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IRS Releases New Voluntary Disclosure Procedures for Post 9-28-2018 Offshore and Domestic Disclosures

On Nov. 29, 2018, the IRS released a [memorandum](#) with new procedures for all voluntary disclosures following the end of the Offshore Voluntary Disclosure Program (OVDP) on Sept. 28, 2018. The new voluntary disclosure procedures apply to both domestic and offshore voluntary disclosures.

What's Changed?

Background

OVDP was initiated in 2009 and designed to bring taxpayers with undisclosed foreign income, accounts, and assets into compliance for U.S. income tax purposes. Taxpayers who were eligible to participate in OVDP and made timely voluntary disclosures were provided the opportunity to receive protection from criminal liability and to resolve their civil tax and penalty obligations on a standardized penalty framework.

Under the most recent iteration of the program, the 2014 OVDP, taxpayers were required to 1) file or amend income tax and information returns, including Foreign Bank Account Reports (FBARs), for eight years and include all previously unreported foreign income and assets; 2) pay tax, a 20 percent accuracy-related penalty (and a delinquency penalty for non-filers) and interest on all previously unreported

income for the eight-year reporting period; and 3) pay a 27.5 percent or 50 percent (for those taxpayers whose offshore banks or advisors were under current investigation) offshore penalty on the highest aggregate value of the taxpayers' previously unreported offshore assets during the eight-year reporting period.

Taxpayers able to reach an agreement with the IRS were issued closing agreements. Taxpayers unable to reach an agreement with the IRS under the terms of OVDP were not provided the opportunity to request an appeal with the Office of Appeals; rather, taxpayers had the option to withdraw from OVDP and have their cases handled under the standard audit process. Many taxpayers who opted out of OVDP found themselves subject to maximum willful FBAR and civil fraud penalties.

The New Procedures

The new procedures change the civil resolution framework for voluntary disclosure cases received after Sept. 28, 2018. Notwithstanding the effective date, the IRS has the discretion to use the new procedures for domestic voluntary disclosures received on or before Sept. 28, 2018.

The new procedures continue to provide taxpayers an ability to come into tax compliance and generally eliminate the risk of criminal prosecution, but there are many changes from the prior OVDP. Some of the changes are logistical changes, such as no longer requiring the filing of required tax returns and additional documents until an IRS agent is assigned to the case. Other changes are more substantive, including changes to the disclosure period and the penalties imposed.

The Disclosure Period

In general, the disclosure period has been reduced from eight years to six years. However, IRS agents have the discretion to expand the six-year disclosure period to include all noncompliant years. In addition, taxpayers may be allowed to expand the disclosure period to correct tax issues in years outside of the disclosure period. As with OVDP, taxpayers must file all required returns and reports for the disclosure period, and pay tax and interest on all previously unreported income.

Penalties

- **Penalty for Failure to Pay or Failure to File**

Under the new procedures, the penalty for underpayment of tax has increased from 20 percent to 75 percent. The IRS will assess a civil-fraud penalty to the tax year during the disclosure period with the highest tax liability. Generally, the taxpayers will be assessed a single civil penalty for fraud or for the fraudulent failure to file income tax returns. It is not clear what, if any, penalties will be imposed on the other years in the disclosure period. However, based on the facts and circumstances of cases, IRS agents can apply the civil-fraud penalty to more than one year during the disclosure period. Taxpayers who wish to request the imposition of lower-accuracy-related penalties instead of civil-fraud penalties may do so, but must present evidence to support their requests.

- **FBAR Penalty**

The FBAR penalty has also been changed under the new procedures. The IRS will assert willful FBAR penalties on taxpayers. In most cases a penalty for a willful FBAR violation will be limited to 50 percent of the highest aggregate balance of all unreported foreign-financial accounts during the disclosure period. Willful FBAR penalties are subject to discretion and, accordingly, IRS agents may recommend a higher or lower penalty based on the taxpayer's facts and circumstances; however, the

total penalty imposed cannot exceed 100 percent of the highest aggregate account balances. Further, taxpayers may request the imposition of non-willful FBAR penalties instead of willful FBAR penalties based on a showing of appropriateness.

- **Additional Penalties**

The IRS will not automatically impose penalties for failure to file information returns. Nonetheless, IRS agents have the discretion to assess these penalties. For taxpayers with non-income tax issues, such as excise taxes, employment taxes, and estate and gift taxes, IRS agents will coordinate with subject matter experts when determining penalties.

