I.R.S. ANNOUNCES MAJOR CHANGES TO AMNESTY PROGRAMS

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Tags
O.V.D.P.

The I.R.S. announced major changes to its amnesty programs last month. These changes can be broken into two parts: changes to the 2012 Offshore Voluntary Disclosure Program ("O.V.D.P."), which can be to referred to as the 2012 Modified O.V.D.P. or the 2014 O.V.D.P., and changes to the streamlined procedures ("Streamlined Procedures"). As the requirements for the latter are relaxed, the requirements for the former are tightened.

The changes in the amnesty programs reflect the new I.R.S. approach for addressing taxpayers with offshore tax issues. The new approach provides one path for willful taxpayers, with steeper penalties but certainty, and another path for taxpayers who believe their conduct was non-willful, with reduced penalties but uncertainty to the extent their conduct is subsequently proven willful.

CHANGES TO O.V.D.P.

The major changes to the 2012 O.V.D.P. include the following:

1. Changes to Preclearance Process

Under the 2012 O.V.D.P., all that was required was to submit a preclearance request was a fax to the I.R.S. O.V.D.P. department that contained the taxpayer's name, social security number, date of birth, address, and if the taxpayer was represented by an authorized party, an executed power of attorney (P.O.A.).

The 2014 O.V.D.P. made changes to this procedure effective for O.V.D.P. submissions made on or after July 1, 2014. Revised 2014 O.V.D.P. F.A.Q. # 23 which provides guidance on preclearance requests, now states as follows:

> (a) Applicant identifying information including complete names, dates of birth (if applicable), tax identification numbers, addresses, and telephone numbers.
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> (b) Identifying information of all financial institutions at which undisclosed OVDP assets (see FAQ 35) were held. Identifying information for financial institutions includes complete names (including all DBAs and pseudonyms), addresses, and telephone numbers.
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> (c) Identifying information of all foreign and domestic entities (*e.g.*, corporations, partnerships, limited liability companies, trusts, foundations) through which the undisclosed OVDP assets (see FAQ

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35) were held by the taxpayer seeking to participate in the OVDP; this does not include any entities traded on a public stock exchange. Information must be provided for both current and dissolved entities. Identifying information for entities includes complete names (including all DBAs and pseudonyms), employer identification numbers (if applicable), addresses, and the jurisdiction in which the entities were organized.

(d) Executed power of attorney forms (if represented).

2. Penalty May Be Increased to 50%

"The offshore penalty will be increased from 27.5% to 50% if, prior to the taxpayer's pre-clearance submission, it becomes public that the financial institution or another party … is under investigation..."

The offshore penalty will be increased from 27.5% to 50% if, prior to the taxpayer's pre-clearance submission, it becomes public that the financial institution or another party facilitating the taxpayer's offshore arrangement is under investigation by the I.R.S. or the D.O.J.

This is reflected in 2014 O.V.D.P. F.A.Q. #7.2, which states:

> Beginning on August 4, 2014, any taxpayer who has an undisclosed foreign financial account will be subject to a 50-percent miscellaneous offshore penalty if, at the time of submitting the preclearance letter to IRS Criminal Investigation: an event has already occurred that constitutes a public disclosure that either (a) the foreign financial institution where the account is held, or another facilitator who assisted in establishing or maintaining the taxpayer's offshore arrangement, is or has been under investigation by the IRS or the Department of Justice in connection with accounts that are beneficially owned by a U.S. person; (b) the foreign financial institution or other facilitator is cooperating with the IRS or the Department of Justice in connection with accounts that are beneficially owned by a U.S. person or (c) the foreign financial institution or other facilitator has been identified in a court- approved issuance of a summons seeking information about U.S. taxpayers who may hold financial accounts (a "John Doe summons") at the foreign financial institution or have accounts established or maintained by the facilitator. Examples of a public disclosure include, without limitation: a public filing in a judicial proceeding by any party or judicial officer; or public disclosure by the Department of Justice regarding a Deferred Prosecution Agreement or Non-Prosecution Agreement with a financial institution or other facilitator.

