

NEWS ANALYSIS

1 Year Later, Frustrations Remain for OVDI Participants

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At this time last year, Swiss banks were embroiled in a fight with the U.S. government, Congress was deadlocked, Mitt Romney was defending his tax proposals, the New York Mets were out of playoff contention, and frustrated practitioners were agonizing over the IRS's seeming intransigence with the 2011 offshore voluntary disclosure initiative (OVDI).

What a difference a year makes.

One year after scrambling to submit applications for the 2011 OVDI, practitioners told Tax Analysts that little has changed and that to their knowledge, most of their participating clients haven't even been assigned revenue agents.

The 2011 OVDI, which expired September 9, 2011, and its predecessor, the 2009 offshore voluntary disclosure program (OVDP), which expired in October 2009, provided a way for U.S. persons with undisclosed foreign bank accounts to come clean to the IRS and avoid criminal prosecution by paying back taxes and a reduced penalty. A third offshore initiative was announced in January, but unlike the others, it does not have an announced end date. (For prior coverage, see *Tax Notes*, July 2, 2012, p. 23, *Doc 2012-13625*, or *2012 TNT 124-1*.)

Practitioners were wary of the 2011 OVDI after experiencing unexpected obstacles with the 2009 OVDP. In 2011 tax bar members Scott D. Michel and Mark E. Matthews wrote of "policy changes and reversals during 2009 and 2010" that led practitioners to question the IRS's fairness during the 2011 OVDI, as well as whether disclosure through the program would best serve clients. (For the special report, see *Tax Notes*, Oct. 17, 2011, p. 369, *Doc 2011-21263*, or *2011 TNT 201-3*.)

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Frustrations included the IRS's apparent backtracking on FAQ 35, which practitioners originally

understood to mean that program participants could argue that their conduct was not willful. The 2011 OVDI resulted in a slew of disclosures from so-called benign account holders: those who were U.S. citizens by birth but had spent their entire lives abroad, and other technically U.S. persons who had little to no actual connection to the United States. (For prior coverage, see *Tax Notes*, Jan. 9, 2012, p. 162, *Doc 2012-258*, or *2012 TNT 4-1*.)

Taxpayers with Canadian retirement accounts have experienced frustration. Those taxpayers, many of whom were unaware of their U.S. tax reporting obligations, sought guidance on their 2011 OVDI applications on how to minimize their potential penalties — whether by requesting relief under reg. section 301.9100-3 or applying for a private letter ruling.

The IRS's guidance came in amended frequently asked questions nearly six months after the 2011 OVDI's extended deadline and stated that the taxpayer should wait to file for section 9100 relief until being contacted by an examiner. But many taxpayers are still waiting for that contact. (For prior coverage, see *Tax Notes*, Sept. 3, 2012, p. 1113, *Doc 2012-18254*, or *2012 TNT 169-1*.)

Last week the IRS finally issued a questionnaire and instructions intended to streamline the process for taxpayers with a low risk of noncompliance. The primary beneficiaries of the new process are taxpayers with Canadian retirement accounts, but practitioners have complained that other low-risk taxpayers likely will not have access to the process. (For related coverage, see p. 1246.)

Many taxpayers were unnecessarily burdened, National Taxpayer Advocate Nina Olson told Tax Analysts. They had to opt into and then out of the program and were discouraged by the threat of disproportionate penalties, she said.

Olson said that to make matters worse, OVDI processing times are longest for those who opted out. Further, the IRS is feeling the consequences of its approach as its employees strain to keep up with the demand, she said, adding, "Our initial review indicates that the IRS has yet to process even 10 percent of the applications to the 2011 OVDI." Practitioners who spoke with Tax Analysts generally had the same complaints.

The IRS disagrees. In a statement, it said that "to date, a majority of the 2011 disclosures have been assigned or are in the process of assignment to revenue agents."

So one year and many thousands of disclosures later, it is unclear what level of activity is taking place in the IRS's service centers in Philadelphia and Austin, Texas, where perhaps hundreds of thousands of pages of documents sit untouched.

Either way, practitioners say the IRS may have bitten off more than it can chew.

Radio Silence

Larry A. Campagna of Chamberlain, Hrdlicka, White, Williams & Aughtry said that while some of his clients' disclosures in the 2011 OVDI have been closed, most have not been assigned a revenue agent.

As for applicants to the 2009 program, Campagna said his firm has handled almost 700 disclosures, only two of which are still open, having been assigned revenue agents in just the last few months. Both cases involve foreign residents, with one being a relatively straightforward disclosure and the other more complicated, he said.

Ken Jones of Sutherland Asbill & Brennan LLP said he doesn't know if any of his cases have been assigned revenue agents: "On the cases that I submitted under the 2011 program, I've heard nothing. But checks were cashed. The IRS is good at cashing checks."

Of the 80 or so disclosures his firm is handling as part of the 2011 OVDI, 30 to 40 percent have been assigned revenue agents, said Niles A. Elber of Caplin & Drysdale. He said the 2011 OVDI was supposed to make the end of the process far more expedient than that experienced during the 2009 OVDP. Things have generally moved slowly, he said.

