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Has the IRS Found its Mojo, Just Like Austin Powers? A Commentary on the Trilogy of IRS Offshore Voluntary Disclosure Programs

For some time now, the IRS has been focusing on offshore income and offshore assets. Since 2009, the IRS has had three different offshore voluntary disclosure initiatives, designed to offer amnesty to non-compliant U.S. taxpayers who would like to come forward to straighten out the federal income tax situation and their informational filing situation (commonly FBARs). As many financial institution customers are affected, the author presents a readable, straightforward analysis of these programs, offering practical insights based on meetings with dozens of taxpayers considering entry into the IRS program.

MELINDA FELLNER BRAMWIT

Never have four letters packed such a punch as F-B-A-R. The FBAR, or Report of Foreign Bank and Financial Accounts, also known as the TD F 90-22.1, has certainly become an integral part of cocktail party conversation and gatherings and blogs. What is interesting to me as a tax practitioner for 20 years is that the FBAR requirement has actually been around since the 1970s as a part of the Bank Secrecy Act.[1] I was only a toddler in the 1970s, but I can tell you, based on research and what colleagues have told me, that the FBAR was not a hopping topic of conversation back then. Fast forward to 2013, however, and the FBAR is no longer an esoteric requirement left over from the Austin Powers era. It now affects an extraordinary number of United States taxpayers, many of whom are either not aware of the requirements or have only recently become aware of them. And many will be asking their banking, investment, and tax advisors about them.

Therefore, after meeting with hundreds of people to discuss offshore income tax issues over the past four years, I felt compelled to concisely describe the FBAR requirement and give an overview of the recent IRS programs that have been designed to offer amnesty to taxpayers wishing to come into compliance with the FBAR and other income-tax-related requirements. I hope that with the practical information in this article, combined with some humor (attempt at humor?) derived from Mike Myers/Austin Powers references (well, there were three Austin Powers movies with 1970s settings, and there are three IRS offshore voluntary disclosure programs with the 1970s FBAR requirement as their focal point; on this connection I hang my hat), readers will have information available to help prepare their clients to act properly and become tax compliant.

[1] Bank Secrecy Act of 1970, 12 U.S.C. § 1951-1959; 31 U.S.C. § 5311-5330.

Melinda Fellner Bramwit is a Member of the law firm of Norris McLaughlin & Marcus, P.A. specializing in transactional tax issues. She may be contacted at mfbramwit@nmmlaw.com.

WHAT EXACTLY IS THE FBAR AND WHO MUST FILE IT?

The Basics. So we know that FBAR reporting is a requirement imposed by the Bank Secrecy Act and that it is separate and apart from a taxpayer's regular

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income tax filing requirement. What else do we need to know? This U.S. Treasury filing requirement dictates that U.S. taxpayers with foreign accounts have two obligations: (1) file the FBAR by June 30 following the calendar year of reporting, and (2) on their regular 1040, Schedule B, check off "yes" in answer to the question in Part III as to whether they have foreign bank accounts.

An FBAR must be filed if the taxpayer:

- Is a U.S. Person;
- Has a financial account that is in a foreign country;
- Has a financial interest in or signature authority over the financial account; and
- Has an aggregate balance in the foreign accounts that exceeds $10,000 at any point in the year.[2]

A "U.S. person" includes a citizen of the U.S. (also a dual citizen of the U.S. and another country); a resident of the U.S.; and a U.S. corporation, partnership, estate, trust, limited liability company, or other business entity. A "financial account" includes, very broadly, any foreign bank, securities, or other financial accounts such as savings deposits, checking accounts, and any other accounts maintained with a person engaged in the business of banking.[3] It can also include an account that is an insurance policy with a cash value, or an annuity policy, or an account with a mutual fund or similar pooled fund.

Statistically, there are increasing rates of FBAR compliance. But, while the number of filings is increasing, it still falls short.