Foreign banks already under investigation include:

- UBS AG;
- Credit Suisse AG, Credit Suisse Fides, and Clariden Leu Ltd.;
- Wegelin & Co.;
- Liechtensteinische Landesbank AG;
- Zurcher Kantonalbank;

- Swisspartners Investment Network AG, swisspartners Wealth Management AG, swisspartners Insurance Company SPC Ltd., and swisspartners Versicherung AG;

- CIBC FirstCaribbean International Bank Limited, its predecessors, subsidiaries, and affiliates;

- Stanford International Bank, Ltd., Stanford Group Company, and Stanford Trust Company, Ltd.;

- The Hong Kong and Shanghai Banking Corporation Limited in India (HSBC India); and

- The Bank of N.T. Butterfield & Son Limited (also known as Butterfield Bank and Bank of Butterfield), its predecessors, subsidiaries, and affiliates.[1]

3. Elimination of Existing Reduced Penalty Structure

The reduced penalty structure under former F.A.Q. #52 and #53 have been eliminated. Former F.A.Q. #52 allowed for a 5% penalty in the case of certain inherited accounts, certain taxpayers who were unaware that they were U.S. citizens, and certain non-U.S. residents who made a good faith showing that the taxpayer complied with their resident country's tax reporting and payment obligations, and who had $10,000 or less U.S. source income for each year. The available path forward for taxpayers who believe their conduct was non-willful is now exclusively through the new Streamlined Procedures.

4. Account Statements

Former F.A.Q. #25 required submission of account statements at the time of the full submission package only if the account exceeded $500,000 in any year of the disclosure period. In such event, the taxpayer was required to keep records available upon request. F.A.Q. #25 has been modified to require taxpayers to submit account statements regardless of account balance at the time of the full submission package. It also now provides that voluminous documents not requiring original signatures may be submitted on CD or DVD.

5. Other Notable Revisions

Other notable revisions include the following:

- F.A.Q. #33 reaffirms with no uncertain terms the I.R.S.'s position of tax non-compliance. It now states that "[e]ven one dollar of unreported gross income from an O.V.D.P. asset will bring it into the offshore penalty base."

- F.A.Q. #35.1 is added and states that the offshore penalty will be applied to the taxpayer's interest in the underlying O.V.D.P. assets without regard to valuation discounts.

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[1] A current list can be found at the following link: http://www.irs.gov/Businesses/International-Businesses/Foreign-Financial-Institutions-or-Facilitators.

6. Effective Date

The 2014 F.A.Q.s are effective for all new submissions made on or after July 1, 2014.[2]

7. Consideration Under New Rules

A taxpayer who made an O.V.D.P. submission prior to July 1, 2014 the taxpayer's case considered under the new guidelines. In this scenario, the taxpayer or the taxpayer's authorized representative must communicate the request in writing to the examiner assigned to the case and, if no examiner has been assigned, to a specified address.

8. Transitional Relief

For taxpayers who already had submitted their intake letter and attachments prior to July 1, 2014, to the extent the taxpayer is eligible for one of the streamlined programs, the taxpayer may apply for a reduced penalty *in lieu* of the 27.5% O.V.D.P. penalty. However, all other terms of the O.V.D.P., including the disclosure period and tax, interest, and other penalties, will continue to apply.

Applying for the reduced penalty entails signing a certification signed under penalty of perjury. This certification must explain that the taxpayer did not act wilfully with respect to all foreign activities/assets, must specifically describe the reasons for the failure to report all income, pay all tax, and submit all required information returns, including F.B.A.R.s, and, if the taxpayer relied on a professional advisor, must include the name, address, and telephone number of the advisor and a summary of the advice.

Relief is not automatic. Before transitional treatment is given, the I.R.S. must agree that the taxpayer is eligible for transitional treatment and must agree that the available information is consistent with the taxpayer's certification of non-willful conduct.

CHANGES TO STREAMLINED PROCEDURES

The Streamlined Procedures were substantially modified. This program is designed for non-willful taxpayers and is divided into two groups: those living in the U.S. ("Domestic Streamlined Program") and those residing offshore ("Foreign Streamlined Program"). No I.R.S. streamlined questionnaire is now required, although many tax practitioners have made their own questionnaires in order to assist in the process. The taxpayer will have to certify that their conduct was non-willful under the appropriate I.R.S. form. Further, the $1,500 threshold has also been eliminated. Each program is described in more detail below.

1. Non-Willful Conduct

Willfulness is the voluntary, intentional violation of a known legal duty, may include "willful blindness" or the reckless disregard of known statutory duties. Non-willful

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[2] 2014 O.V.D.P. F.A.Q. #1.2.

conduct includes conduct that is due to negligence, inadvertence, mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law. The determination of whether the taxpayer's conduct was willful or non-willful may be established by inference and circumstantial evidence.

