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Tax Law Alert

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IRS Announces 2012 Offshore Disclosure Program ("2012 OVDP")

No deadline for 2012 OVDP as of now and no New Jersey guidance as of yet

In April and August of 2011, we published alerts on the 2011 Offshore Voluntary Disclosure Initiative ("2011 OVDI") offering eligible taxpayers a uniform, streamlined and predictable process permitting them to come into compliance with United States income tax laws concerning offshore accounts and offshore entities. The 2011 OVDI followed the IRS 2009 Offshore Voluntary Disclosure Program ("2009 OVDP") and provided a detailed form of guidance in a question and answer publication ("2011 Q and A"). Fast forward to 2012, where, on January 9, the IRS announced its third initiative in this arena, the 2012 OVDP.

What are the differences between 2011 OVDI and 2012 OVDP?

Though the IRS has said it would be issuing more guidance on 2012 OVDP, as of the date of this publication, 2012 OVDP is identical to 2011 OVDI, with these tweaks:

The offshore penalty, or "slap," has increased from 25% to 27.5%

The program pertains to disclosure of the eight years prior to the date the taxpayer comes forward (i.e., a taxpayer coming forward in 2012 would disclose for 2004-2011); and

There is currently no deadline for this program.

Though currently there is no further guidance as to 2012 OVDP the IRS has said that the 2011 Q and A would apply in most circumstances to guide taxpayers. Accordingly, there are references throughout this alert to 2011 Q and A.

Who are some potential candidates for 2012 OVDP?

Taxpayers who failed to file Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts ("FBAR")). The FBAR is typically required to report direct or indirect financial interest in, or signature authority over, a financial account offshore where the account balance exceeds $10,000. Penalties may be as high as $100,000 (or 50% of the account balance, if higher) for each failure to file without 2012 OVDP.

Taxpayers who failed to file Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts. Many taxpayers are unaware that certain transfers to offshore trusts carry reporting obligations. Failure to comply can carry a penalty of up to 35% of the gross reportable amount without 2012 OVDP.

Taxpayers who failed to file Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations. Depending on ownership percentage, certain U.S. officers, shareholders or directors in certain foreign corporations must report information to the IRS. Failure to do so can carry a penalty of $10,000 per return without 2012 OVDP.

What are the terms of 2012 OVDP?

To apply for acceptance into 2012 OVDP, taxpayers must:

1. Provide previously-filed original and amended returns for the applicable years (the program covers the eight years immediately preceding the date of disclosure).
2. Provide amended returns detailing unreported income (if applicable).
3. Provide original or amended offshore informational returns (if applicable) such as FBAR or Form 3520.
4. Fully cooperate in the OVDP process.
5. Pay the 20% accuracy-related penalty on the full amount of underpayment of tax for all years.
6. Pay the failure to file penalties and/or failure to pay penalties (if applicable).
7. Pay an offshore penalty, in lieu of other penalties which may have applied, of 27.5% of the highest aggregate account balance in foreign bank accounts/entities or value of foreign assets during the program years, which may be reduced to 12.5% or 5% in certain cases (see "What else do you need to know?" below).
8. Submit payment of all tax, penalties and interest above and execute a closing agreement with respect to the transaction.

What else do you need to know?

A feature that commentators for the IRS have said will continue to apply in 2012 OVDP, and which was absent in 2009 OVDI, is reduction of the offshore penalty from 27.5% to 12.5%, or in some cases to 5%:

The 12.5% reduced rate applies to taxpayers whose highest aggregate account balance in the program years is less than $75,000.

The 5% reduced rate applies to taxpayers who meet all four of the following conditions: (i) did not open or cause the account to be opened, rather than allowing a change in ownership of an existing account, upon the death of the owner of the account; (ii) have exercised minimal, infrequent contact with the account (*e.g.*, requesting balance); (iii) have, except for a withdrawal closing the account and transferring the funds to an account in the U.S., not withdrawn more than $1,000 from the account in program years; and (iv) can establish that all applicable U.S. tax has been paid on the funds deposited into the account.

In some situations, where there is no unreported income but simply a failure to file certain information returns (*e.g.*, Form 5471 or Form 3520), there is no penalty for taxpayers who qualify for 2012 OVDP and submit the information returns.

New Jersey has not issued any formal position to date on whether it will open a parallel program to 2012 OVDP.

As with any legal decision, taxpayers need to evaluate the benefits and burdens of this program as applied to their respective situations. The 2012 OVDP can be a lengthy process, which we can help you navigate.

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