

STATE OF THE OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

KNOWING YOUR OPTIONS AND AVOIDING TRAPS

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AGENDA

- Brief Background and History
- Options Available for U.S. Persons with Undisclosed Foreign Financial Assets
- Advising Your Clients Regarding Voluntary Disclosure Options
- Questions

OVDP BACKGROUND AND HISTORY

- History of undisclosed accounts and unreported income from foreign financial assets.
 - 2000 State Department report – \$4.8 trillion in offshore accounts.
 - 2008 Senate report – U.S. loses \$100 billion in annual tax revenues due to offshore tax abuses (Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs).
 - Up to \$70 billion in annual tax losses from individual tax evasion using offshore structures (testimony of Prof. Avi-Yonah before House W&M, Mar. 31, 2009).
- 2008 DOJ investigations into American-owned accounts in LGT (Lichtenstein) and UBS (Switzerland).
- Led to a series of voluntary disclosure initiatives and programs focused on disclosure of offshore financial assets and related income.
- 2012 Streamlined procedures introduced for nonresidents, updated in June 2014.
- As of June 2014, aggregate of 45,000 OVDP participants netting \$6.5 billion in taxes, penalties and interest in the various OVDP iterations.

OPTIONS FOR UNDISCLOSED FOREIGN FINANCIAL ASSETS AND INCOME

- Do nothing / quiet disclosure
- Delinquent FBAR submission procedures
- Delinquent international information return submission procedures
- Streamlined filing compliance procedures
 - Foreign
 - Domestic
- Offshore Voluntary Disclosure Program

DO NOTHING

- Doing nothing is probably not a reasonable strategy going forward or with respect to past compliance problems.
- International information sharing is increasing
 - Swiss – U.S. bank settlement program.
 - Increasing emphasis by IRS on international information exchange via treaties / TIEAs.
 - FATCA
 - OECD initiative for *Standard on Automatic Exchange of Financial Account Information* (51 jurisdictions signed multilateral C.A. agreement Oct. 29, 2014 to quickly implement OECD standard).
- Quiet disclosure (amend open years).
 - Significant risk from FBAR failure-to-file penalties (and possibly other information return penalties – e.g., Form 8938).
 - Must fully understand client's facts and weigh options.

DO NOTHING

- Applicable penalties outside of OVDP.
 - FBAR failure to file
 - Non-willful \$10,000 per account (subject to reasonable cause relief)
 - Willful – greater of 50% of account balance or \$100,000
 - Other information return filing failures
 - Form 8938 – \$10,000 (can increase to max of \$50,000)
 - Form 3520 – up to 35% of amounts related to trusts and 25% of unreported gifts from foreign individuals and estates
 - Form 3520-A – greater of \$10,000 or 5% of gross value in trust
 - Possible criminal sanctions
- Voluntary disclosure programs won't be available forever.

DELINQUENT FBAR SUBMISSION PROCEDURES

- Report of Foreign Bank and Financial Account (FBAR) – FinCEN Form 114 (previously TD F 90-22.1)
- Rules are similar to those under 2012 OVDP (old FAQ 17):
 - Taxpayer who failed to file FBAR and is not under civil exam or criminal investigation by IRS and has not already been contacted by IRS about delinquent FBARs.
 - Must Include statement explaining why filing late.
 - No failure to file penalty if taxpayer properly reported all income and paid all tax on income related to accounts (e.g., procedure not available if no tax due because of FTC – old FAQ 51.1).
- FBARs will not be automatically subject to audit.
- Six-year limitations period (regardless of whether FBAR was filed), so limited look-back.

DELINQUENT INTERNATIONAL INFORMATION RETURN SUBMISSION

- Covers other international information returns (3520, 3520-A, 5471, 5472, 926, etc.)
- Eligibility
 - TP who failed to file but who does not need OVDP or Streamlined Procedures,
 - Has reasonable cause for failure to file,
 - Is not under civil exam or criminal investigation, and
 - Has not already been contacted by IRS.
- Procedures
 - File amended returns including delinquent returns for all but Forms 3520 / 3520-A (file those according to applicable instructions).
 - Attach to each delinquent form a statement describing “all facts establishing reasonable cause for the failure to file” signed under penalties of perjury.