Elber said only a few of his cases were settled based on the taxpayer's initial submission, adding that the degree to which a revenue agent requests more information varies. Providing the information can get complicated, especially when dealing with foreign banks and other financial institutions that may not keep information necessary to file U.S. tax returns, he said. "Asking a bank for cost basis information from 1976 is nearly a fool's errand," Elber said.

Not Ready for Prime Time

A common complaint practitioners had with the 2009 OVDP was the relative inexperience of revenue agents working the cases. That seems to have improved for the 2011 OVDI.

Joseph M. Erwin, a solo practitioner in Dallas, said revenue agents he encountered during the 2009 OVDP were mostly inexperienced. "Most of them did not have an understanding of the issues. It took at least six months for them to start understanding what they were doing," he said.

Erwin said the 2009 OVDP was at times a "spectacular affair," with revenue agents assigned to taxpayers with no apparent consideration for where the taxpayer was located. "The agents were asking people to come in and be interviewed from the other side of the country," he said.

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Campagna said the IRS tends to take longer with disclosures of individuals residing abroad. "I think the IRS took longer to assign some of those [foreign resident] cases, and it takes longer to handle them, given the logistics," he said. Revenue agents inexperienced with foreign account disclosures slow the process, he said.

Overall, the pace at which the IRS is handling the 2011 disclosures is faster than that of the 2009 disclosures, but problems persist, Campagna said. He said he had at least one case in which the agent seemed unfamiliar with the procedures and unaware of the techniques that had been used.

By the time the 2011 OVDI was announced, the agents had gained some institutional knowledge and "had their protocols down better," Erwin said. "They were still inflexible, generally, but they understood what the issues were," he added.

"There are some agents who seem satisfied with 90 percent of the material being there, and some agents are looking for 99.9," Elber said. Trying to move cases along with a revenue agent who cannot be persuaded to accept the taxpayer's findings is a difficult task, and one that can end with an opt-out, he said. "It leaves you scratching your head. These are the cases that aren't closing easily," he said.

Elber lamented the disparate treatment, saying, "Each taxpayer should experience the same set of circumstances as they're processed through the system."

For many practitioners, the minor details add up to headaches. For example, the IRS's multiple requests for new or updated powers of attorney are inconvenient. "I don't mind doing a power of attorney, or even two," Elber said. "But you start multiplying that for hundreds of clients?" He added that while he'd like to say that practitioners and the OVDI program agents are working together to make the process easier, that isn't the case. "I've done enough powers of attorney over and over and over again that that message simply isn't going through," he said.

The IRS admitted to some “early issues with powers of attorney in the 2009 program” because of the need to get revised powers of attorney that also covered foreign bank account reports. “However, we heard the concerns of the practitioner community and adjusted this process for the 2011 and 2012 versions of the program,” the IRS said. “We modified the powers of attorney guidelines up front to avoid the need to revise powers of attorney to cover FBAR issues.”

The training of IRS personnel was an important component of efforts to adjust to the program between 2009 and 2011, the IRS said. “We learned a lot from the 2009 initiative,” said IRS spokesman Dean Patterson.

Great Expectations?

It’s still unclear how taxpayers and practitioners will fare in the third offshore disclosure program. It’s equally unclear how quickly and efficiently the IRS will move through the remaining 2011 disclosures and begin work on the 2012 disclosures.

The Treasury Inspector General for Tax Administration is considering auditing the costs of, and revenue generated by, the 2009 OVDP but has not made a final decision, a TIGTA spokesman said.

According to the IRS, about 1,500 disclosures were made in the first five months of the 2012 program. About 33,000 were made under the first two programs combined, resulting in \$5 billion in back taxes, interest, and penalties. (For an IRS release (IR-2012-64), see *Doc 2012-13611* or *2012 TNT 124-8*.)

As for the newest iteration of the disclosure program, Jones said clients are considering it but are being cautious, taking a “wait-and-see attitude.”

Olson said the IRS has reduced the burden of correcting disclosure-related errors. It has clarified

that taxpayers can opt out penalty free and that it will allow some nonresidents to self-correct outside the voluntary disclosure regime, she said.

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That self-correction stems from a June announcement that proposed a new procedure intended to help U.S. citizens living abroad and dual citizens with low compliance risks become current on their income tax return filing obligations and to help people with foreign retirement account issues.

Nonetheless, as the IRS receives more information from financial institutions that enables it to identify more FBAR noncompliance, “it will increasingly face the choice of whether to devote more enforcement resources to address it, expand its outreach and self-correction options for benign actors, or ignore the noncompliance altogether,” Olson said.

Elber said he advises clients on what they might expect from the program and that each client’s situation differs. “The best you can do in terms of providing accurate advice is to say, ‘Here’s our experience,’” he said.

Elber said he finds it surprising that taxpayers continue to express interest in offshore disclosure programs. He said that during the 2009 OVDP he received 10 to 12 calls a day from taxpayers seeking to enter the amnesty program, but that that number is now just several per week. Still, “it’s enough that the IRS is getting people’s attention,” he said. ■