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IRS Expands Relief for Some Foreign Account Disclosures, Tightens Rules for Willful Neglect

BNA Snapshot

Key Development: IRS expands streamlined procedures for disclosing offshore accounts if noncompliance wasn't willful.

Key Takeaway: IRS tightens rules for offshore voluntary disclosure program if taxpayers willfully failed to report foreign accounts.

By Alison Bennett

June 18 — The Internal Revenue Service is making it easier for taxpayers to disclose offshore accounts in cases where they weren't willfully trying to hide the money from U.S. tax authorities, providing streamlined procedures with little to no penalties to more participants.

At the same time, the requirements are getting tougher to enter an offshore voluntary disclosure program (OVDP)—one that offers a set penalty and protection against criminal prosecution. Under changes announced June 18, taxpayers will have to provide much more information at the outset. The current 27.5 percent penalty will rise to 50 percent if the taxpayer's bank, or facilitator who helped the taxpayer establish an offshore arrangement, is under public investigation by the government.

"Our aim is to get people to disclose their accounts, pay the tax they owe, and get right with the government," IRS Commissioner John Koskinen said in a statement June 18. While the streamlined procedures have been expanded to help taxpayers who may not have been aware of their responsibilities and are not intentionally evading taxes, the agency is still determined to crack down on evasion, he said.

"Even though we're tightening components of the OVDP, we still believe it's a better deal than the alternative, because if we find you, you will face higher penalties and, as the record shows, could face criminal prosecution and jail time," Koskinen said.

The announcement comes before the July 1 effective date of the Foreign Account Tax Compliance Act, which requires banks outside the U.S. to report accounts held by U.S. taxpayers.

Expanded Relief

Previously, the streamlined procedures were only open to those who owed less than \$1,500 in taxes and to taxpayers living abroad. According to an IRS news release (IR-2014-73), the expanded procedures are now open to those owing more than \$1,500 in taxes and those who live both abroad and in the U.S. They eliminate a questionnaire on risk and require taxpayers to certify that violations weren't willful.

Penalties for non-U.S. taxpayers will be waived, while U.S. residents who qualify will pay a one-time “miscellaneous offshore penalty” of 5 percent of the foreign account's highest aggregate account balance and asset value. IRS posted a description of the new procedures online.

Whether taxpayers utilize the streamlined procedures or the more formal OVDP process, “we're very hopeful that we'll see an increased number of taxpayers coming forward,” IRS Large Business & International Division Deputy Commissioner (International) Michael Danilack told reporters June 18. The intent is to make the streamlined procedures accessible to a much larger group of taxpayers, he said during a news conference.

At the same time, Danilack said, the IRS expects the OVDP to keep getting tougher and said now is the time to come forward. “If you're engaged in willful evasion, the time is getting quite short for you to come in,” he said. “We are very intent on stamping out evasion.”

Tightening OVDP

In addition to the 50 percent penalty if a taxpayer's bank or adviser is under public investigation, changes to the OVDP include:

- requiring additional information from taxpayers applying to the program,
- eliminating the existing reduced penalty percentage for certain non-willful taxpayers in light of the expansion of the streamlined procedures,
- requiring taxpayers to submit all account statements and pay the offshore penalty at the time of the OVDP application, and
- enabling taxpayers to submit voluminous records electronically rather than on paper.

In a set of frequently asked questions and answers on the changes to the OVDP on the IRS's website, the agency said it would consider financial institutions to be under investigation if they are or have been under specific investigation by the IRS or the Justice Department in connection with accounts that are beneficially owned by a U.S. person.

They would also meet this criteria if they are cooperating with the IRS or the Justice Department in connection with such accounts or have been identified in a court summons seeking information about U.S.-owned accounts.

Examples of a public disclosure include, but aren't limited to, a public filing in a judicial proceeding or a public disclosure by the Justice Department of banks with deferred prosecution agreements or nonprosecution agreements.

Determining Willfulness

For taxpayers who want to take advantage of the streamlined procedures, the IRS won't be providing examples of conduct it would consider as willful noncompliance to help with the self-certification process, Danilack said in response to questions at the news conference.

