

IRS Eases Access to Offshore Voluntary Disclosure Programs

The changes give taxpayers who mistakenly failed to report foreign assets a simpler path back to tax compliance.

On June 18, 2014, the Internal Revenue Service (IRS) announced major modifications to the terms of its programs to encourage the reporting of offshore assets. The changes expand two existing programs for those with undisclosed offshore accounts and delinquent taxes — the Offshore Voluntary Disclosure Program (OVDP) and the Streamlined Disclosure Program (SDP) — and formalize another program to correct delinquent reporting only. According to IRS Commissioner John Koskinen, the newly revised process “opens a new pathway for people with offshore assets to come into tax compliance,” and “reflects a carefully balanced approach to ensure everyone pays their fair share of taxes owed.”¹ The “new pathway” allows certain US resident and non-US resident taxpayers who failed to report foreign assets to take advantage of a simplified disclosure program that brings them back into tax compliance with substantially reduced or no penalties.

The IRS’ offshore voluntary compliance program has been through numerous iterations over the years. The latest version of the OVDP follows on the success of three earlier disclosure programs aimed at foreign account reporting, announced in 2009, 2011 and 2012, respectively. To date, more than 45,000 US taxpayers have taken advantage of the disclosure initiatives, generating approximately US\$6.5 billion in revenues for the US government.

The IRS’ announcement of significant new modifications to its offshore compliance programs dovetails with the ongoing focus of the US Departments of Treasury and Justice, as well as Congress, on obtaining information from foreign banks with US accountholders. Thus, Commissioner Koskinen mentioned the Justice Department’s ongoing amnesty program for Swiss banks² and the July 1, 2014 implementation of global banking transparency through the Foreign Account Tax Compliance Act (FATCA), stating, “It’s clear that the days of hiding assets in accounts overseas are coming to an end,” and “There is no reason not to come into compliance.” The IRS’ most recent revisions to the disclosure programs are designed to pressure those who unlawfully hid assets overseas, and who have not previously disclosed, to enter the program immediately. Simultaneously, the program offers a better and less burdensome program for those who made unintentional mistakes in failing to report their accounts. Taxpayers with unreported overseas accounts and assets should be aware of the increasing risks of delay and should discuss the various compliance programs with an experienced tax professional.

Taxpayers’ Options to Return to Compliance

The new IRS 2014 offshore compliance programs offer taxpayers in a variety of circumstances the opportunity to disclose and fix prior tax non-compliance. The IRS offers three options: (1) the delinquent information return program, (2) the new Streamlined Disclosure Program (SDP) for US resident and non-

resident taxpayers whose conduct is non-willful and (3) the 2014 Offshore Voluntary Disclosure Program (2014 OVDP) for those who knowingly violated the law. Each taxpayer's specific facts and circumstances will determine which of the three options should be selected. Taxpayers who are currently participating in the Offshore Voluntary Disclosure Program may be eligible for reduced penalties under the new SDP, subject to Transition Rules. None of the programs is available to a taxpayer who is already under IRS audit or whose non-compliance has been identified by the government. Thus, time is of the essence, particularly in light of the ever-increasing pressures on foreign banks to disclose US account holder information.

Simplified and Expanded Options for the Least Culpable

The delinquent information return program allows taxpayers to file delinquent Foreign Bank Account Reports (FBARs,³ due annually) and other information reporting forms without penalty in cases where there is no unreported income and all taxes were timely paid. The scope of this program is limited because the IRS position has been that even a single dollar of unreported income makes a taxpayer ineligible for a penalty-free disposition. Taxpayers must not be under audit or have been contacted by the IRS regarding the delinquent forms.

If taxes are due, eligibility for the newly revised streamlined program turns on a determination of the taxpayer's "willfulness," that is, whether the taxpayer intentionally violated the law in failing to disclose overseas assets and pay applicable taxes. A US resident or non-resident taxpayer who is able to certify that he acted non-willfully (without intent to violate the law) may use the newly revised streamlined procedures. Under the new SDP, a taxpayer must sign, under penalties of perjury, the following statement: "My failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to non-willful conduct. I understand that non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of good faith misunderstanding of the requirements of the law."⁴

Participants in the program are also required to explain the reasons for the errors or omissions. A false certification could expose a disclosing taxpayer to potential civil fraud, FBAR and information return penalties, as well as criminal liability. Recently, IRS officials have stated publicly that IRS personnel will review all certifications. If a disclosing taxpayer is selected for audit, either due to a review of the certification or under normal audit selection criteria, the IRS will inquire as to the veracity of the taxpayer's assertion of non-willfulness.

Under the new SDP, eligible US taxpayers who resided outside the US in any one or more of the most recent three years for which the US tax return due date (or properly requested extended due date) has passed (2011 through 2013), will not pay any penalties. Eligible US taxpayers who resided in the US during this period must pay a "miscellaneous penalty" equal to five percent of the highest aggregate balance/value of the taxpayer's foreign financial accounts during the years in the covered tax return period (three years) and the covered FBAR period (six years). The IRS will not impose accuracy-related penalties, information return penalties, or FBAR penalties on participants in the SDP (see chart below).

The newly revised SDP allows both US resident and non-resident taxpayers to avoid the more complex OVDP process and enjoy reduced penalties while coming into tax compliance. Until now, there was no formal pathway for *US residents* who unintentionally failed to report foreign financial assets to fix prior non-compliance without entering the time-consuming OVDP with its attendant significant penalties. Taxpayers considering the new SDP should consult with experienced tax professionals regarding the IRS view of willfulness and fraudulent conduct before making a submission, as the definitions are not necessarily consistent with the common understanding of the terms.

