

Overview of 2011 IRS Offshore Voluntary Disclosure Initiative

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M. Robinson & Company

- We are nationally recognized thought leaders in the IRS' 2011 Offshore Voluntary Disclosure Initiative (2011 OVDI)
- Correctly Predicted the IRS 2011 OVDI announcement
- Articles in:
 - Boston Business Journal – February 4, 2011
 - Journal of Taxation – April 2011

What You Will Learn

- IRS Experiences Institutional Humiliation
- The Coming Crackdown: The IRS Response to Institutional Humiliation
- How to Come Forward
- Eligibility to Participate in the 2011 OVDI
- Requirements for Participation in 2011 OVDI

What You Will Learn (continued)

- The Challenge of “Getting It Done”
- Limited Amnesty from Criminal Prosecution for 2011 OVDI Participants
- Civil Penalty Structure for 2011 OVDI Participants
- Waiver of Civil Penalties for Tax-Compliant Taxpayers

What You Will Learn (continued)

- Dangers and Opportunities for Affected Taxpayers
- Dangers and Opportunities for Tax Return Preparers
- How M. Robinson & Company Can Help Affected Taxpayers

IRS Experiences Institutional Humiliation

The 2009 OVDP

- The March 23, 2009 Offshore Voluntary Disclosure Program (2009 OVDP)
 - It was based on information provided by a whistleblower.
 - IRS expected about 1,000 taxpayers to come forward.
 - Before the Program closed on October 15, 2009, nearly 15,000 taxpayers came forward
 - Nearly 3,000 came forward after the 2009 OVDP closed.
 - Average recovery per taxpayer: About \$200,000.

Important Questions

- Why have tens of thousands of otherwise law-abiding American ignored their legal obligations?
- Why has IRS—a once feared agency of the United States—been reduced to offering a second massive amnesty in less than *two* years?

Tax Enforcement 101

- Taxes are NOT voluntary contributions.
- Taxpayers will NOT pay a tax if government lacks the will or the means to collect the tax.
- Effective Tax Enforcement requires:
 - **Will** to Collect the Tax
 - **Means** to Collect the Tax
- Computers provide governments with the means to collect the tax efficiently and inexpensively.
- But IRS computers lack reliable information.

The Coming Crackdown: The IRS Response to Institutional Humiliation

Step 1: Indentify Non-Compliant Taxpayers

Sources of Information

- Whistleblowers – who may claim as much as 30 percent collected by the U.S. Treasury
- Cooperating criminal targets
- Deposits of Cash over \$10,000
- Investigations of Foreign Banks
 - Far East
 - Swiss Banks
- Tax Treaties/John Doe Summonses to Foreign Banks
 - Switzerland

FATCA: Computerized Identification of Non-Compliant Taxpayers

- FATCA: Foreign Account Tax Compliance Act. It requires foreign banks and brokerage companies to provide 1099-type information to IRS computers. Effective 2013.
- Already in Compliance: HSBC Banque Canada
 - Promised Compliance: Bank Leumi-Israel

Computerized Databases

- Database: IRS has created several databases using:
 - Information taken from 15,000 participants in the 2009 OVDP and the nearly 3,000 taxpayers who voluntarily came forward after the 2009 OVDP closed.
 - Other sources

Allocation of Audit Personnel

- IRS has allocated about 1 IRS auditor in 10 – nationwide:
 - To process the nearly 18,000 taxpayers who have come forward voluntarily.
 - To address the factors involved in massive non-compliance.
 - (Possibly) to work on the database, described above.

Step 2: Second Chance to Come Forward – Tougher Terms

Comparison 1: Number of Years

- Number of years included in the OVDI:
 - 2009 OVDP – 6 years: 2003 – 2008
 - 2011 OVDI – 8 years: 2003 – 2010

Comparison 2: Acceptance Into the Program

- 2009 OVDP – File three page letter by **October 15, 2009 Deadline**
- 2011 OVDI – Complete the following by **August 31, 2011 Deadline**
 - File accurate and complete income tax returns for the years 2003-2010.
 - File accurate and complete FBARS for the years 2003-2010.
 - 2010 FBAR due June 30, 2011.
 - File accurate and complete Title 26 offshore-related information returns (such as Form 3520) for the years 2003-2010.