A taxpayer has a "financial interest" in a foreign account when he or she is the owner of record of, or has legal title to, the account regardless of whether the account is maintained for personal benefit or for the benefit of others.[4] A taxpayer has signature authority or a similar authority when he or she has the authority alone or in conjunction with another to control the disposition of money, funds, or other assets held in a financial account by direct communication to the person with whom the financial account is maintained.[5]

[2] See instruction to Form TD F-90.22.1.

[3] TD F 90-22.1 (FBAR form and instructions).

[4] Id.

[5] Instructions to Form TD F 90-22.1.

Compliance and Penalties for Noncompliance. Those are the basic, general rules surrounding the FBAR requirement. It is interesting that, statistically, there are increasing rates of FBAR compliance. The number of FBARs filed from 2004 to 2009 increased over 145 percent (from 217,699 to 534,043).[6] In 2010, 594,488 FBARs were filed; in 2011, 818,134.[7] While the number of filings is increasing, however, it still falls short; the IRS has estimated informally that 1 million U.S. taxpayers are actually required to file the FBAR. Clearly there is a profound incidence of noncompliance in filing the FBAR.

The FBAR is an informational return only—meaning that properly filed, it carries no tax obligation in and of itself. The problem comes when one fails to file the informational return; the penalties for non-compliance are high.

Potential Criminal Penalties. A criminal, willful (knowing violation of a legal duty) failure to comply with the FBAR requirements is a felony that can subject a taxpayer to a fine of not more than $250,000, or five years in prison, or both.

Potential Civil Penalties. A civil, non-willful failure to file the FBAR can lead to a penalty of up to $10,000 for each violation, and this penalty may be imposed for each account.[8] A willful civil violation can lead to a penalty up to the greater of $100,000 or 50 percent of the account balance at the time of the violation. The burden is on the IRS to establish willfulness, i.e., that there was there was a voluntary intentional violation of a known legal duty.[9]

[6] Jaime Arora, "Few Have Been Disqualified From OVDP After Being Previously Cleared, Officials Say," 2013 TNT 70-7 (April 11, 2013).

[7] Id.

[8] IRM 4.26.16.4.

[9] A finding of willfulness must be supported by evidence of willfulness as outlined in the Internal Revenue Manual:

1. The test for willfulness is whether there was a voluntary, intentional violation of a known legal duty.
2. A finding of willfulness under the BSA must be supported by evidence of willfulness.
3. The burden of establishing willfulness is on the Service.
4. If it is determined that the violation was due to reasonable cause, the willfulness penalty should not be asserted.
5. Willfulness is shown by the person's knowledge of the reporting requirements and the person's conscious choice not to comply with the requirements. In the FBAR situation, the only thing that a person need know is that he has a reporting requirement. If a person has that knowledge, the only intent needed to constitute a willful violation of the requirement is a conscious choice not to file the FBAR.

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BEYOND THE FBAR REQUIREMENT

The FBAR is only one of the requirements that U.S. taxpayers owning interests in foreign accounts must contend with. But there are other obligations from an income tax perspective separate and apart from the FBAR.

U.S. taxpayers are taxed on their "worldwide income," i.e their income from whatever source derived and from wherever earned. By way of example, a U.S. taxpayer who has rental income from an apartment she owns in India must include that rental income in her U.S. tax computation (although she may be eligible for a foreign tax credit on her U.S. income tax return for the tax paid in India on that rental income.) This is the case irrespective of the fact that she may have sufficient deductions attributable to this rental income that it, in fact, produces no taxable income (i.e., she may have $60 of rental income and $80 of rental expense.) I have found this to be a major misunderstanding for many non-compliant U.S. taxpayers, who do not understand that even if no additional tax is owing offshore income like this still must be included on their U.S. returns. If it is not, the taxpayer is not compliant for U.S. tax purposes. There are many taxpayers in the offshore voluntary disclosure programs with this issue, and it is a painful web to be caught in.

THE THREE VOLUNTARY DISCLOSURE PROGRAMS

Just as the Austin Powers movies came in a grouping of three, there are three iterations of the IRS programs. In order to understand the present we must look at the past, it is said, so I will address them in order of implementation.

