

Clock is Ticking for Offshore Account Voluntary Disclosures

By David F. Axelrod

For many years, the Internal Revenue Service ("IRS") has had a "voluntary disclosure" policy in its Criminal Manual. Under the policy, a disclosure preliminarily accepted by the Criminal Investigation Division (CI) is referred for civil resolution. (The voluntary disclosure policy is contained in IRM § 9.5.11.9 (09-09-2004), which may be found at <http://www.irs.gov/irm/part9/ch05s13.html#d0e42497>).

The IRS's recent enforcement initiatives regarding offshore accounts and entities have led to an increase in the number of voluntary disclosures in this area. Some taxpayers have, however, been reticent because of uncertainty regarding the penalties to which they may be exposed. To alleviate that concern and encourage those taxpayers to come forward, the IRS has adopted a uniform procedure and penalty structure for processing such voluntary disclosures.

According to the IRS website, this procedure is to enable taxpayers with undisclosed foreign accounts or entities to "become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution." See IRS website May 6, 2009 Frequently Asked Questions ("FAQs"), at <http://www.irs.gov/newsroom/article/0,,id=206012,00.html>, FAQ no. 3. The procedure was promulgated in a March 23, 2009 memorandum by the Deputy Commissioner for Services and Enforcement, which may be found at the same place on the IRS website. The key provisions of the memorandum are:

- Taxes and interest due will generally be assessed going back six years (taxpayers are expected to file correct delinquent or amended returns for tax years going back to 2003, inclusive);
- Taxpayers will be required to file or amend all returns, including information returns and Reports of Foreign Bank and Financial Accounts (Form TD F 90-22.1, commonly known as "FBARs," for "Foreign Bank Account Reports");
- An accuracy or delinquency penalty will be assessed for all years (no reasonable cause exception will be considered);
- In lieu of all other penalties that may apply, the IRS will assess a penalty equal 20% of the amount in the foreign bank accounts or entities in the year with the highest aggregate account or asset value. (If there has been no activity in the account or entity during the period controlled by the taxpayer, and all taxes have been paid on the funds therein, this penalty may be reduced to 5%).

This procedure applies only to taxpayers that make qualifying voluntary disclosures under § 9.5.11.9. Importantly, the procedure remains in effect only until September 23, 2009. At that point, the IRS will decide whether and how to continue the practice. See FAQ no. 16.

In the absence of a voluntary disclosure, a host of penalties may be imposed for failures to file an alphabet soup of IRS forms, including penalties for failures to file:

- FBARs;
- Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts;
- Form 3520-A, Information Return of Foreign Trust With a U.S. Owner;
- Form 5471, Information Return of U.S. Person with Respect to Certain Foreign Corporations;
- Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business;
- Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation; and
- Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships.

In addition, fraud penalties may be imposed under Internal Revenue Code §§ 6651(f) or 6663. Possible criminal charges include income tax evasion (§ 7201), failure to file an income tax return (§ 7203) and failure to file an FBAR (31 U.S.C. § 5322).

A different procedure applies to those who reported all taxable income but failed to file FBARs. (This contrasts to those who failed to file FBARs and failed to report offshore income, discussed above.) The IRS advises that in this situation, taxpayers should file the delinquent FBARs and attach a statement explaining why the reports are being filed late, and "the IRS will not impose a penalty for the failure to file the FBARs." FAQ no. 9. But see *Caceres v. United States*, 440 U.S. 741, 755-56 (1979) (declining to suppress evidence obtained in violation of procedures established by the Internal Revenue Manual). **The September 23, 2009 deadline also applies to this procedure.**

Some taxpayers have attempted so-called "quite disclosures," by filing amended returns and paying related tax and interest for previously unreported offshore income, without otherwise notifying the IRS or following the voluntary disclosure procedure contained in IRM § 9.5.11.9. The IRS cautions that it will scrutinize amended tax returns reporting increases in income, and may take enforcement action where its voluntary disclosure procedure has been ignored. FAQ no. 10. Thus, to take advantage of the uniform procedure and penalty structure for reporting previously undisclosed offshore income, "[t]hose taxpayers must send previously submitted documents, including copies of amended returns, to their local [Criminal Investigation] office by September 23, 2009," in accordance with the prescribed voluntary disclosure procedure.

In short, the IRS offers taxpayers an opportunity to resolve their tax liabilities for unreported offshore income with reasonable certainty regarding the penalties, and little risk of criminal prosecution, so long as the prescribed procedures are followed. But, the clock is ticking...