Comparison 2: Acceptance Into the Program (continued)

- Compute the additional taxes, penalties and interest.
- Pay the additional taxes, penalties and interest (or arrange to make payment arrangements satisfactory to the IRS).

Comparison 3: Tougher Penalties

- Reasonable Cause/Mitigation:
 - Permitted under 2009 OVDP, FAQ A35.
 - NOT permitted under 2011 OVDI, FAQ A50
 - This applies to:
 - Failure to File Penalty – up to 25 percent of unreported tax
 - Failure to Pay Penalty – up to 25 percent of unpaid tax
 - Accuracy Related Penalty – 20 percent of understated tax

Comparison 3: Tougher Penalties (continued)

- Increased Rates for “Miscellaneous Penalty”
 - 2009 OVDP:
 - General Rate: 20 percent
 - Exceptional Rate: 5 percent
 - 2011 OVDI:
 - General Rate: 25 percent
 - Intermediate Rate – Under \$75,000: 12.50 percent
 - Exceptional Rate: 5 percent

Comparison 3: Tougher Penalties (continued)

- Amount Subject to Penalty – 2009 OVDP:
 - The highest aggregate balance in the unreported foreign account(s) over the six-year period (2003 to 2008). Limited to foreign bank, brokerage, retirement accounts, etc.
- Amount Subject to Penalty – 2011 OVDI:
 - “[A]ll of the taxpayer’s offshore holdings that are related in any way to tax non-compliance, regardless of the form of the taxpayer’s ownership or the character of the asset.” 2011 OVDI FAQ, A35.

Comparison 3: Tougher Penalties (continued)

Amounts Subject to Penalty - 2011 OVDI:

- Amounts in foreign accounts NOT reported on FBARS
- FMV of foreign businesses with unreported FBARS
- FMV of foreign businesses with unreported income
- FMV of foreign real estate and other assets whose income was NOT reported.
- THERE IS NO DE MINIMUS EXCEPTION
- Penalty Ceiling: The sum of all statutory penalties WITHOUT taking into account reasonable cause, lack of willfulness and other mitigating circumstances.

Step 3: Higher Civil Penalties and Enhanced Criminal Enforcement

Coming Forward After August 31, 2011

- IRS does NOT want more than about 1,000 taxpayers to complete the work and to come forward by the August 31, 2011 deadline.
- Rather, it may expect that most affected taxpayers will NOT be able to come forward by the August 31, 2011 deadline.

Benefits to IRS Arising from Low Turnout

- IRS Avoids institutional humiliation a second time around.
- IRS and the DOJ position themselves to:
 - Collect more money and
 - Step up criminal enforcement

IRS Collects More Money

- Those who are unable to come forward will be subject to additional financial penalties:
 - IRS reserves the right to go back to periods prior to 2003. 2011 OVDI FAQ, A11.
 - IRS will attempt to maximize the tax, penalties and interest by using, for example, the civil fraud penalty – at 75 percent of the understated tax – in place of the miscellaneous penalty at 25 percent of the fair market value of property connected to non-compliance with the income tax and bank secrecy laws of the United States. 2011 OVDI FAQ, A5 & A11.

The DOJ Steps Up Criminal Enforcement

- Successful convictions for tax evasion and violations of the bank secrecy laws of the United States require “willfulness” – a term that has been defined by the United States Supreme Court as “the intentional disregard of a known legal duty.”
- To date, the DOJ has NOT instituted criminal actions when the taxpayer merely failed to report income earned abroad or failed to file timely and accurate FBARs.
- After the 2011 OVDI closes, it will be much easier for the DOJ to prove willfulness.