Many non-compliant U.S. taxpayers do not understand that even if no additional tax is owing, offshore income still must be included on their U.S. returns. There are many taxpayers in the offshore voluntary disclosure programs with this issue, and it is a painful web to be caught in.

The First Program—The 2009 OVDP: The International Man of Mystery. How could the IRS bring more taxpayers into the system and encourage compliance with both the FBAR filing requirement and the federal income tax return filing generally? Prior to 2009, the IRS had a voluntary disclosure practice in its criminal manual for many years,[10] which set forth a basic procedure to follow. In 2009, the IRS found that recent enforcement efforts in the offshore area had led to an increased number of voluntary disclosures. With the increased filings, the IRS thought it best to establish a uniform, streamlined program based on the existing practice, with set guidelines and penalties that would give taxpayers predictability as far as the penalties they would face if they participated in the program. The IRS objective was to bring into compliance taxpayers with undisclosed foreign accounts and undisclosed foreign entities used to avoid or evade U.S. tax.

The 2009 Offshore Voluntary Disclosure Program (2009 OVDP) was outlined in a detailed question and

6. Under the concept of "willful blindness", willfulness may be attributed to a person who has made a conscious effort to avoid learning about the FBAR reporting and recordkeeping requirements. An example that might involve willful blindness would be a person who admits knowledge of and fails to answer a question concerning signature authority at foreign banks on Schedule B of his income tax return. This section of the return refers taxpayers to the instructions for Schedule B that provide further guidance on their responsibilities for reporting foreign bank accounts and discusses the duty to file Form 90-22.1. These resources indicate that the person could have learned of the filing and recordkeeping requirements quite easily. It is reasonable to assume that a person who has foreign bank accounts should read the information specified by the government in tax forms. The failure to follow-up on this knowledge and learn of the further reporting requirement as suggested on Schedule B may provide some evidence of willful blindness on the part of the person. For example, the failure to learn of the filing requirements coupled with other factors, such as the efforts taken to conceal the existence of the accounts and the amounts involved may lead to a conclusion that the violation was due to willful blindness. The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blindness.

7. Willfulness can rarely be proven by direct evidence, since it is a state of mind. It is usually established by drawing a reasonable inference from the available facts. The government may base a determination of willfulness in the failure to file the FBAR on inference from conduct meant to conceal sources of income or other financial information. For FBAR purposes, this could include concealing signature authority, interests in various transactions, and interests in entities transferring cash to foreign banks.

IRM 4.26.16.4.5.3 (07-01-2008), FBAR Willfulness Penalty—Willfulness, available at http://www.irs.gov/irm/part4/irm_04-026-016.html.

[10] IRM 9.5.11.9.

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answer publication of the IRS on May 6, 2009.[11] In sum, the program required taxpayers to:

1. Provide a letter describing the details of their disclosures (following a sample provided on the IRS website) or contact a Special Agent at IRS, Criminal Investigation locally, to advise the IRS of their intent to participate in the 2009 OVDP;
2. Provide originally filed copies and amended returns (Form 1040X) detailing any unreported offshore income;
3. Provide amended or original informational returns, as applicable for the particular taxpayer—i.e., the FBAR or other informational returns for beneficiaries of trusts as a Form 3520 (Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts) or a Form 5471 (Information Return of U.S. Person With Respect to Certain Foreign Corporations);
4. Pay the tax attributable to the unreported income, pay an accuracy related penalty of 20 percent of the underpaid tax, plus interest (the income based penalty);
5. Pay a penalty equal to 20 percent of the highest aggregate balances of the offshore accounts for the program years (for 2009 OVDP the applicable years were 2003–2008) (the asset-based penalty).