“These are all very human stories,” Danilack said. “Everyone has a different set of facts. It's really up to the taxpayer to make that determination and tell us their story.” He suggested if taxpayers have questions as to whether their conduct was willful, they should consult with their tax advisers.

In response to another question, the IRS official said that taxpayers who have already entered the OVDP,

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but feel they might now be eligible for the streamlined procedures, may be able to get the beneficial penalty structure if they qualify under a set of special transition rules.

Danilack said taxpayers that have already reached a closing agreement with the IRS under the OVDP won't be eligible to reopen their cases and participate in the streamlined process. "Those folks are done," he told reporters.

The IRS posted a specific set of frequently asked questions and answers on the transition rules on its website. Those procedures will allow participants an opportunity to remain in the OVDP while taking advantage of the favorable penalty structure under the streamlined procedures, the agency said (see related story in this issue).

Mixed Reactions

Practitioners had mixed reactions June 18, but all said many of the changes are positive.

"There are generally good developments," Bryan Skarlatos, a partner with Kostelanetz and Fink LLP in New York, told Bloomberg BNA. "Expanding the streamlined program for nonresidents is very helpful. Whether the new 5 percent penalty is good for residents will depend on the detailed terms."

The 50 percent penalty for customers of banks under investigation is "understandable," Skarlatos said. "However, I am not sure how people can be determined to know of a grand jury investigation, which by its nature is secret."

Skarlatos said he was very concerned about the requirement to submit bank records with the application for the OVDP. "It can take months to collect offshore bank records and that will significantly delay a taxpayer's ability to get into the program," he said.

Scott Michel, a member of Caplin & Drysdale in Washington, said, "My first impression is really quite positive" and said the expansion of the program to nonresidents offers a valuable path back into compliance. "This is a vehicle for a large number of people to fix their problems, Michel told Bloomberg BNA.

Caution Urged

He said taxpayers should be cautious in asserting that their noncompliance wasn't willful and should carefully consult with their advisers before doing so, noting that the IRS has been "pretty aggressive" in its determinations of non-willful transgressions.

Michel said the increase of the OVDP penalty to 50 percent if a bank or facilitator is under investigation was something that many were expecting and said now is the time to come forward. "There are a lot of people waiting to see what happens with their banks. It's a real gamble to delay in situations where your bank could end up on the news," he told Bloomberg BNA.

Josh O. Ungerman, a partner with Meadows, Collier, Reed, Cousins, Crouch & Ungerman LLP in Dallas, speaking to Bloomberg BNA June 18, called the IRS announcement "bittersweet."

He said a pressing question is whether banks that are in "Category 2" proceedings as part of the Justice Department's nonprosecution program for Swiss banks will be considered as under investigation if their customers want to go into the streamlined procedures.

However, Ungerman, chairman of the American Bar Association Section of Taxation's Civil & Criminal Tax Penalties Committee, said "The streamlined expansion of relief is welcome and in my opinion long overdue."



Burden Lightened

James Mastracchio, head of the tax controversy practice at Baker & Hostetler LLP, told Bloomberg BNA June 18 that he thinks the expanded streamlined procedures will alleviate the pressure for people who were going into the OVDP and opting out in the effort to get a lower penalty. "I think it will be a lot less expensive and a lot less burdensome and hopefully, a lot quicker," Mastracchio said.

He noted that if taxpayers want to go into the streamlined program, it is important for them to sit down with their advisers and have a "heart to heart" discussion on whether their conduct might be considered willful.

Once they take that route, they no longer have the criminal protection offered by the OVDP and "it's irreversible," he cautioned.

In addition to the news release (IR-2014-73), the IRS provided two fact sheets: one on OVDP statistics (FS-2014-6) and a second on program requirements (FS-2014-7).

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For More Information

Texts of the Koskinen statement, IR-2014-73, FS-2014-6 and FS 2014-7 are in TaxCore.

Text of the FAQs on the changes to the OVDP is online at <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised>.

Text of the FAQs on rules for taxpayers to transition from the OVDP to the streamlined procedures is at <http://www.irs.gov/Individuals/International-Taxpayers/Transition-Rules-Frequently-Asked-Questions-FAQs>.

Text of a description of the new streamlined procedures is online at <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures>.

The FAQs and further information can be found at <http://www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program>.