How to Come Forward

“Normal” IRS and “Normal” DOJ Disclosure Policies

- “Normal” IRS Voluntary Disclosure Policy
 - IRM 9.5.11.9: Voluntary Disclosure Practice: Criminal prosecution will likely not be recommended if (1) communication is truthful, timely, and complete, (2) taxpayer shows a willingness to cooperate, and (3) taxpayer makes good faith arrangements to pay.
 - In existence over 50 years; about 100 taxpayers per year.
- “Normal” DOJ Disclosure Policy
 - DOJ Criminal Tax Manual 4.01[2]: Voluntary disclosure (1) must be timely and (2) taxpayer must thereafter fully cooperate with the government.

Pre-Clearance

- Importance of Pre-Clearance
 - Avoiding admissions against interest
- How to Obtain Pre-Clearance from IRS
 - Fax the taxpayers' name, date of birth, social security number and address to **(215) 861-3050** (POA must be included if represented).
- How to Obtain Pre-Clearance from the DOJ

What if IRS Refuses Pre-Clearance?

Taxpayers responses range from:

- Provide all information as if taxpayer *was* accepted into the Program; to
- Do nothing
 - It is NOT possible to fail to report all income and all foreign bank accounts on an ongoing basis.
 - AICPA and ABA Rules of Ethics
 - The 2011 OVDI FAQ requires that the tax return preparer refuse to prepare ongoing returns. FAQ A47.

Eligibility to Participate in the 2011 OVDI

Who Is Eligible to Participate

- Taxpayers who are:
 - NOT Compliant with international income tax obligations.
 - Not under civil examination.
 - Not under criminal investigation.
 - It does NOT matter whether the examination or investigation involves international tax obligations.

Participation Requirements

What to Provide?

PROVIDE:

- Offshore Voluntary Disclosures letter
 - Optional format letter available at www.irs.gov.
- Original and/or Amended income tax returns
- Original and/or Amended FBARs
- Overseas-related Title 26 disclosure forms (e.g., foreign gifts, foreign trusts, foreign partnerships, foreign corporations, etc.)

What to Provide? (continued)

PROVIDE (continued)

- Bank Statements
- Penalty Computation Form
- Other Documents

For How Many Years?

Number of Years:

- 2003
- 2004
- 2005
- 2006
- 2007
- 2008
- 2009
- 2010

Payment/Arrange to Pay

PAY:

- Failure-to-file penalty, if applicable, up to 25 percent
- Failure-to-pay penalty, if applicable, up to 25 percent
- Substantial Understatement Penalty – 20 percent
- Miscellaneous Penalty – up to 25 percent of all assets related to underreported income taxes.

OR:

- Arrange to Pay the above.

Deadline for Documentation and Payment

Deadline for Providing Documents and Paying (or Arranging to Pay) Additional Taxes, Penalties, and Interest:

- **August 31, 2011**

Consequences for Failure to Meet Deadline

- Not in the 2011 OVDI
- Taxpayers Subject to Higher Penalties
- Taxpayers Subject to Years Before 2003
- This May Be the IRS' intention
 - Massive admissions to an amnesty result in institutional humiliation
 - Lower participation in 2011 OVDI followed by substantially higher penalties eases institutional humiliation

The Practical Challenges of “Getting It Done”

Obtaining Foreign Bank and Brokerage Account Statements

- Must be submitted when the account balances exceed \$1 million.
- Must be available if accounts are less than \$1 million.
- Translating them when they are in French, German etc.

Tax Accounting For Foreign Accounts

- U.S. tax accounting rules must be followed for transactions in foreign currencies.
- Gain or loss on foreign currency transactions must be translated into U.S. currency.
- Gain or loss on currency conversions must be calculated.
- PFIC (foreign mutual fund) income must be calculated or approximated.

Accounting for Fund Transfers

Fund transfers must be accounted for:

- To avoid reporting transfer deposits as income.
- To avoid paying a 2011 OVDI Miscellaneous Penalty on the same money transferred from account to account.
- To avoid paying a 2011 OVDI Miscellaneous Penalty on the same money converted from a bank or brokerage account into real estate, art, etc. that is otherwise subject to the Miscellaneous Penalty.