In exchange for fulfilling all of the above requirements, a taxpayer would be free from criminal prosecution and other potential issues surrounding his or her filings. The 2009 OVDP had a set six-month term.[12] At the end of their 2009 OVDP case, taxpayers were given a closing statement of liabilities owed. In certain limited circumstances the 20 percent penalty noted in Item 5 above would be reduced and a taxpayer would pay a only 5 percent penalty (very fact sensitive and generally applied to accounts where a taxpayer did not cause an account to be opened or inherited it or merely re-titled it).[13]

The IRS has said that there were over 15,000 disclosures in the 2009 program from around the world. Then the program closed and no one knew what would come next—until February of 2011, that is.

The Second Program—The 2011 OVDI: The Spy Who Shagged Me. People often say the sequel is never as good as the original; certainly true Austin Powers fans would agree the original movie was far better than its sequel. So what about the IRS sequel to the 2009 OVDP? IRS Commissioner Douglas Shulman announced on February 8, 2011, that there would be a new program available.[14] This program, the 2011 Offshore Voluntary Disclosure Initiative (2011 OVDI) had an original closing date of August 31, 2011, which was extended to September 9, 2011 due to Hurricane Irene.

Participation Requirements. The details of participation in the 2011 OVDI were as follows for those tax years covered by the voluntary disclosure (generally 2003 through 2010, inclusive) on or before August 31, 2011. All applicants were required to:

1. File copies of previously filed original federal income tax returns as well as complete and accurate amended federal income tax returns for all tax years covered by the voluntary disclosure, with applicable schedules detailing the amount and type of previously unreported income from the account or entity;
2. Prepare a signed Offshore Voluntary Disclosure Letter (a new creation);
3. Pay the amount of tax, interest, and accuracy-related penalty under Internal Revenue Code Section 6662(a), and, if applicable, the failure to file and failure to pay penalties under Section 6651(a)[15];
4. Complete a new form, known as a Foreign Account or Asset Statement, providing specific information as to each account;

[11] See http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers.

[12] Id.

[13] To qualify for the 5 percent asset-based penalty a taxpayer must show all four of the following conditions: (i) did not open or cause the account to be opened (unless the bank required that a new account be opened, rather than allowing a change in ownership of an existing account, upon the death of the owner of the account); (ii) has exercised minimal, infrequent contact with the account, e.g., to request the account balance, or update accountholder information such as a change in address, contact person, or email address; (iii) has not, except for a withdrawal closing the account and transferring the funds to an account in the United States, withdrawn more than $1,000 from the account in any year for which the taxpayer was non-compliant; and (iv) can establish that all applicable U.S. taxes have been paid on funds deposited to the account (i.e., only account earnings have escaped U.S. taxation). For funds deposited before January 1, 1991, if no information is available to establish whether such funds were appropriately taxed, it will be presumed that they were.

[14] See http://www.irs.gov/uac/IRS-Commissioner-Doug-Shulman%27s-Statement-on-the-2011-Offshore-Voluntary-Disclosure-Initiative.

[15] Taxpayers were allowed the opportunity, if they could not pay the total amount of tax, interest, and penalties as described above, to submit a proposed payment arrangement and a completed Collection Information Statement.

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5. Complete a penalty computation worksheet showing the applicant's determination of the aggregate highest account balance of the undisclosed offshore accounts, fair market value of foreign assets, for purposes of determining the asset-based penalty (which was 25 percent, i.e. 5 percentage points higher than the 2009 OVDP);
6. Submit signed agreements to extend the period of time to assess tax (including tax penalties) and to assess FBAR penalties;
7. If disclosing offshore financial accounts with an aggregate highest account balance in any year of $1 million or more, submit a new form, the Foreign Financial Institution Statement;
8. Submit Form TD F 90.22-1, Report of Foreign Bank and Financial Accounts, for foreign accounts maintained during calendar years covered by the voluntary disclosure and/or copies of previously filed FBARs;
9. If disclosing offshore financial accounts with an aggregate highest account balance in any year of $500,000 or more, submit copies of offshore financial account statements reflecting all account activity for each of the tax years covered by the voluntary disclosure.