DELINQUENT INTERNATIONAL INFORMATION RETURN SUBMISSION

- Significant changes from 2012 OVDP (old FAQ 18):
 - Taxpayers who have unreported income or unpaid tax are not precluded from filing delinquent international information returns.
 - Requirement for reasonable cause statement under penalties of perjury.
 - Unlike old FAQ 18, penalty relief is not automatic. Failure to file penalties imposed if IRS does not accept TP's reasonable cause explanation.
- “Longstanding authorities regarding what constitutes reasonable cause continue to apply.”
- Which years to file – IRC § 6501(c)(8) part of 2010 HIRE Act:
 - Limitations period for assessment of “any tax” expires three years after filing international information returns (including those unrelated to the information return if no reasonable cause).
 - Could reach as far back as 2006 (earliest year that was still open under § 6501 when provision was enacted). See *CCA 201206014*.

STREAMLINED FILING COMPLIANCE PROCEDURES

- Two versions (residents and non-residents) designed to provide U.S. taxpayers a streamlined procedure to:
 - File amended or delinquent tax and information returns, and
 - Resolve their tax and penalty obligations.
- Significant changes from original streamlined procedure announced in 2012.
 - Extended eligibility to U.S. residents,
 - Eliminated the \$1,500 tax liability ceiling, and
 - Eliminated risk assessment process.
- General eligibility rules (as of June 18, 2014):
 - Individual taxpayers only (including estates).
 - Taxpayer must certify under penalties of perjury that conduct was non-willful.
 - No past or current civil exam or criminal investigation “for any taxable year” (even if exam issue is unrelated to undisclosed offshore assets).
 - Procedures available to TPs who previously “quiet filed” outside of OVDP (however, previously assessed penalties will not be abated).
 - Must have valid TIN (can substitute completed ITIN application if applicable).

STREAMLINED FILING COMPLIANCE PROCEDURES

- General treatment under the Streamlined Procedures
 - Tax returns will be processed like any other returns (no acknowledgment and no closing agreement).
 - Tax returns will not be subject to IRS audit automatically, but may be audited and subject to verification procedures.
 - Accuracy and completeness of submission may be checked against information from banks and financial advisors.
 - 5% miscellaneous penalty on highest account balances for participants in Streamlined Domestic Offshore Procedure (U.S. residents).
 - No protections from criminal liability.
 - Additional penalties may be assessed if IRS receives or discovers evidence of willfulness, fraud or criminal conduct.

STREAMLINED FILING COMPLIANCE PROCEDURES

- Coordination with OVDP:
 - Must choose – application to OVDP precludes application to Streamlined Procedures unless OVDP application letter submitted before July 1, 2014. (See transition rules, below).
 - Application for Streamlined Procedures precludes participation in OVDP.

TRANSITIONING TO STREAMLINED FROM OVDP

- Limited availability
 - Only persons who submitted full voluntary disclosure letter and attachments by July 1, 2014.
 - Must not have received a fully executed Form 906.
 - Opted out but not yet received a letter initiating an exam and Notice 609.
- Must meet eligibility requirements for SFOP or SDOP.
- If transition accepted, subject to applicable SFOP or SDOP penalty structure (still pay 20% accuracy, failure-to-file, failure-to-pay penalties).
- Can apply for transition after submission of OVDP package (8-year disclosure period).
- All other terms of OVDP will continue to apply (closing agreement, MTM PFIC, etc.)
- OVDP participants whose transition is denied remain in OVDP and can still opt out.

STREAMLINED FOREIGN OFFSHORE PROCEDURES (“SFOP”)

- Eligibility (in addition to the general eligibility rules):
 - Meet applicable non-residency requirement (for joint return filers, both spouses must qualify).
 - U.S. citizens and lawful permanent residents – in any one or more of the most recent three years for which filing date has passed:
 - Individual did not have a U.S. abode (“home, habitation, residence, domicile, or place of dwelling”), and
 - Individual was physically outside the U.S. for at least 330 full days
 - Non citizens and not lawful permanent residents – did not qualify as resident under the substantial presence test under IRC § 7701(b)(3) for any one or more of the most recent three years for which filing date has passed.
 - IRC § 911 applies for purposes of these procedures (except the bona fide residence test does not apply for purposes of determining eligibility).
 - Failed to report income from a foreign financial asset and pay tax.
 - May have failed to file FBAR.
 - Failures resulted from non-willful conduct.