Other Tax Accounting Issues

- Preparing Complex Overseas Related Title 26 disclosure returns for foreign gifts, foreign trusts, foreign partnerships and foreign corporations.
- Reporting complex transactions – such as installment sales in foreign currencies – on tax returns.
- Reporting Subpart F income.

Limited Amnesty for 2011 OVDI Participants

IRS Voluntary Disclosure Amnesty

- IRS will NOT refer a taxpayer who meets all of the requirements of the 2011 OVDI to the Tax Division of the DOJ for criminal prosecution.

DOJ Voluntary Disclosure Amnesty

- DOJ will not prosecute taxpayers who voluntarily disclose if:
 - The disclosure is timely; and
 - A disclosure is not timely if (a) the IRS has already initiated an inquiry that is likely to lead to the taxpayer and the taxpayer is reasonably thought to be aware of that activity, or (b) some event occurred before the disclosure which the taxpayer probably knew about and is likely to cause an audit into the taxpayer's liabilities (IRS agreement with UBS?)
 - The taxpayer fully cooperates with the government after the disclosure.

Civil Penalty Structure for 2011 OVDI Participants

Regular Penalty

Regular Penalty is the sum of the following four penalties:

- Accuracy-Related Penalty – 20 percent
- Failure-to-File Penalty – Up to 25 percent
- Failure-to-Pay Penalty – Up to 25 percent
- “Miscellaneous Penalty” – Rates: 5%, 12.50%, 25%

Ceiling Penalty

The total penalties under the 2011 OVDI cannot exceed the sum of all civil statutory penalties **WITHOUT** taking into account reasonable cause, lack of willfulness and other mitigating factors. [2011 OVDI FAQ, A50.](#)

Problems with 2011 OVDI Penalty Structure

- No opportunity to consider reasonable cause or lack of willfulness.
- NO opportunity to settle or appeal regular or ceiling penalties.

Opting Out

- Election to opt out is irrevocable.
- Taxpayer still is in regular voluntary disclosure program and is still retains limited amnesty protection.
- IRS will consider reasonable cause and willfulness.
- Taxpayer has the right to appeal to the IRS Appeals Office and the Courts.

The Miscellaneous Penalty

Miscellaneous Penalty: Part 1: The Penalty Rates

- Regular Penalty Rate: 25%
- Reduced Penalty Rate: 12.50%
 - If the fair market value of all property associated with underreported income is less than \$75,000 for the calendar years 2003 through 2010.
- Lowest Penalty: 5%
 - This is designed principally for the children of holocaust survivors who inherit their parent's offshore accounts and property.

Part 2: Property Subject to the Penalty

- The penalty amount is:
 - The fair market value of assets whose income was not reported; and
 - The fair market value of assets purchased with income that was not reported.
- There is NO De Minimis (negligible) amount of income. The failure to report a dollar of income could subject a \$1 million to the penalty amount.
 - The total penalty cannot exceed the ceiling penalty.

Part 3: Misc. Penalty in Lieu of Penalties NOT Assessed

The Miscellaneous Penalty is in place of penalties which include:

- The offshore-related disclosure penalties such as the 25 percent penalty for failure to report foreign gifts of over \$100,000 using Form 3520
- The non-willful Bank Secrecy Act Penalty for failure to report bank and brokerage accounts with a cumulative balance of \$10,000 or more.
- The willful Bank Secrecy Penalty of the greater of 50% of the account balance or \$100,000.

Waiver of Civil Penalties for Tax Compliant Taxpayers

Eligibility for Waiver of Penalties

All penalties are waived for taxpayers who:

- Are compliant with their income tax obligations
- Owe FBARs
- Owe overseas-related Title 26 Disclosure Forms

How to Waive Penalties

How to Have Penalties Waived:

- File the FBAR or Title 26 disclosure forms
- On or before August 31, 2011
- Attach an appropriate explanation
- Provide proof that taxpayer is compliant with income tax obligations.

