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IRS Creates Dilemmas For Foreign Account Holders

by Seth Entin

The Internal Revenue Service announced significant changes in June to its offshore voluntary disclosure program, or OVDP, for U.S. individuals with undisclosed foreign accounts and assets. These changes contain the good for some individuals, the bad for others and forecast the ugly for more.

The program allows a U.S. person to avoid criminal prosecution and limit civil penalties for failing to disclose foreign accounts and assets and/or report the income generated from them.

Under this program, a non-compliant U.S. individual typically must file eight years of tax returns and foreign bank account reports, or FBARs, and other disclosures, and pay the delinquent taxes and



penalties on the delinquent taxes, interest and an additional “offshore” penalty of 27.5 percent of highest value of the individual’s foreign assets related to noncompliance during the last eight years.

Many Swiss banks are either under investigation by the U.S. government or are joining a nonprosecution program. It is expected that eventually the U.S. government

will obtain information about the U.S. clients of these banks. Furthermore, the Foreign Account Tax Compliance Act, or FATCA, and related inter-governmental agreements will eventually force foreign financial institutions, no matter where they are located, to divulge the identities of their U.S. clients to the IRS.

This new era of transparency is forcing many peo-

ple who have not yet come clean with the U.S. government to do so now, before the consequences get worse.

The changes to the OVDP contain the “good” for U.S. individuals who were not “willful” in their noncompliance. According to the IRS commissioner, these changes provide “a new pathway for people with offshore assets to come into tax compliance.”

But, at the same time, these changes contain the “bad,” potentially raising the penalties for those whose noncompliance was willful, and they proclaim the “ugly” for those who are caught before initiating a voluntary disclosure.

GOOD, BAD, UGLY

The IRS expanded what is known as the “streamlined” disclosure program to allow more people who were “nonwillful” to resolve their IRS compliance issues.

As modified, this program allows U.S. taxpayers who reside abroad, and who certify (under penalties of perjury) that they were nonwillful and meet other requirements, to file only three years of tax returns and six years of FBARs, to only pay three years of back taxes and interest, and to avoid penalties.

Moreover, the IRS took a

major step by expanding this streamlined program to even include some individuals who reside in the U.S. This allows individuals who reside in the U.S., and who certify (under penalties of perjury) that they were nonwillful and meet other requirements, to file three years of tax returns and six years of FBARs, to only pay three years of back taxes and interest, and to pay a penalty of 5 percent (rather than 27.5 percent or higher) of the value of their foreign financial assets.

The IRS announced that, starting Aug. 4, the 27.5 percent offshore penalty will be increased to 50 percent if, prior to the taxpayer’s voluntary disclosure, it becomes public that a financial institution where the taxpayer holds an account or another party facilitating the taxpayer’s offshore arrangement is under investigation by or cooperating with the U.S. government.

An individual will not qualify for the OVDP (or even for the streamlined procedure) if the IRS already has information regarding his or her noncompliance. An individual who is caught before making a voluntary disclosure is exposed to criminal prosecution and multiple civil penal-

ties, including an FBAR penalty of 50 percent of the value of his or her foreign accounts per year. As made clear by the federal case of *United States v. Zwerner* earlier this month (a South Florida case), the IRS can and will impose penalties for willful failure to file an FBAR that are well in excess of the value of the account.

The noose is tightening. The U.S. government’s investigations of foreign banks and its gathering of information under FATCA will lead to the detection of many U.S. persons with undisclosed foreign accounts and assets. As stated by the IRS commissioner on June 18, “the days of hiding assets in accounts overseas are coming to an end.” However, at this point, it may still not be too late from many noncompliant taxpayers to come forward and make a voluntary disclosure.

U.S. individuals with offshore compliance issues should speak to a tax attorney to analyze their options.

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