These were the general requirements for the 2011 OVDI. Taxpayers who were disclosing interests in offshore entities potentially needed to prepare and submit Form 3520 (Annual Return to Report Transactions With Foreign Trusts) or Form 5471 (Information Return of U.S. Persons With Respect to Ownership in Foreign Corporations) or other informational forms. For taxpayers with accounts involving Passive Foreign Investment Companies (PFICs), a new computation was introduced.

From the 2011 OVDI program items outlined above, we can see the IRS honing and toughening its method of bringing non-compliant taxpayers into the U.S. tax system. Most notably, the "asset-based penalty" rose considerably over the 2009 OVDP, becoming 25 percent of the highest aggregate balances in the offshore accounts for the program years, and the program reporting period expanded to eight years, as opposed to only six years in the 2009 OVDP. Accordingly, the price tag got higher; 2011 OVDI participants had to pay back taxes and interest for up to eight years along with paying the accuracy-related and/or delinquency penalties from the 2009 OVDP.

Qualifying for Reduced Penalties. Similar to the 2009 OVDP initiative, taxpayers in the 2011 OVDI could qualify for a reduced penalty of 5 percent of the highest aggregate account balance (asset-based penalty) in limited situations.[16] Essentially, these taxpayers did not cause the account to be opened, had infrequent contact with respect to the account, and withdrew less than $1,000 per program year from the subject account. For the 2011 OVDI, a new penalty category of 12.5 percent of the highest aggregate balance in the program years for smaller offshore accounts emerged. Taxpayers whose accounts or assets were under $75,000 in the aggregate for all program years qualified for this lower rate.[17]

There was also a lot of commentary about Question and Answer 17 and Question and Answer 18 in the 2011 OVDI,[18] which provide relief for those taxpayers who paid all their back taxes so that they were fully compliant from a U.S. income tax perspective and whose only failure to file was for informational purposes, i.e., Form 5471 or Form 3520 or FBAR. Taxpayers who simply needed to file these informational returns were not subject to the asset-based penalty of 25 percent mentioned above. They simply filed the missing informational returns with no penalty using the IRS guidance in the 2011 Q and A. This could be a tremendous benefit to taxpayers who fit with these facts, as outside of these disclosure programs, a failure to file a Form 3520 can result in a penalty as high as the greater of $10,000 or 35 percent of the gross value of assets transferred to a foreign trust.

The Opt-Out Option. The 2011 OVDI also brought with it the formal introduction of the concept of "opt-out," and never have two little words meant so much. The 2009 OVDP did mention that taxpayers who disagreed with their penalty computation could elect to have a regular audit but did not describe the option in detail. The 2011 OVDI adopts the phrase "opt-out" and also introduces a manual on opt-out and removal (circumstances when the IRS can take a taxpayer out of the program). In sum, taxpayers who went through the 2011 OVDI and disagreed with their penalty computation had the right to notify the IRS that they were "opting out" of the program. Accordingly, they were taken out of the program and subjected to a regular audit of all of the years at issue. They also were no longer guaranteed the benefit of immunity from criminal

[16] See IRS, 2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers (the "2011 Q and A"), Question 52, available at http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers.

[17] Id.

[18] See 2011 Q and A, supra note 16.

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prosecution that the 2011 OVDI program admittance afforded.

A detailed discussion of the opt-out concept is beyond our scope here, but it is important to note that the IRS published extensive examples of when a taxpayer might choose to exercise this right, using numerical examples.[19] Most of these examples turn on the concept that entry into the 2011 OVDI and other IRS offshore programs presupposes that the taxpayer acted willfully, and the penalty for the willful failure to file is streamlined in the 25 percent asset-based penalty. Taxpayers who feel the IRS will not succeed in proving they acted willfully in a full audit may wish to take their chances by opting out. They potentially could end up with a penalty for a non-willful filing that is lower than the streamlined penalty the program offers. The wisdom of this decision, of course, is very fact sensitive.

