRS will only be able to assess tax, penalties, and interest for three years.

However, if the period of limitations was open, then six years of liability may be assessed. Under what circumstances might the period of limitations remain open? One such scenario is if the IRS can prove a substantial omission of gross income. Second, the statute of limitations for asserting FBAR penalties is six years from the date of the violation, or the date that an unfiled FBAR was due to have been filed. Similarly, if there was a failure to file certain information returns, such as Form 3520, Form 5471, or Form 8938, the statute of limitations will not have begun to run. Finally, if the IRS can prove fraud, there is no statute of limitations for assessing tax.

xxiv. Does my case remain within the Voluntary Disclosure Program even after opting out?

Yes. Therefore, you must cooperate fully with the examiner by providing all requested information and records. In addition, you must pay, or make arrangements to pay, the tax, interest, and penalties that are ultimately assessed.

xxv. If I opt out and the IRS discovers during a full scope examination that there were issues that I did not previously disclose, can my case be referred back to Criminal Investigation for review?

Yes.

xxvi. If I opt out and the IRS conducts a full examination, may I appeal any tax and penalties imposed by the IRS? How about the IRS's decision on the terms of the OVDP closing agreement?

After a full examination, any tax and penalties imposed by the IRS may be appealed. However, the IRS's decision with respect to the terms of the OVDP closing agreement may not.

d. Requirements of the Offshore Voluntary Disclosure Program

Taxpayers must:

- Submit copies of previously filed original (and, if applicable, previously filed amended) federal income tax returns for tax years covered by the voluntary disclosure;
- Submit complete and accurate amended federal income tax returns (for individuals, Form 1040X, or original Form 1040 if delinquent) for all tax years covered by the voluntary disclosure, with applicable schedules detailing the amount and type of previously unreported income from the foreign account or domestic source (e.g., Schedule B for interest and dividends, Schedule D for capital gains and losses, Schedule E for income from partnerships, S corporations, estates or trusts and, for years after 2010, Form 8938, Statement of Specified Foreign Financial Assets). For taxpayers who began filing timely, original, compliant returns that fully reported previously undisclosed foreign financial accounts before making the

voluntary disclosure for certain years of the disclosure period, copies of the previously filed returns for the compliant years;

- File copies of FBARs (Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts) for foreign financial accounts maintained during the disclosure period;
- Submit a copy of your completed and signed Offshore Voluntary Disclosure Letter (including attachments);
- Submit a completed “Foreign Account or Asset Statement” for each previously undisclosed OVDP asset during the disclosure period;
- Submit a completed and signed “Taxpayer Account Summary With Penalty Calculation”;
- Complete and sign agreements to extend the period of time to assess tax (including tax penalties) and to assess FBAR penalties. The agreements to extend the period of time to assess tax and FBAR penalties must follow the instructions provided. Failure to extend the period of time to assess tax and assess FBAR penalties will render your OVDP submission incomplete;
- Submit copies of statements for all financial accounts reflecting all account activity for each of the tax years covered by your voluntary disclosure. For OVDP assets other than foreign financial accounts, provide all relevant documents pertaining to the asset. For example, if a taxpayer has foreign issued life insurance with cash value, provide all documents governing the policy and, if any, all legal and tax opinions issued to the taxpayer relating to the policy.
- Pay, in lieu of all other penalties that may apply to your undisclosed foreign assets and entities, including FBAR and offshore-related information return penalties and tax liabilities for years prior to the voluntary disclosure period, a miscellaneous Title 26 offshore penalty, equal to 27.5% of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the period covered by the voluntary disclosure;
- Submit full payment of any Title 26 tax liabilities for years included in the offshore disclosure period and all tax, interest, accuracy-related penalties for underpayments related to offshore accounts and entities, and, if applicable, the failure to file and failure to pay penalties with the required submissions or make good faith arrangements with the IRS to pay in full the tax, interest, and these

penalties (the suspension of interest provisions of IRC § 6404(g) do not apply to interest due in this program);

- Execute a Closing Agreement on Final Determination Covering Specific Matters, Form 906; and
- Agree to cooperate with IRS offshore enforcement efforts by providing information about offshore financial institutions, offshore service providers, and other facilitators, if requested.