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IRS Announces New Voluntary Disclosure Program for Offshore Accounts and Assets

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On January 9, 2012, the Internal Revenue Service (“IRS”) reopened an Offshore Voluntary Disclosure Initiative (“OVDI”) to give U.S. taxpayers with offshore accounts an unprecedented third opportunity to disclose such accounts, pay any taxes and penalties due, and avoid criminal prosecution. The IRS decided to reopen the program based on continued interest in voluntary disclosure after the close of the most recent OVDI in September 2011. Under the previous two OVDI programs in 2009 and 2011, the IRS collected \$4.4 billion from 33,000 taxpayers.

Similar to the prior programs, the 2012 OVDI enables a taxpayer with undisclosed foreign accounts to come forward and pay any unpaid tax due on the earnings of those accounts as well as a fixed penalty. In exchange, the taxpayer avoids potentially significant higher civil and criminal penalties should the IRS discover the undisclosed foreign accounts on its own. In order to participate in the program, individuals must file all original and amended tax returns and pay any tax due on income associated with the foreign accounts for a look-back period of eight years. The taxpayer must also disclose all foreign accounts on Form TD F 90-22.1, “Report of Foreign Bank and Financial Accounts”, commonly referred to as an FBAR, for those eight years.

U.S. Authorities Continue Vigorous Pursuit of Offshore Tax Evasion

With the opening of this third OVDI, the IRS remains committed to identifying taxpayers who have undisclosed offshore accounts. IRS Commissioner Douglas Shulman warned that “Our focus on offshore tax evasion continues to produce strong, substantial results for the nation’s taxpayers. We have billions of dollars in hand from our previous efforts, and we have more people wanting to come in and get right with the government. This new program makes good sense for taxpayers still hiding assets overseas and for the nation’s tax system. As we’ve said all along, people need to come in and get right with us before we find you. We are following more leads and the risk for people who do not come in continues to increase.”

Along these lines, the IRS is currently conducting a civil investigation of at least 11 confirmed Swiss banks, and some sources estimate the number is closer to 21. The Department of Justice (“DOJ”) has joined the IRS in pursuing criminal charges against these Swiss banks.

As part of this effort, the DOJ notified certain Swiss banks and identified them as targets of a criminal investigation into allegations that their advisors assisted U.S. clients in avoiding payment of U.S. income tax. In response to the investigation, some institutions plan to disclose



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the names of U.S. clients to Swiss tax authorities. The Swiss tax authorities will then forward this information to the IRS and the DOJ.

Some institutions have started contacting their U.S. clients, giving them various options:

1. Agree to let the Swiss tax authorities obtain their account information for the purpose of disclosure to the U.S. authorities;
2. Hire Swiss attorneys to contest account information disclosure; or,
3. Close their accounts.

The Swiss government has been rumored to have proposed a multi-billion dollar settlement to the U.S. authorities in an effort to achieve an all-encompassing solution which would include all Swiss banks. Switzerland has reached similar agreements this year with Germany and the U.K. on untaxed assets; however, in those agreements, the identity of clients was not disclosed. The DOJ is rumored to be opposed to any deal that involves only money and does not include disclosure of client names and information.

It is very possible that the Swiss banks currently under investigation will follow some institutions in disclosing U.S. clients while others will attempt to jettison accounts held by U.S. taxpayers. Further, it is reasonable to believe that additional banks around the world are being investigated by the IRS for similar activities. To facilitate these investigations, it is believed the IRS has opened field offices in Australia, Panama, China, Singapore and Hong Kong.

Reporting Requirements

A U.S. person who has authority over or interest in a foreign financial account is required to disclose the account to the IRS, if the aggregate value of foreign accounts equals or exceeds \$10,000. Accounts are disclosed by filing the FBAR form filed with the Treasury Department, which is filed separately from the taxpayer's tax return and is due to the Treasury by June 30 of each year.

Taxpayers who elect not to disclose their offshore accounts and pay any tax due on associated income may be subject to a civil penalty of \$10,000 per account per year. If the failure to disclose is found to be willful, the penalty may increase to the greater of \$100,000 or 50 percent of the highest account balance per year for six years (effectively, a 300 percent penalty). Moreover, the taxpayer could be assessed criminal penalties or a fine of up to \$500,000 and/or ten years imprisonment.

In addition, in November 2011, the IRS issued a new reporting form, Form 8938, "Statement of Specified Foreign Financial Assets". This form is required to be attached to an individual income



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tax return (Form 1040) for all tax years beginning with the 2011 tax year. Individuals who own certain specified foreign financial assets may need to file this new Form 8938. Specified foreign financial assets generally include:

1. A financial account held at a foreign bank,
2. Stock or securities issued by a non-U.S. person,
3. An interest in a foreign entity, or,
4. A financial instrument or contract with an issuer that is a non-U.S. person.

The reporting threshold varies depending on the individual's marital and residency status. For a married couple living in the U.S., the threshold is \$100,000. Note that the requirement to file this Form 8938 is in addition to the requirement to file the FBAR. Many individuals will be required to file both forms during a particular tax year.

What This Means to You

For the eligible taxpayer, the 2012 OVDI offers clear benefits to encourage taxpayers to disclose offshore accounts rather than risk IRS detection. Given the potential for extremely high penalties and criminal prosecution that could be involved with non-disclosure, taxpayers who are eligible to participate in the 2012 OVDI would be well advised to consult with an attorney in connection with the decision regarding whether to enter the 2012 OVDI.

Terms of the 2012 Initiative

The penalty scheme under the 2012 OVDI is similar to that under the 2011 initiative. A taxpayer will pay a penalty of 27.5 percent on the highest aggregate balance of the unreported accounts during the eight-year look-back period. This penalty represents an increase from 25 percent under the 2011 OVDI and 20 percent under the 2009 OVDI. Additionally, the taxpayer will pay a 20 percent accuracy-related or delinquency penalty on the amount of income tax that should have been paid on any unreported income during the look-back period.

Certain individuals whose aggregate value of offshore accounts or assets did not exceed \$75,000 in any calendar year will be eligible for a reduced penalty of 12.5 percent instead of 27.5 percent. Moreover, individuals with special circumstances, such as those individuals whose accounts were created on their behalf by others and have not made any significant withdrawals, may be eligible for a reduced penalty of 5 percent.



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Apart from the increased penalty amount of 27.5 percent, the main difference between the 2012 OVDI and prior programs is that there is no deadline for the current OVDI program. It will remain open until the IRS determines otherwise. However, the IRS has stated that the terms of the program could change at any time. The IRS could increase penalties for all or some classes of taxpayers or end the program entirely.

IRS Examinations of High Income and High Net Worth Taxpayers are Sharply Increasing

- The Treasury Department reported that the IRS audited 12.48 percent of all individual income tax returns which reflected income exceeding \$1 million during fiscal 2011 – an unprecedented new level of examinations.
- The Previous high examination level was 8.36 percent in 2010.
- The new IRS Wealth Squad, focused on audits of the top 1percent, is conducting extremely onerous audits of affluent families and family offices including all of their entities, trusts and businesses in a comprehensive manner.
- The audit rate also climbed for corporations with assets over \$250 million; 27.6 percent of such businesses were examined in 2011.

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