

IRS Announces Changes to the Offshore Voluntary Disclosure Program

As you may have read, the Internal Revenue Service ("IRS") recently announced changes to its offshore voluntary disclosure programs and announced new options for taxpayers to come into compliance with their U.S. tax obligations.

This alert summarizes some of the significant modifications made to the program and summarizes the new, expanded Streamlined Filing Compliance Procedures Program, which is now available for taxpayers who previously filed U.S. tax returns and for taxpayers who reside in the U.S. (as long as the other eligibility requirements are satisfied).

I. Changes to the Offshore Voluntary Disclosure Program (the "offshore program" or "OVDP")

In many respects, the offshore program remains the same – generally, taxpayers who participate in the program must submit, with respect to the prior eight years, amended or delinquent tax returns, applicable information returns and the Report of Foreign Bank and Financial Accounts (the "FBAR") and submit payment of tax, interest, applicable tax return penalties and the offshore penalty (which is now either 27.5% or 50%, as noted below). As in the 2012 OVDP, the offshore penalty is based on highest aggregate value of the taxpayer's undisclosed foreign accounts and assets.

In exchange for coming forward under the offshore program, the IRS will not recommend criminal prosecution to the U.S. Department of Justice for any issue relating to tax noncompliance or to the failure to file FBARs and will not assess the penalties that could otherwise be assessed in a standard audit.

The recent modifications made to the program, effective July 1, 2014, include the following:

- **New 50% offshore penalty.**

- Beginning on August 4, 2014, a taxpayer will be subject to a 50% offshore penalty (rather than the 27.5% offshore penalty) if prior to the taxpayer's submission of the "pre-clearance letter" either (i) a foreign financial institution at which the taxpayer has or had an account or (ii) a facilitator who helped the taxpayer establish or maintain an offshore arrangement has been publicly identified as being under investigation or as cooperating with a government investigation.
- The IRS has published a list of foreign financial institutions or facilitators meeting the criteria described above. See the link at the bottom of this alert for the most up-to-date list. The current list (which is subject to change) is copied immediately below. Note that the list is not the same as the 14 "category 1" banks under criminal investigation by the U.S. Department of Justice.

1. UBS AG;
2. Credit Suisse AG, Credit Suisse Fides, and Clariden Leu Ltd.;
3. Wegelin & Co.;
4. Liechtensteinische Landesbank AG;
5. Zürcher Kantonalbank;

6. swisspartners Investment Network AG, swisspartners Wealth Management AG, swisspartners Insurance Company SPC Ltd., and swisspartners Versicherung AG;
7. CIBC FirstCaribbean International Bank Limited, its predecessors, subsidiaries, and affiliates;
8. Stanford International Bank, Ltd., Stanford Group Company, and Stanford Trust Company, Ltd.;
9. The Hong Kong and Shanghai Banking Corporation Limited in India (HSBC India); and
10. The Bank of N.T. Butterfield & Son Limited (also known as Butterfield Bank and Bank of Butterfield), its predecessors, subsidiaries, and affiliates.

- Although the current IRS list contains only the institutions noted above, the list may expand significantly in the coming weeks; thus, we would expect that the August 4th deadline will be a key date for taxpayers with accounts at many Swiss institutions. Taxpayers who wish to participate in the offshore program and who hold undisclosed foreign financial accounts at any institutions under criminal investigation should consider submitting pre-clearance letters prior to August 4th, 2014. In addition, taxpayers should closely monitor the IRS list for any changes.

- **Elimination of reduced offshore penalties.** The 5% and 12.5% offshore penalties, which were available for certain taxpayers in 2012 OVDP, have been eliminated in light of the new, expanded Streamlined Program (discussed below).
- **Additional information requested in "pre-clearance" letter.** In addition to identifying information about the taxpayer and an executed power of attorney, taxpayers must also submit identifying information about the foreign financial institutions where the taxpayer held an undisclosed foreign account and identifying information about the foreign and domestic entities through which the taxpayer held the undisclosed OVDP assets.
- **Account statements and payment of offshore penalty.** All taxpayers now must submit all account statements for the undisclosed foreign account(s) and must submit payment of the offshore penalty at the time of the application.
- **Electronic submission of some documents.** Taxpayers may submit voluminous documents that do not require original taxpayer signatures on a compact disc or a USB removable storage device (flash drive).

See the links at the end of this alert for more information about the offshore program.

II. Expanded Streamlined Filing Compliance Procedures ("Streamlined Program")

A. In general

Generally, the new Streamlined Program is available for taxpayers who certify that their failure to report foreign financial assets and pay all tax due with respect to those assets did not result from willful conduct on their part. Unlike the OVDP, the Streamlined Program does not provide any protection from criminal prosecution.

The key changes made to the Streamlined Program are the following:

- U.S. taxpayers residing in the U.S. are now eligible.
- U.S. taxpayers who previously filed U.S. tax returns are now eligible.

