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2011 Offshore Voluntary Disclosure Initiative – August Update!

On February 8, 2011, the IRS Commissioner announced a second offshore voluntary disclosure initiative (the "2011 OVDI") for U.S. taxpayers who still have unreported foreign accounts. The 2011 OVDI largely continues the practices of the 2009 OVDP, but it imposes higher penalties and taxes. The good news is that the penalty was only increased from 20% to 25% and that criminal prosecution will not be recommended for complying participants; the bad news is that taxes, tax penalties and interest have to be paid for an 8-year period rather than a 6-year period.

Requirements and Penalties under the 2011 OVDI

Unlike the 2009 OVDP, the 2011 OVDI requires that participating taxpayers submit their amended tax returns, including all previously unfiled information returns and FBARs, and pay the taxes, interest and penalties **on or before August 31, 2011**. This requirement was intended to simplify the processing of the information by the IRS, but will make it difficult for many taxpayers to comply. Taxpayers who plan on participating in the 2011 OVDI should begin the process as soon as possible to comply with the August 31, 2011 deadline.

The 2011 OVDI imposes a 25% penalty on the highest balance in the account(s) during the 8-year period beginning in 2003. Although the 25% penalty imposed under the 2011 OVDI is more severe than the 20% penalty imposed under the 2009 OVDP, in most cases it is still significantly less severe than the substantial civil, and in some cases criminal, penalties which may otherwise be imposed on a U.S. taxpayer for each year the taxpayer failed to accurately disclose a foreign financial account or offshore corporation or trust, etc. on an FBAR, etc.

It should be noted that it is entirely legitimate for U.S. taxpayers to have foreign accounts and offshore corporations, trusts, etc.; however, subject to limited exceptions, U.S. taxpayers must report foreign accounts to the U.S. Treasury on the Form 90-22.1 (often referred to as the "FBAR") and must pay tax on any income earned from those accounts. There are additional reporting requirements for ownership interests in offshore corporations, trusts, and partnerships.

Another piece of good news is that the IRS will not impose penalties for failure to file Forms 5471 or 3520 if, for example, such forms are filed before August 31, 2011 **and** there is otherwise no unreported income or tax liabilities.

The 2009 OVDP ended on October 15, 2009; however, some estimated 3,000 taxpayers have applied to participate in the regular IRS voluntary disclosure program since that date. Those taxpayers have largely been notified that they have been rolled into, and must comply with, the 2011 OVDI.

The Application Process

The IRS has released a lengthy FAQ, which is updated from time to time. The FAQ provides additional information on the application process, how to deal with Passive Foreign Investment Company ("PFIC") issues, how to qualify for the 5% penalty, etc. As expected, the FAQ strongly suggests that taxpayers who have made "quiet disclosures" in the past should participate in the 2011 OVDI, and provides that if the "quietly filed" amended tax returns are audited, the IRS could seek to impose criminal sanctions as well as examine years before 2003.

Participation in the 2011 OVDI involves a three-step process.

1. The first step is to send a pre-clearance letter to the designated IRS Criminal Investigation Division. Our experience is that it takes about 1 week to get a fax back from the CID approving the taxpayer's participation in the 2011 OVDI.
2. Once approved, the next step is to send a clearance letter to the IRS's special task force in Philadelphia; that group has up to 30 days to approve continued participation in the 2011 OVDI.
3. The last step is to file a set of specified documents, including originally filed tax returns, amended tax returns, FBARs, statute of limitation extensions, etc. and a check for the unpaid taxes, interest

and penalties, with the IRS in Austin, TX before the end of August 2011.

Accordingly, taxpayers who have not yet started the process may end up having to send in the specified documents to the IRS under Step 3 before they receive the letter under Step 2 in order to meet the August 31, 2011 deadline.

The IRS has amended the FAQs to provide for an extension of time, of up to 90 days, to get the specified documents to the IRS; however, the extension of time is at the sole discretion of the IRS, and requires that the taxpayer have "reasonable cause." We believe that the IRS will generally not grant such extension requests. As a result, we recommend that any extension requests be made as soon as possible, so that the response from the IRS is received before the August 31, 2011 deadline.

If you have unreported foreign financial accounts, you should strongly consider participating in the 2011 OVDI unless you and your tax advisors are very comfortable that you can prove that your past failures to file the FBARs were non-willful. Otherwise, if the IRS discovers the unreported accounts, they are likely to be very aggressive in determining the applicable penalties, which in a worst-case situation can exceed the amount in the foreign accounts. The IRS has begun to take action against Credit Suisse and HSBC, similar to the actions they took against UBS, in order to get access to undisclosed account information. The IRS's efforts to locate unreported foreign accounts will only increase in the next few years.

For additional information, please contact the authors or any member of the [Venable Tax and Wealth Planning Group](#).

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