

# Voluntary Disclosure of Offshore Income

The IRS has announced a new amnesty program for taxpayers with undisclosed offshore accounts or assets. This initiative presents an opportunity to come forward voluntarily and avoid significant penalties.

The IRS issued IR 2011-14, “2011 Offshore Voluntary Disclosure Initiative” (OVDI), on February 8, 2011. This initiative gives taxpayers the opportunity to come forward and report their undisclosed income from hidden offshore accounts. A similar initiative in 2009 netted 15,000 taxpayers coming forward, with another 3,000 coming forward after the initiative ended. Taxpayers who didn’t come forward then and elected to wait for a follow-up program that might be more forgiving or beneficial will find their gamble failed. The new initiative isn’t as generous as the 2009 version, and one senses from the tone of IR 2011-14 that the likelihood of a third initiative in the near future is small. Those wishing to take advantage of this initiative have until August 31, 2011, to do so. Let’s take a look at some of the issues featured in the IR 2011-14 FAQ ([www.irs.gov/businesses/international/article/0,,id=235699,00.html](http://www.irs.gov/businesses/international/article/0,,id=235699,00.html)).

## Eligibility

According to Questions 12-14, taxpayers who have undisclosed offshore accounts or assets are eligible to apply for the IRS Criminal Investigation’s (CI) Voluntary Disclosure Practice and the 2011 OVDI penalty regime for tax years 2003 through 2010. Eligible taxpayers include corporations, partnerships, and trusts, excluding taxpayers against whom the IRS has initiated a civil examination, regardless of whether the examination relates to undisclosed foreign accounts or undisclosed foreign entities. In addition, taxpayers under criminal investigation by CI are ineligible.

## Why Make a Voluntary Disclosure?

Taxpayers with undisclosed foreign accounts have an opportunity to become compliant, avoid substantial civil penalties, and generally eliminate the risk of criminal prosecution. Better yet, taxpayers have the opportunity to calculate the cost of becoming compliant—failure to come forward during this initiative puts taxpayers at risk of being discovered by the IRS, which will result in substantial penalties and unanticipated costs. The IRS is actively engaged in

seeking the identities of those with undisclosed foreign accounts, and the OVDI is likely the last chance for a taxpayer to become compliant and avoid the consequences when found. A list of the possible penalties and criminal charges that could be assessed to a taxpayer when caught is given in Questions 5-6 of the FAQ.

## Key Features of the Initiative

Question 7 describes the terms of the initiative. The taxpayer must provide copies of previously filed original and amended federal income tax returns for tax covered by the voluntary disclosure, as well as complete and accurate amended returns for all tax years covered by the voluntary disclosure, including applicable schedules dealing with the amount and type of previously unreported income from the account or entity (e.g., Schedule B for interest and dividends, Schedule D for capital gains and losses, and Schedule E for income from partnership, S corporations, estates, and trusts.) In addition, complete and accurate original or amended offshore-related information returns and Form TD F 90-22.1 for calendar years 2003 through 2010 must be filed, and the taxpayer must coop-

erate in the voluntary disclosure process, including providing information about offshore financial accounts, institutions, and facilitators and signing agreements to extend the period of time for assessing tax and penalties.

In addition, the taxpayer must execute a Closing Agreement on Final Determination Covering Specific Matters, Form 906, and pay the following:

- ◆ 20% accuracy-related penalties under IRC §6662(a) on the full amount of the tax underpayments for all years;
- ◆ Failure to file penalties under IRC §§6651(a)(1) and (2), if applicable;
- ◆ A miscellaneous Title 26 offshore penalty equal to 25% (or, in limited cases, 12.5% or 5%) of the highest aggregate balance in foreign bank accounts/entities or value of foreign

assets during the period 2003 through 2010 (in lieu of all other penalties that may apply, including FBAR and offshore-related information return penalties); and

- ◆ All taxes, interest, accuracy-related penalties, and, if applicable, the failure to file and pay penalties with the required submissions package (see Question 25)—or make good faith arrangements with the IRS to pay in full the taxes, interest, and penalties.

### Exceptions to the 25% penalty

There are very few situations where a taxpayer might get a lower tax-rate penalty. First, the IRS will compare the amount due under the offshore initiative for all applicable years with the amount owed under the FBAR. The taxpayer would pay the lower of the

two amounts (see Question 50).

Second, a taxpayer may qualify under the 5% penalty provision if he or she satisfies one of two categories. The taxpayer satisfies the first condition if he or she (1) did not create the account; (2) exercised minimal, infrequent contact with the account; (3) withdrew less than \$1,000 per year; and (4) paid all applicable U.S. taxes on the funds deposited into the account. The second category applies to foreign residents who were unaware they were U.S. citizens. For illustrations of these two categories, see Question 52.

Third, a taxpayer who doesn't qualify under the first two exceptions may qualify under the 12.5% offshore penalty if the highest aggregate account balance in each of the applicable years (2003-2010) is less than \$75,000.

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**Table 1. IRS Example of Tax Penalties**

Year	Amount on Deposit	Interest Income	Account Balance
2003	\$1,000,000	\$50,000	\$1,050,000
2004		\$50,000	\$1,100,000
2005		\$50,000	\$1,150,000
2006		\$50,000	\$1,200,000
2007		\$50,000	\$1,250,000
2008		\$50,000	\$1,300,000
2009		\$50,000	\$1,350,000
2010		\$50,000	\$1,400,000

Potential taxes to taxpayer who participates in the voluntary disclosure and has a 35% marginal tax rate:

- ◆ \$350,000 (\$1,400,000 x 25%), which is the additional penalty in lieu of the FBAR and other potential penalties that may apply; plus
- ◆ \$140,000, which is the income tax on the interest (eight years at \$17,500 (\$50,000 x 35%) plus interest; plus
- ◆ \$28,000 (\$140,000 x 20%), which is the accuracy-related penalty.

Potential taxes to taxpayer who doesn't participate and gets caught by the IRS:

- ◆ \$4,375,000, which is FBAR penalties for willful failure to file complete and correct FBARs (\$550,000 (2004), \$575,000 (2005), \$600,000 (2006), \$625,000 (2007), \$650,000 (2008), \$675,000 (2009), \$700,000 (2010)); plus
- ◆ \$140,000, from above; plus
- ◆ \$28,000, from above; plus
- ◆ Interest and possible additional penalties and possible criminal prosecution.

## Taxes

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### Penalty Structure

The IRS provides an example that involves a taxpayer with an offshore account that has a balance of \$1 million in 2003 and who doesn't report the earnings. As shown in Table 1, participating in the OVDI will result in a penalty of \$518,000 for the taxpayer, compared to \$4,543,000 if the taxpayer doesn't take part in the initiative and the IRS subsequently discovers the offshore account. The true difference between the two penalty amounts is the 25% penalty and the FBAR penalty. Needless to say, the penalty amounts are significantly different.

### Coming Clean

This new OVDI is best summarized by IRS Commissioner Doug Shulman, who said, "Combating international tax evasion is a top priority for the IRS. We have additional cases and banks under review. The situation will just get worse in the months ahead for those hiding assets and income offshore. This new disclosure initiative is the *last*, best chance for people to get back into the system" [emphasis added]. Taxpayers with offshore accounts now will need to decide whether to come forward and elect the penalty under the initiative or wait and see if they get caught. **SF**

*Anthony P. Curatola is the Joseph F. Ford Professor of Accounting at Drexel University in Philadelphia, Pa., and a member of IMA's Greater Philadelphia Chapter. You can reach Tony at (215) 895-1453 or [curatola@drexel.edu](mailto:curatola@drexel.edu).*

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