- The \$1,500 tax threshold has been eliminated. Under the prior program, a taxpayer who owed more than \$1,500 of tax during any of the three prior tax years was not eligible for the program.
- The “risk assessment” process and Streamlined questionnaire have been eliminated. As noted below, an eligible taxpayer now must submit a certification where he or she certifies that non-compliance was not willful.

The expansion of the Streamlined Program to include a wider base of taxpayers – and the new requirement that participating taxpayers must certify that their non-compliance was not willful – suggests that the IRS views the Streamlined Program as the mechanism that such taxpayers should use to come into compliance and pay little or no penalties. It seems likely that if an eligible taxpayer decides not to take advantage of the program and instead submits a “quiet disclosure” that is subsequently audited, the IRS will be less sympathetic to the taxpayer and less willing to abate FBAR penalties during the audit due to “reasonable cause.”

To participate in the program, eligible taxpayers must submit (among other things) delinquent or amended tax returns for the previous three years, FBARs for the previous six years, a certification that the taxpayer’s non-compliance was not willful and payment of tax, interest and (for taxpayers residing inside the United States) the 5% offshore penalty. Taxpayers must send all the submission materials in paper form to a special IRS office in Austin, Texas. All returns submitted through the program must have a valid Taxpayer Identification Number (“TIN”). See link at the end of this alert for more details about the program.

B. Taxpayers residing outside the U.S.

Other key features of the Streamlined Program with respect to taxpayers residing outside the U.S. include the following:

- **No offshore penalty.** Eligible taxpayers who reside outside the U.S. and participate in the Streamlined Program are not required to pay any offshore penalty.
- **Taxpayers must have a TIN.** As noted above, all returns submitted under the Streamlined Program must include a valid TIN (generally, a social security number or, for taxpayers who are not eligible for a social security number, an Individual Taxpayer Identification Number (“ITIN”). This requirement will be particularly important for taxpayers living outside the U.S. Taxpayers who must apply for an ITIN may submit an ITIN application (IRS Form W-7) with their submission to the Streamlined Program.

C. Taxpayers residing inside the U.S.

Other key features of the Streamlined Program with respect to taxpayers residing inside the U.S. include the following:

- **5% offshore penalty.** Eligible taxpayers who reside inside the U.S. and participate in the Streamlined Program are required to pay a 5% offshore penalty.
- **Payment of penalty.** Eligible taxpayers must pay the 5% penalty at the time that the taxpayer submits its other submission materials (e.g., tax returns, FBARs, etc.).

III. Delinquent FBAR and/or international information return submission procedures

The IRS has maintained a procedure for certain taxpayers to file delinquent FBARs or international information returns (such as Form 5471 and Form 3520) without participating in OVDP or the Streamlined Program. The procedure is available only for taxpayers who do not need to file delinquent or amended tax returns to report and pay additional tax and who meet certain other requirements. See the links at the end of this alert for more information about the procedures.

IV. Transition Procedures

Generally, taxpayers who are currently participating in an earlier offshore voluntary disclosure program may remain in the program and still take advantage of the new penalty structure of the Streamlined Program. To receive transitional treatment, a taxpayer must submit the non-willful certification (described above) and must otherwise be eligible for the Streamlined Program. The IRS has provided guidance on how a taxpayer applies for transitional treatment. See the link at the end of this alert.

V. Links

The IRS news release regarding the changes to the offshore program and the new, expanded Streamlined Program is available here: <http://www.irs.gov/uac/Newsroom/IRS-Makes-Changes-to-Offshore-Programs;-Revisions-Ease-Burden-and-Help-More-Taxpayers-Come-into-Compliance>

A summary of the options available for U.S. taxpayers with undisclosed foreign financial assets is available here: <http://www.irs.gov/Individuals/International-Taxpayers/Options-Available-For-U-S--Taxpayers-with-Undisclosed-Foreign-Financial-Assets>

A summary of the new, expanded Streamlined Filing Compliance Procedures is available here: <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures>

The updated 2014 Offshore Voluntary Disclosure Program Frequently Asked Questions is available here: <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised>

The IRS list of the Foreign Financial Institutions or Facilitators that meet the criteria for the new 50% penalty is available here: <http://www.irs.gov/Businesses/International-Businesses/Foreign-Financial-Institutions-or-Facilitators>

A description of the Delinquent FBAR Submission Procedures is available here: <http://www.irs.gov/Individuals/International-Taxpayers/Delinquent-FBAR-Submission-Procedures>

A description of the Delinquent International Information Return Submission Procedures is available here: <http://www.irs.gov/Individuals/International-Taxpayers/Delinquent-International-Information-Return-Submission-Procedures>

The frequently asked questions for the transition rules is available here: <http://www.irs.gov/Individuals/International-Taxpayers/Transition-Rules-Frequently-Asked-Questions-FAQs>

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

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