STREAMLINED FOREIGN OFFSHORE PROCEDURES (“SFOP”)

- Procedures:
 - File delinquent or amended tax returns (including all information returns) for each of the most recent three years. Write “Streamlined Foreign Offshore” at the top of each return.
 - Include full payment of all tax and related interest due.
 - File delinquent or amended FBARs for each of the most recent six years.
 - File statement certifying eligibility for SFOP and that failures to file tax returns, report all income, pay all tax, and submit all information returns (including FBARs) were due to non-willful conduct.
- Outcome:
 - No failure-to-file and failure-to-pay penalties, accuracy penalties, information return penalties or FBAR failure-to-file penalties unless IRS determines original noncompliance was fraudulent and/or willful.
 - Retroactive relief for failure to timely elect income deferral on retirement plans otherwise eligible for deferral under a treaty.

STREAMLINED DOMESTIC OFFSHORE PROCEDURES (“SDOP”)

- Eligibility (in addition to the general eligibility rules):
 - Fail to meet applicable non-residency requirement for SFOP.
 - Have previously filed a U.S. tax return (if required) for each of the most recent three years for which due date has passed.
 - Thus, residents who failed to file in any one year are ineligible.
 - Failed to report income from a foreign financial asset and pay tax.
 - May have failed to file FBAR.
 - Failures resulted from non-willful conduct.

STREAMLINED DOMESTIC OFFSHORE PROCEDURES (“SDOP”)

- Procedures:
 - File amended tax returns (including all information returns) for each of the most recent three years.
 - Include full payment of all tax and related interest due.
 - Include payment for 5% miscellaneous penalty.
 - File delinquent or amended FBARs for each of the most recent six years.
 - File statement certifying eligibility for SDOP and that failures were due to non-willful conduct.
 - Must retain records supporting calculation of 5% penalty.
- Outcome:
 - As with SFOP, no additional penalties (except for 5% miscellaneous penalty) unless IRS determines original noncompliance was fraudulent and/or willful.
 - Retroactive relief for failure to timely elect income deferral on retirement plans otherwise eligible for deferral under a treaty.

STREAMLINED DOMESTIC OFFSHORE PROCEDURES (“SDOP”)

- Calculation of miscellaneous penalty:
 - 5% of the highest aggregate balance / value of taxpayer’s foreign financial assets for the tax return period (three years) or the FBAR years (six years).
 - Highest aggregate balance determined by aggregating the year-end account balances and year-end asset values.
 - As with OVDP penalty, only include assets for which there has been tax noncompliance (*i.e.*, failure to include income).
 - Do not include non-financial assets (rental property, etc.) even if non-compliance. Asset is included in penalty base if it should have been, but was not, included on the FBAR or Form 8938.

CERTIFYING NON-WILLFULNESS

- “Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.”
- For SFOP / SDOP, must include a personal statement providing specific reasons for the failures to report income and pay tax.
 - Simple statement stating non-willful will not suffice.
- If arguing reliance on tax professional, should provide name and contact information.

WHAT IS NON-WILLFUL BEHAVIOR?

- IRS view that the concept of willfulness is well documented in the case law and relying on practitioners to analyze risk.
 - FBAR willfulness in *Williams* and *McBride* cases; CCA 2006023026
 - A “voluntary intentional violation of a known legal duty.” *Cheek*, 498 U.S. 192.
- Definition intentionally left broad.
- Things to consider:
 - Willful blindness / recklessness (see *Williams*, *McBride*)
 - Whether accounts disclosed to tax return preparer
 - Numbered accounts and / or accounts in jurisdictions known for bank secrecy
 - Frequent movements of accounts or funds
 - Answers to Schedule B question re foreign accounts
 - Prior year compliant behavior
- Risks of certifying non-willfulness:
 - IRS can determine that original noncompliance was fraudulent and/or willful (in which case you may have two problems).
 - Uncertainties regarding the client’s facts and the criteria IRS will use to assess non-willfulness.

OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

- Significant changes from 2012 OVDP:
 - Beginning August 4, 2014, a 50% penalty applies to all OVDP assets if, at the time the pre-clearance fax was submitted, any assets were held at financial institutions that were publicly identified as under investigation or cooperating with IRS / DOJ.
 - Includes those identified in court-approved summons.
 - List available at <http://www.irs.gov/Businesses/International-Businesses/Foreign-Financial-Institutions-or-Facilitators>
 - OVDP miscellaneous penalty now due with submission.
 - 12.5% and 5% penalty options eliminated (reduced penalties available via Streamlined Procedures).
 - More taxpayer information provided in pre-clearance fax and application letter.
 - Updated forms, and procedural changes to the submission process.

OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

- Eligibility:
 - Legal source income invested in undisclosed OVDP assets.
 - Truthful, timely and complete disclosure.
 - Disclosure initiated before IRS has received information from a third party regarding the taxpayer's noncompliance.
 - No civil exam or criminal investigation.
 - Individuals and entities can participate.
 - Can't have initiated an application for Streamlined Procedures.

OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

- OVDP application procedures:
 - Pre-clearance fax
 - Identify all financial institutions at which undisclosed OVDP assets held.
 - Identify foreign & domestic entities holding OVDP assets.
 - CI will notify taxpayers whether eligible to make offshore voluntary disclosure (advertise 30 days, but may take longer).
 - OVDP application letter
 - Due 45 days from receipt of IRS notification to make disclosure.
 - OVDP application letter and attachments disclosing detailed information regarding offshore accounts and assets.
 - Preliminary acceptance by CI (advertised within 45 days).
 - Separate application letter for domestic voluntary disclosure.

OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

- OVDP application procedures:
 - OVDP package – due 90 days from date of preliminary acceptance (additional 90-day extension available on request).
 - Eight years of original, amended returns.
 - Eight years FBARs (filed electronically).
 - Full payment of tax, accuracy and F-T-F / F-T-P penalties + interest (mailed separately).
 - Full payment of 27.5% OVDP penalty (or as applicable, 50% penalty).
 - Statute waiver forms, penalty calculation worksheet.
 - Copies of bank statements (now automatic).
 - PFIC mark-to-market method still available.
 - If under the 2012 OVDP, can follow those submission requirements.

OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

- OVDP assets (penalty base for offshore penalty).
 - All offshore holdings that are related in any way to tax non-compliance regardless of form of ownership.
 - Includes non-income producing assets if acquired with improperly non-taxed funds.
 - Note differences from SDOP penalty base.
- Case resolution
 - Case eventually transferred to examiner for certification, issuance of Form 906.
 - No examiner discretion.
 - Timelines vary with complexity of taxpayer's facts.
 - No appeals (but can opt out).

OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

- Opting out of OVDP
 - Taxpayer can opt out of OVDP penalty structure and into all otherwise applicable penalties.
 - Election to opt out is irrevocable.
 - Results in full examination process (including availability of appeals).
 - Must consider the maximum penalties that could apply, however in practice IRS seems to not be assessing maximum penalties (e.g., FBAR failure to file).
 - Consider penalty mitigation factors in IRM § 4.26.16.4.6 and be prepared to argue reasonable cause.

ADVISING YOUR CLIENT AS TO WHICH OPTION IS APPROPRIATE

- Consider using a “flow chart” to help with decision-making.
 - See Alexey Manasuev Tax Analysts article, Aug. 25, 2014.
- If all income has been reported, then may only need to file delinquent FBARs.
- International information return procedure.
 - Must make reasonable cause argument.

ADVISING YOUR CLIENT AS TO WHICH OPTION IS APPROPRIATE

- If unreported income, then becomes a closer issue.
 - International information return procedures may still work if client had reasonable cause.
 - Streamlined procedures available if client is eligible and non-willful.
 - Query how much owed tax is too much for Streamlined?
- If willful (and certainly if there is a risk of criminal sanctions) then OVDP is likely the best bet.
- Recognize that you may not have all of the facts at the beginning of the engagement.

CURRENT ISSUES

- Canadian “Snowbird” problem
 - U.S. person, living in United States for 35 days each year but who has not filed tax returns is ineligible for either versions of Streamlined Procedures.
- Non-residency requirement for SFOP can be more restrictive than that under 2012 Streamlined Program.
- Rev. Proc. 2014-55 (deferral filing relief for U.S. persons with Canadian RRSPs or RRIFs) automatically available to “eligible individuals.”
 - Deemed treaty election to defer income for eligible taxpayers.
 - Ineligible persons (persons who have not satisfied any U.S. tax filing obligation for each year) must seek IRS consent to elect deferral.
- Compliance complexity if assets include PFICs.



QUESTIONS?