The I.R.M. lists four examples in the context of the failure to file an F.B.A.R. These examples are reproduced below:

- Example 1. A person admits knowledge of, and fails to answer, a question concerning signature authority over foreign bank accounts on Schedule B of his income tax return. When asked, the person does not provide a reasonable explanation for failing to answer the Schedule B question and for failing to file the F.B.A.R. The example concludes that a determination that the violation was willful likely would be appropriate in this case.

- Example 2. A person files the F.B.A.R., but omits one of three foreign bank accounts. The person had closed the omitted account at the time of filing the F.B.A.R. The person explains that the omission was due to unintentional oversight. During the examination, the person provides all information requested with respect to the omitted account. The information provided does not disclose anything suspicious about the account, and the person reported all income associated with the account on his tax return. The example concludes that the willfulness penalty should not apply absent other evidence that may indicate willfulness.

- Example 3. A person filed the F.B.A.R. in earlier years but failed to file the F.B.A.R. in subsequent years when required to do so. When asked, the person does not provide a reasonable explanation for failing to file the F.B.A.R. In addition, the person may have failed to report income associated with foreign bank accounts for the years that F.B.A.R.'s were not filed. The example concludes that a determination that the violation was willful likely would be appropriate in this case.

- Example 4. A person received a warning letter informing him of the F.B.A.R. filing requirement, but the person continues to fail to file the F.B.A.R. in subsequent years. When asked, the person does not provide a reasonable explanation for failing to file the F.B.A.R. In addition, the person may have failed to report income associated with the foreign bank accounts. The example concludes that a determination that the violation was willful likely would be appropriate in this case.

2. Foreign Streamlined Program

In order to qualify for the Foreign Streamlined Program, the taxpayer must, in general, meet the following eligibility requirements:

a. The taxpayer must have failed to report the income from a foreign financial asset and pay tax as required by U.S. law, and may have failed to file an F.B.A.R.;

b. The failure to report income, pay tax, and submit required information returns was due to non-willful conduct;

c. The taxpayer must meet the following non-residency requirement. The non-residency requirement will vary depending on the status of the individual.

i. *U.S. Citizens and Lawful Permanent Residents*: Individual U.S. citizens or lawful permanent residents, or estates of U.S. citizens or lawful permanent residents, meet the applicable non-residency requirement if, in any one or more of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed, the individual did not have a U.S. abode and the individual was physically outside the United States for at least 330 full days.

ii. *Non-U.S. citizens and Other Residents*: Individuals who are not U.S. citizens or lawful permanent residents, or estates of individuals who were not U.S. citizens or lawful permanent residents, meet the applicable non-residency requirement if, in any one or more of the last three years for which the U.S. tax return due date (or properly applied for extended due date) has passed, the individual did not meet the substantial presence test (*i.e.*, the 183-day test) under the U.S. tax residency rules.

If the taxpayer is eligible, the taxpayer must:

a. File delinquent or amended tax returns, together with required information returns, for the last three years for which the U.S. tax return due date (or properly applied for extended due date) has passed;

b. File any delinquent F.B.A.R.'s for each of the most recent six years for which the F.B.A.R. due date has passed;

c. Remit the full amount of tax and interest due in connection with these filings; and

d. Sign a written statement declaring under penalties of perjury that the taxpayer is eligible for the program, is now compliant with the F.B.A.R. filing obligations, and that the past non-compliance was due to non-willful conduct.

If the taxpayer is eligible and fulfills the other requirements of the program, the taxpayer will not be subject to the following:

a. Failure-to-file penalties;

b. Failure-to-pay penalties;

c. Accuracy-related penalties;

d. Information return penalties; and

e. F.B.A.R. penalties.

3. Domestic Streamlined Program

In order to qualify for the Domestic Streamlined Program, the taxpayer must, in general, meet the following eligibility requirements:

a. The taxpayer must not meet the non-residency requirements described above (for joint filers, one or both of the spouses must fail to meet the applicable non-residency requirement);

b. The taxpayer must have filed a U.S. tax return (if required) for every year out of the most recent three-year period for which the U.S. tax return due date (or properly applied for extended due date) has passed;

c. The taxpayer must have failed to report gross income from a foreign financial asset and pay tax as required by U.S. law and may have failed to file an F.B.A.R. and/or one or more international information returns with respect to the foreign financial asset; and

d. The taxpayer's failure was due to non-willful conduct.