Right to Proceed in the IRS Appeals Office

An additional change to the civil resolution framework is that taxpayers who cannot reach an agreement with the IRS will retain the right to go to Appeals. However, questions remain regarding the Appeals process. It is unclear whether taxpayers who request an appeal with the Office of Appeals will still be subject to the framework of the voluntary disclosure program, including the six-year disclosure period if the appeal is unsuccessful. In addition, the new procedures allow for IRS agents to request revocation of preliminary acceptance to the voluntary disclosure program when taxpayers fail to cooperate with the civil disposition of the case. Therefore, it remains unclear if taxpayers who are unable to reach an agreement with the IRS and wish to seek relief with Appeals will lose their protection from criminal liability. Under OVDP, taxpayers generally retained that protection, so one would expect the same result now.

Domestic Voluntary Disclosures

The release of new voluntary disclosure procedures brings the domestic voluntary disclosure program in line with the offshore voluntary disclosure program. Before the release of the new procedures there was no true conformity between the two programs, and the rules that applied to OVDP generally did not apply to the domestic program. The domestic voluntary disclosure program was not as structured and fully developed as OVDP. There was no set disclosure period or penalty regime, and the procedures depended on the facts and circumstances involved in each case. The new voluntary disclosure procedures are more onerous than the prior domestic voluntary disclosure program; however, the new procedures allow for greater transparency for taxpayers with domestic non-compliance issues. The new procedures provide taxpayers considering making a domestic voluntary disclosure greater guidance as to the parameters of the program.

What's Good?

When the end of OVDP was announced in March 2018 (See GT Alert, [IRS Announces It Will End the Offshore Voluntary Disclosure Program Effective September 28, 2018](#)), taxpayers concerned that their conduct would be construed as willful or fraudulent were uncertain as to what future compliance programs would look like. The new procedures should ease these concerns. Taxpayers who make timely voluntary disclosures and are willing to cooperate with the IRS can potentially receive protection from criminal prosecution while resolving their tax and reporting issues.

Non-willful taxpayers who wish to come into U.S. tax compliance but who do not meet the requirements of the Streamlined Filing Compliance Procedures have the option to participate in the new voluntary disclosure program. The FBAR penalties under the new procedures are not as rigid as OVDP's offshore penalty. Under OVDP, the offshore penalty was set at 27.5 percent or 50 percent of the highest aggregate value of the taxpayers' previously unreported offshore assets, and was nonnegotiable. The new procedures

allow for taxpayers to request non-willful FBAR penalties if they present convincing evidence. However, the ability of taxpayers to succeed in obtaining reduced non-willful FBAR penalties is currently unknown. Taxpayers who reside outside the United States but fail to meet the non-residency requirement of the Streamlined Offshore Procedures, and have not filed a U.S. tax return for the most recent three years as required by the Streamlined Domestic Procedures, may wish to consider the new voluntary disclosure procedures.

In addition, under the new procedures, voluntary disclosures will continue to be resolved by agreement, presumably a Form 906 Closing Agreement. The agreement offers taxpayers finality, which taxpayers participating in other compliance programs do not receive. Taxpayers participating in the Streamlined Filing Compliance Procedures, the Delinquent FBAR Submission Procedures, and the Delinquent International Information Return Submission Procedures may never hear from the IRS after they file their submissions.

What's Bad?

The new voluntary disclosure procedures allow for the IRS to impose additional penalties and larger penalties on taxpayers filing a voluntary disclosure and, at least for now, the circumstances for doing so are unknown. As discussed above, under the last iteration of OVDP, the only penalties asserted by the IRS were 1) a 20 percent accuracy penalty on underpayments of tax; 2) a failure to file penalty, if applicable; and 3) a 27.5 percent or 50 percent offshore penalty. Because the size and number of penalties were set by OVDP, taxpayers looking to participate in the program could estimate the total cost of resolving their tax issues prior to entering OVDP. Under the new procedures, the IRS has discretion to impose a litany of penalties on taxpayers, as well as the discretion to determine the size of the penalty. Penalties for the failure to file information returns will not be automatically imposed, but IRS agents can impose them during the resolution of the voluntary disclosure. As a result, some taxpayers could face a broad range of potential penalties. Moreover, while the offshore penalty under prior OVDPs was known before entering into the programs, the IRS now has the ability to impose maximum FBAR penalties, up to 100 percent of the value of taxpayers' offshore accounts, if IRS agents choose to do so under the new voluntary disclosure procedures. Taxpayers with an interest in foreign entities and foreign trusts may face multiple penalties for failure to file information returns for the six years in the disclosure period.

Conclusion

Noncompliant U.S. taxpayers should consult with counsel to calculate their maximum tax, interest, and penalty exposure under the new procedures and determine whether filing a voluntary disclosure is appropriate. Although the new voluntary disclosure practice has upped the ante for all taxpayers, it remains a viable option for those with criminal exposure. Assessing this exposure is key before taking any action.

We expect that additional information regarding the new voluntary disclosure procedures will be forthcoming. The IRS plans to release revised forms and will update sections of the Internal Revenue Manual to reflect changes to the voluntary disclosure procedures.

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