Significantly, the revised programs impact those who may currently be in the existing OVDP process. Taxpayers currently in the OVDP who have not yet executed a final closing agreement and who believe they meet the qualifications for the new SDP may request the five percent or zero penalty treatment available under the new SDP. The taxpayer need not “opt out” of the OVDP but must complete the self-certification of non-willfulness. The examiner assigned to the case will look at the facts and circumstances of the taxpayer’s case and determine whether to incorporate the streamlined penalty terms into the closing agreement.

Many taxpayers will welcome the expanded and simplified procedures with reduced penalty exposure. However, legal observers have criticized the recent modifications because tens of thousands of taxpayers have completed the OVDP program and have been subject to FBAR penalties ranging from 25-27.5 percent, although many of them may have qualified for much lower penalties now available under the newly announced procedures. The IRS has not addressed this apparent inequity for prior non-willful participants in earlier versions of the OVDP.

The Need to Act Quickly

For taxpayers who willfully failed to report their foreign financial assets, or knowingly failed to report income therefrom, the 2014 OVDP is available and virtually guarantees protection from criminal prosecution, while at the same time providing a cap on the significant civil penalties that could otherwise be imposed. The 2014 OVDP is similar to past programs we have described in a previous [Client Alert](#) and will remain open indefinitely, but its terms could change at any time. The base penalty is 27.5 percent of the highest aggregate value of the foreign bank accounts or value of foreign assets during the disclosure period. Under the 2014 Program, the penalty will be increased to 50 percent for any foreign financial accounts that were held at a bank publicly identified as being under investigation or as cooperating with a government investigation. Participants must file eight years of amended returns and other information reporting forms, as well as pay all taxes, interest and accuracy-related and applicable delinquency penalties. The 27.5 percent or 50 percent FBAR penalty is due at the time the amended returns are filed.

The 2014 OVDP imposes new burdens on participants. Payments and the deadlines for submitting certain documentation have been accelerated. Participants must now include additional information when submitting an application to participate in the OVDP, and must provide all foreign account statements at the time of the amended tax return submission. Because of the availability of the streamlined procedures for non-willful conduct, the potential for reduced penalties under the OVDP (e.g., the five percent penalty for individuals who were unaware they were US citizens) has been eliminated. The IRS has also removed the OVDP guidelines covering the same conduct now incorporated into the delinquent information return program.⁵

Summary of Program Changes

This chart highlights the more prominent features of the 2014 OVDP and revised SDP:

	2014 OVDP	SDP (non-resident)⁶	SDP (US resident)
Who may participate	Individuals, estates, partnerships, corporations and other entities	Individuals and estates	Individuals and estates
Willful failure to report	Eligible	Not eligible	Not eligible
Prior tax returns filed	Not required	Not required	Must have filed
Under IRS audit	Not eligible (even if taxpayer not aware of audit)	Not eligible	Not eligible
Must self-certify non-willfulness	Not required	Required	Required
File amended tax returns with payment	Required	Required	Required
Applicable penalty	27.5% of foreign financial assets (or 50% if bank publicly under investigation), plus standard tax penalties	None	5% of foreign financial assets
Required filings	Original or amended tax returns (8 years), FBARs (8 years) and other miscellaneous forms	Original or amended returns (3 years), FBARs (6 years)	Amended returns (3 years), FBARs (6 years)

Taxpayers Should Contact Legal Counsel Immediately

For US taxpayers who have undeclared accounts, this latest IRS announcement is another significant signal that compliance with US law is unavoidable. When viewed in the context of the US government's multi-faceted crackdown on offshore tax evasion, including recent announcements of intergovernmental cooperation around the world, this announcement reflects the continued retrenchment of bank secrecy laws.

Given the complexity of the evolving offshore compliance initiatives and the risk of increased penalties as banks come under investigation, taxpayers should engage legal counsel as soon as possible to discuss the benefits and burdens of the revised programs and to explore whether the new programs may present a workable solution for resolving issues associated with undisclosed offshore accounts.

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¹ See IRS Makes Changes to Offshore Programs; Revisions Ease Burden and Help More Taxpayers Come into Compliance, IR-2014-73 (June 18, 2014).

² See [US Allows Swiss Banks With Undisclosed Accounts To Wipe the Slate Clean, Latham & Watkins Client Alert](#) (November 8, 2013).

³ A Report of Foreign Bank and Financial Account (FBAR or FinCEN 114) generally must be filed if a US person had a financial interest in or signature authority over at least one financial account located outside of the US; and the aggregate value of all foreign financial accounts exceeded US\$10,000 at any time during the calendar year to be reported.

⁴ See IRS Certification by U.S. Person Residing Outside of the United States for Streamlined Foreign Offshore Procedures, available at: <http://www.irs.gov/pub/irs-utl/CertNonResidents.pdf>.

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- ⁵ Taxpayers who have properly reported and paid tax on all income but simply failed to file FBARs may avoid all FBAR penalties. See Delinquent FBAR Submission Procedures, available at: <http://www.irs.gov/Individuals/International-Taxpayers/Delinquent-FBAR-Submission-Procedures>.
- ⁶ The term non-resident is defined differently for US citizens and green card holders versus those who are not citizens or green card holders. For citizens and green card holders, a person is a non-resident if, in any one or more of the most recent three years for which the US tax return due date has passed, the individual did not have a US abode and the individual was physically outside the US for at least 330 full days. For all others, a person is a non-resident if, in any one or more of the last three years for which the US tax return due date has passed, the individual did not meet the substantial presence test under US Internal Revenue Code section 7701(b)(3).