If the taxpayer is eligible, the taxpayer must:

a. File amended U.S. tax returns for every year out of the three-year period for which the U.S. tax return due date (or properly applied for extended due date) has passed, including required information returns;

b. File delinquent F.B.A.R.s for the most recent past six years for which the due date has passed;

c. Pay a 5% penalty on the highest aggregate balance/value of the foreign financial assets during the years in the applicable tax return and F.B.A.R. period. For these purposes, the 5% miscellaneous offshore penalty applies to foreign financial assets in the following set of circumstances:

i. If the asset should have been, but was not, reported on an F.B.A.R. in a given year;

ii. If the asset should have been, but was not, reported on Form 8938 in a given year; and

iii. If the asset was properly reported for a given year, but gross income in respect of the asset was not reported in that year.

d. Submit a signed written statement declaring under penalties of perjury that the taxpayer is eligible for the program, is now compliant with the taxpayer's F.B.A.R. filing obligations, that the past non-compliance was due to non-willful conduct, and that the 5% miscellaneous offshore penalty is accurate.

If the taxpayer is eligible and fulfills the other requirements of the program, the taxpayer will not be subject to the following:

a. Accuracy-related penalties;

b. Information return penalties;

c. F.B.A.R. penalties.

4. Disqualifications

It should be noted that if the I.R.S. has initiated a civil examination of a taxpayer's returns for any taxable year, regardless of whether the examination relates to undisclosed foreign financial assets, the taxpayer will not be eligible to use the Streamlined Procedures. However, the guidelines note that taxpayers under examination should consult with their agent.

5. General Treatment Under These Programs

The guidelines note that tax returns submitted under these procedures will be processed like any other return submitted to the I.R.S. Accordingly, receipt of the returns will not be acknowledged by the I.R.S. and the streamlined filing process will not culminate in the signing of a closing agreement.

6. Caution

The guidelines state that returns submitted under these procedures will not be subject to I.R.S. audit automatically. However, the I.R.S. warns that:

a. Submission under these procedures disqualifies the taxpayer from participating in the O.V.D.P. at a later date;

b. Returns may be selected for audit;

c. Returns may also be subject to independent verification procedures and may be checked against third-party information received from banks, financial advisors, and other sources; and

d. Returns submitted under these procedures may be subject to I.R.S. examination, additional civil penalties, and even criminal liability, if appropriate. Therefore, if willfulness is proven after submission, the taxpayer receives no penalty protection. In other words, the taxpayer may be subject to the 50% F.B.A.R. penalty (per violation) and possible criminal penalties.

"The objective of the changes in the amnesty program is to bring taxpayers that have offshore tax issues back into the system as fully compliant."

The guidelines to the new procedures encourage taxpayers who are concerned that their failures were due to willful conduct to participate in the O.V.D.P. The guidelines also encourage taxpayers to consult with competent tax professionals to assess which program they should enter into before making a decision.

CONCLUSION

The objective of the changes in the amnesty program is to bring taxpayers that have offshore tax issues back into the system as fully compliant. The prior complaint was the O.V.D.P. was too harsh for non-willful taxpayers. Therefore, certain taxpayers made so-called quiet disclosures, corrected their mistakes only on a go-forward basis, or have

refrained from doing anything. Based on these recent changes, taxpayers have no excuse for not correcting known errors.

We expect that the I.R.S. will be harsh on offshore tax compliance issues to the extent the taxpayer refrains from correcting known mistakes. We further expect the I.R.S. to make examples of those who willfully avoided taxes but have entered into the revised Streamlined Procedures in order to receive a reduced penalty that they were not entitled to. The changes in the amnesty programs further reflect the policy shift to use tax professionals as gatekeepers in order to determine which program the taxpayer should enter into. This saves the I.R.S. resources by putting the burden, and the costs, on the taxpayer and the taxpayer's trusted advisor.

As these programs may close, taxpayers are well-advised to take advantage of these programs sooner than later. Taxpayers living offshore whose conduct was non-willful may be entitled to a path forward as simple as filing late returns without penalties. Taxpayers living onshore may be entitled to a substantially reduced penalty even in the case of non-willful violations that lack reasonable cause. Many tax practitioners believe that the amnesty programs may close when automatic information reporting begins under F.A.T.C.A., which may be as early as March of next year for the 2014 calendar year. Therefore, prompt attention is recommended.