When Commissioner Shulman announced the 2011 OVDI, he released a statement that included the following, in pertinent part:

> For those hiding assets offshore, there is an obvious reason to come in now. If we find you, you face harsher penalties and the possibility of jail time. If you come in voluntarily, you pay a steep price but avoid going to jail.
>
> We have been getting better and better at detecting offshore accounts—therefore the risk of being caught is increasing. We now have a number of other banks under investigation, based on information we received from our first round of disclosures and from other sources. Tax secrecy continues to erode. And starting in a couple of years, new laws will come into effect that will give us more information than ever on offshore holdings. As I've made clear throughout my tenure as IRS Commissioner, we are not letting up on pursuing offshore tax evasion, and there's going to continue to be more in the works.[20]

This commentary clearly demonstrates the IRS determination to pursue offshore tax evasion. The 2011 OVDI closed with more than $5 billion in collections with over 33,000 voluntary disclosures filed.[21] Enter the current program, launched in January 2012.

The Third Program—The 2012 OVDP: Goldmember—Getting Mojo. It is hard to say if anyone outside of the IRS knew there would be a third program.[22] But in January 2012 the IRS launched the third iteration of the Offshore Voluntary Disclosure Programs, the 2012 OVDP. Current statistics show that at least 1,500 disclosures were made under the 2012 OVDP in its first six months of operation.[23] According to the Taxpayer Advocate, an agency established to assist taxpayers with IRS issues, a total of approximately 310 taxpayers have opted out of the 2009 OVDP and the 2011 OVDI combined,[24] and a total of 38,000 taxpayers have come forward so far.

The 2012 OVDP brings some notable changes from the 2011 OVDI. Once again, the asset-based penalty imposed on the program year with the highest aggregate account balances has climbed, rising to 27.5 percent. The years a taxpayer must go back to amend to include unreported income now include the eight years immediately prior to the year of disclosure (i.e., currently a participant would disclose 2004–2011, although some taxpayers, by the time this article goes to press, may disclose 2005–2012.) Perhaps the biggest development, when you look at the trio of programs, is that the 2012 OVDP has no set closing date as of now. Interesting. What does this mean? No one knows for certain, but in my view it means that the offshore voluntary disclosure program is here to stay. The IRS has published a new set of Questions and Answers on its website, providing guidance for the 2012 OVDP that is more detailed than that for the 2011 OVDI.[25]

NEW STREAMLINED PROGRAM FOR U.S. TAXPAYERS LIVING ABROAD

In an interesting development, in June 2012, the IRS announced a streamlined program for certain U.S. taxpayers living abroad that is completely separate and apart from the programs discussed above. This program was designed to assist United States citizens (including those with dual citizenship) who have been living outside of the country for a certain number of years to come into the U.S. taxing system again.[26] As a

[19] Id. at Question 51.

[20] Shulman statement, supra note 14.

[21] IRS Says Offshore Effort Tops $5 Billion, Announces New Details on the Voluntary Disclosure Program and Closing of Offshore Loophole, IR-2012-64, June 26, 2012, available at http://www.irs.gov/uac/IRS-Says-Offshore-Effort-Tops-$5-Billion,-Announces-New-Details-on-the-Voluntary-Disclosure-Program-and-Closing-of-Offshore-Loophole.

[22] I definitely did not, though I did predict that, based on her acting performance in the second Austin Powers movie, Heather Graham would not obtain the lead in the third.

[23] Id.

[24] Arora, supra note 6; Michael Cohn, "IRS Offshore Disclosure Programs Net $5.5 Billion" (Accounting Today, Apr. 26, 2013), available at http://www.accountingtoday.com/news/IRS-Offshore-Disclosure-Programs-Net-Billions-66521-1.html.

[25] 2012 OVDP Q and A, available at http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers.

[26] IR-2012-64, supra note 21.

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collateral program to the IRS Offshore Voluntary Disclosure initiatives, it definitely merits some discussion.

