

IRS Hot Topics

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IRS reopens offshore OVDI program for indefinite time period

The IRS reopened their successful Offshore Voluntary Disclosure Initiative (OVDI) for nonfilers of both U.S. tax returns and Foreign Bank Account Reports (FBARs) on January 9, 2012 with News Release IR-2012-5. This announcement provided further guidance to both taxpayers who have just become aware of their filing obligations or did not participate in the 2009 and 2011 OVDI programs. Practitioners who advise clients with a wide variety of facts and circumstances can now offer the options set forth in IR-2012-5 along with the alternatives set forth in FS-2011-13¹ if a delinquent return filer owes no tax.

While much of the new program's structure remains the same as the 2011 OVDI, there are a few key differences.

The new OVDI will be open for an indefinite time period, unlike the 2009 and 2011 programs which had specific deadlines. Shortly after the 2011 OVDI ended on December 9, 2011, the IRS Commissioner announced that there would be continuing enforcement efforts for those deliberately hiding funds in offshore accounts, but would also provide a reasonable path forward for U.S. dual citizens, green card holders or long term expatriates who had no intent to cheat the U.S. Treasury and had reasonable cause for their past non-compliance. The speed with which the new OVDI was announced after the last one closed indicates the Service's responsiveness to the requests from various stakeholders. There is no set deadline to this program, but the IRS has stated that they may change the terms of the program going forward at any time.

¹ See IRS Hot Topics article dated Jan 4, 2012

The new OVDI is announced at a time when better use of Exchange of Information Articles in our Tax Treaties and other Tax Information Exchange Agreements (TIEAs), plus information gathered from the prior two OVDIs, make it increasingly risky to continue noncompliance with tax return and FBAR filing requirements. An unprecedented amount of information on U.S. taxpayers' foreign assets will soon become available as the Foreign Account Tax Compliance Act (FATCA) and Foreign Financial Asset Reporting (Form 8938 and new IRC § 6038D) become effective for 2011 individual tax returns.

Penalty structure of the new OVDI

Each OVDI has had a set penalty structure on unreported offshore accounts, but this penalty has increased with each OVDI. The new 2012 OVDI is based on the 2011 OVDI, but the maximum "FBAR related" penalty is increased from 25% to 27.5% based on the highest aggregate balance in foreign accounts (or entities or value of foreign assets) during the tax years within the OVDI period. Taxpayers who enter this program must file original or amended tax returns for up to eight years, pay all back taxes, as well as accuracy and delinquency penalties applicable to the balance due on those returns. The new OVDI retains the opportunity for participants to qualify for a lower penalty of 12.5% or 5%, if they meet certain conditions. Those conditions were described in the prior OVDI's Frequently Asked Questions (FAQs). The IRS announced it will be updating those FAQs and

releasing more specific information within the next month.

PwC observation

Many U.S. dual citizens, green card holders or long term expatriates who have lived outside the U.S. for a long period of time may qualify for the lower penalty or even no penalty. Each situation turns on a number of specific facts and circumstances that should be explored on a case by case basis to determine the best way forward.

Opt out option still available

The new OVDI program retains the opt out option that was available in the prior programs. The opt out process was described in the 2011 FAQs and the IRS also released their internal guidance to examiners. The decision to opt out is irrevocable and results in the taxpayer's submission being referred for a full scope examination. The advantage of filing an OVDI submission and then opting out is that a full voluntary disclosure has been made to the IRS as opposed to a "quiet" or "soft" disclosure which does not relieve the taxpayer from potential criminal prosecution. Individuals who choose to participate in and then opt out of the new OVDI may be subject to examinations of up to eight years of tax returns within the OVDI period.

Taxpayers, who reported and paid tax on all their taxable income but did not file FBARs, should consider not participating in the newly announced OVDI. Instead they may consider filing the delinquent FBARs with the

Department of Treasury. Under the 2011 OVDI, the IRS agreed not to impose a penalty for the failure to file the delinquent FBARs if there were no underreported tax liabilities and the FBARs were filed by August 31, 2011 (FAQ 17). We anticipate, consistent with FS-2011-13, the IRS will follow the same course under the new OVDI since those with no underreported tax liabilities are not truly within the range of taxpayers the IRS is trying to identify. It is unclear whether FS-2011-13 will be rigidly applied and apply only to those with no tax due, or may be expanded to include individuals with de minimis amounts below a specified amount. It is also unknown whether IRS will offer similar relief for delinquent international information returns, such as Forms 5471 and 3520, as was offered in FAQ 18 in the prior OVDI. The IRS stated in IR-2012-5 that more details will be available within a month and the FAQs will be updated.

PwC observation

We understand the IRS has received more opt out submissions than were initially anticipated. As of yet, there is

little history regarding how extensive the IRS audits will be of the 2011 OVDI opt out subjects and how they are being conducted. Taxpayers considering this option either in the prior OVDIs or the new one should consult their tax advisor.

Conclusion

There are many considerations before a taxpayer should determine whether to pursue a voluntary disclosure of prior tax noncompliance regarding their offshore accounts. Since the new OVDI asserts an offshore penalty based on foreign financial accounts and asset valuations, for many with smaller financial account values the aggregate offshore penalty determination, even for multiple years, would be less outside the OVDI. Each taxpayer should consider their specific situation and the options available, before making a decision about how best to become compliant regarding their previously unreported offshore accounts and income.

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