Requirement for DOJ Amnesty

- The above amnesty only applies to IRS.
- To obtain the amnesty of the DOJ, taxpayers **MUST** comply with the timeliness and cooperation requirements of DOJ's Criminal Tax Manual (DOJ CTM), Paragraph 4.01.
 - It is unclear whether the IRS' investigation into offshore accounts would be considered "some event [that] occurred before the disclosure . . . [which] is likely to cause an audit into the taxpayer's liabilities." DOJ CTM 4.01[2].
 - If the IRS investigation is classified as such, DOJ may not consider a disclosure timely.

Dangers and Opportunities

Dangers for Affected Taxpayers

- Failure to come forward will leave taxpayers vulnerable to criminal prosecution
 - Willfulness is defined as “the intentional disregard of a known legal duty.”
 - Given the publicity of the 2011 OVDI, most taxpayers now know of their legal duties.
- IRS will find many non-compliant taxpayers and may bring criminal charges.

Dangers for Affected Taxpayers Continued

- Criminal Conviction can lead to:
 - Loss of licenses to practice medicine or any other profession requiring licenses.
 - Immigration Problems (including deportation) for taxpayers with H-1 visas and Green Cards.

Opportunities for Affected Taxpayers

Opportunities

- To become tax compliant
- To avoid the imminent IRS crackdown
- To benefit from reduced penalties
- To avoid criminal responsibility (in most cases)

Dangers and Opportunities for Tax Return Preparers

Dangers Arising From Intentionally Failing To Prepare an FBAR

- Loss of Right to Practice Before IRS
- Civil and Criminal Penalties

Circular 230 Issues

- Preparation of 2010 Tax Return with Knowledge of Prior FBAR Non-Compliance is Circular 230 Violation.

Opportunities

- Help taxpayers who need help badly
- Learn new skills and perform interesting work

How M. Robinson & Company Can Help Affected Taxpayers

Devising a Strategy

- “Quiet Disclosure” vs. Participation in the 2011 OVDI
- Pre-Clearance
 - With IRS
 - With the DOJ (in cooperation with criminal defense counsel)
- A Back-Up Plan if IRS or the DOJ does NOT grant pre-clearance

Preserving the Attorney/Client Privilege

- Preserve the Attorney/Client Privilege for the taxpayer
- Allow the taxpayer's CPA to practice under the M. Robinson attorney/client privilege (with *Kovel* letter)

Working Cooperatively with Criminal Defense Counsel

- Working as co-counsel with a criminal defense attorney may help:
 - To devise an effective strategy to avoid convictions; and
 - To reduce the sentence, upon conviction, by addressing mitigating factors.

Minimizing Penalties Within the 2011 OVDI

- Lowest penalty amount: 12.50 percent or even 5 percent in lieu of the 25 percent penalty.
- Lowest amount of property subject to penalty: calculated on the basis of the year with the highest aggregate account balance (or value of assets connected to tax non-compliance) from 2003 to 2010.
- Trace deposits from account to account and from account to properties – to avoid a “double-up” on penalties.

Minimizing Penalties Outside the 2011 OVDI

- Advising whether to “opt out”
- Documenting reasonable cause, lack of willfulness and mitigating factors
- Taking appeals to the IRS Appeals Office
- Taking appeals to the U.S. Tax Court, the U.S. District Court, and the U.S. Court of Claims.

Helping the Taxpayer to “Get It Done”

“Getting it Done” by helping the taxpayer “hit the ground running:”

We know how to:

- Obtain foreign bank and brokerage account statements.
- Translate and understand these account statements.

Helping the Taxpayer to “Get It Done” - Continued

- Perform the tax accounting needed to obtain the information the taxpayer needs to report.
- Calculate or estimate PFIC (foreign mutual fund) income.
- Prepare corrected tax returns OR review tax returns prepared by the taxpayer's CPA
- Prepare the “Source of Funds” disclosure

Questions?

- Call M. Robinson & Company - 617/428-6900
- Our experienced attorneys will give you or your clients a few minutes on the telephone without charge.

The End