The procedure officially went into effect on September 1, 2012.[27] Essentially designed for taxpayers who present a low compliance risk, the procedure is available for non-resident United States taxpayers who have resided outside of the United States since January 1, 2009, and have not filed a United States income tax return from January 1, 2009, to the present. Taxpayers meeting these residency and failure-to-file criteria must present a low compliance risk in the eyes of the Internal Revenue Service. Low compliance risk is defined by many factors. Internal Revenue Bulletin 2012-64 states, in pertinent part, "Absent any high risk factors, if the submitted returns and application show less than $1500 in tax due in each of the years, they will be treated as low risk and proceed in a streamlined manner." The risk level may rise, however, if certain factors are present, such as a taxpayer's failure to declare all of his or her income in the residence country, previous assessment of FBAR penalties against the taxpayer, submitted returns claiming a refund, and others.[28] Generally an eligible taxpayer will have simple returns.

From a procedural standpoint, taxpayers this streamlined program will be required to file delinquent tax returns along with appropriate related information returns for the past three years and to file delinquent FBARs for the past six years. Submissions from taxpayers who present higher compliance risk will be subject to a more thorough review and potentially subject to an audit, which could cover more than three tax years.

There is no published data available yet as to participation in the streamlined program. I have interviewed some taxpayers who potentially qualify for the program. To me, the introduction of the streamlined program shows an effort on the part of the IRS to recognize that many U.S. taxpayers living abroad the past few years may not be aware of filing requirements. This procedure allows such taxpayers to cure their noncompliance in a straightforward program with no asset-based penalty. The requirements are clearly quite strict, though, and very fact sensitive.

DON'T FORGET FATCA FOR 2012—FORM 8938

But wait, there's more to worry about than the FBAR and IRS compliance programs. I do need to mention a new income tax development which is similar to the FBAR filings. Under the Foreign Account Tax Compliance Act (FATCA),[29] certain U.S. taxpayers holding financial assets outside of the U.S. must now report those to the IRS. FATCA also requires financial institutions to report certain information, but for purposes of this article I will discuss only individuals here.[30] In general, U.S. taxpayers who own foreign financial assets with a total value in excess of $50,000 may need to report certain information about those assets on new Form 8938, which must be attached to the taxpayer's annual income tax return. Higher aggregate asset thresholds apply to U.S. taxpayers (1) who are married and file joint returns or (2) who reside abroad.

To be subject to this reporting requirement, three factors must be present:

1. The taxpayer must be a "specified individual," generally, a U.S. citizen, a resident alien who lives in the U.S. for any part of the year, and certain non-resident aliens;
2. The taxpayer must have an interest in certain specified foreign financial assets (e.g. stock or securities); and
3. The aggregate value of the specified foreign financial assets must exceed thresholds that vary according to taxpayer's filing status (these filing thresholds are higher than the FBAR $10,000 threshold and, in some cases, apply to assets which are quite different than those that must be reported on the FBAR).

The penalty for failure to report the requisite information on Form 8938 is also different from the FBAR, and is, generally, $10,000 for failure to file Form 8938 where required or up to $50,000 for continued failure after the taxpayer is notified.

What most taxpayers do not know is that filing the Form 8938 does not relieve them from what would otherwise be a requirement that they file the

[27] IRS Announces Efforts to Help U. S. Citizens Overseas Including Dual Citizens and Those with Foreign Retirement Plans, IR 2012-65, June 26, 2012, available at http://www.irs.gov/uac/IRS-Announces-Efforts-to-Help-U.-S.-Citizens-Overseas-Including-Dual-Citizens-and-Those-with-Foreign-Retirement-Plans.

[28] IR-2012-64, supra note 21.

[29] P.L. 111-147, 124 Stat. 71 (2010).

[30] For more on FATCA issues for financial institutions, see, e.g., Ian M. Comisky & Matthew D. Lee, "The Foreign Account Tax Compliance Act: An End to Bank Secrecy," elsewhere in this issue; Marnin Michaels, Tom O'Donnell & Rodney Read, "FATCA Compliance: Preparing for 2013—Notice 2010-60 and Practical Steps to Take Now," 24(4) J. Tax'n & Reg. Fin. Insts. 5 (Mar./Apr. 2011); Susan Nevas, "The Second FATCA Notice: A Sharper Enforcement Tilt," 24(6) J. Tax'n & Reg. Fin. Insts. 13 (July/Aug. 2011); James N. Calvin, Kenneth M. Kess, & Pascal Noel, "Non-U.S. Financial Institutions and Investment Funds to Function as Tax Intermediaries Under FATCA," 25(6) J. Tax'n & Reg. Fin. Insts. 35 (July/Aug. 2012); and Ehab Farah, "FATCA: Recent Developments and the Intergovernmental Model I Agreement," 26(3) J. Tax'n & Reg. Fin. Insts. 5 (Jan./Feb. 2013).

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FBAR. This is a common misconception. There is a lot of IRS guidance on how to report on both forms together.[31] There are some clear distinctions between items reportable on the FBAR or the other informational returns such as the Form 5471 and the Form 8938 that are filed with a taxpayer's regular federal income tax return and they are spelled out in the chart referenced above.

CONCLUSION AND SOME PERSONAL OBSERVATIONS

This article does not address every potential IRS offshore filing issue. That was not the intention. The intention, rather, was to give a thoughtful and concise presentation of potential issues many U.S. taxpayers may unknowingly face so they can be more informed. I also would like to offer some personal observations from people I have met with throughout the course of the three programs.

What most taxpayers do not know is that filing the Form 8938 does not relieve them from what would otherwise be a requirement that they file the FBAR. This is a common misconception.

So far, I submit, these programs are not attracting the criminals. Most people I have seen in my practice are those whom I refer to as "taxpayers who cannot sleep at night." Learning that they have been noncompliant in their tax filings has troubled them, so they come in to consult and report. The vast majority of these people are not criminals; they simply want to do the right thing.

The question then becomes: What is the right thing for a given taxpayer? This is not an easy question to answer and depends on the facts and circumstances of each particular case. For example, what is the right thing for a taxpayer to do who included all income and filed all FBARs for every program year except for one and now, upon learning of the IRS programs, is faced with a decision where he might have to pay almost a third of the account to the IRS as an asset-based penalty?

How a taxpayer chooses to act may depend whether his or her acts have risen to the level of being willful. So then, what about the concept of willfulness? As we have discussed above, entering the OVDP program presupposes one has been willful and intentionally violated a known legal duty. If a taxpayer has gone through the program and chosen to "opt-out" the IRS needs to prove that person was willful. Before anyone goes down that road, it is essential to know what the facts will show. One must also consider that outside of the IRS programs, the penalty for a willful failure to file an FBAR could be more than $100,000.

What about those who have been tax compliant? Based on my client interviews, I can tell you that some taxpayers are income tax compliant, but their failure to file relates to the filings, discussed above, for Forms 5471 and 3520 or the FBAR itself. Taxpayers who fall into this category are given a tremendous benefit in the offshore programs by being able to correct their errors with no penalty, when typically the failure to file these forms could carry large penalties of the greater of $10,000 or 35 percent of the gross value of assets transferred to a foreign trust (Form 3520) or $10,000 per each calendar year failure to file (Form 5471).

A frequent client question has been whether there is a "de minimis" amount of unreported income that the IRS will allow for these purposes. If a taxpayer had, say, $100 or less of unreported income per year, will the IRS take this into account and perhaps assess a smaller penalty (i.e., lower than 27.5 percent) than it imposes on someone who had, say, $10,000 of unreported income per year? The answer is that there is no de minimis amount for these purposes, although some practitioners have said that de minimis amounts of income may be relevant for the opt-out audit.

What is also interesting is that the new program has no closing date. Many people have asked me whether I think that is going to encourage or discourage compliance. This is a tough one. In the first two programs most practitioners definitely saw droves of taxpayers come in close to deadline, scrambling to apply. Without the pressure looming of an anticipated closure date, it is hard to say whether taxpayers will feel the need to seek consultation immediately. Only time will tell. ■

[31] See http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements.

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