

# Partial Offshore Tax Amnesty — Voluntary Disclosure 2.0

By Dennis Brager

**E**arlier this month, the Internal Revenue Service announced a new “Offshore Voluntary Disclosure Initiative” for those who failed to file foreign bank account reports (FBAR). It is the successor to the IRS’ previous offshore disclosure program, which ended on Oct. 15, 2009, and is intended to be less favorable than the earlier program.

Any U.S. citizen or resident who has signature authority over, or a financial interest in, a financial account located in another country is required to file a report with the Treasury Department on Form TD F 90-22.1 (Report of Foreign Bank and Financial Account) aka FBAR if the balance was more than \$10,000 at any time during the calendar year. The willful failure to do so is a felony. There are also civil penalties equal to the greater of \$100,000 or 50 percent of the account balance; and the penalty can be imposed on an annual basis, which can easily exceed the amount in the account. The penalties are imposed pursuant to the Bank Secrecy Act, codified as part of Title 31 of the U.S. Code, and not in Title 26, which contains the tax laws. Initially the U.S. Treasury Department was tasked with the job of enforcing the FBAR rules; however that authority was delegated to the IRS.

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Under the new voluntary disclosure initiative, the IRS has given taxpayers until Aug. 31 to come clean. Those who come in from the cold will pay a reduced one-time FBAR penalty of 25 percent of the highest account balance at any time from 2003 to 2010. In addition, amended returns must be filed for 2003 to 2010 reporting any previously unreported income. Tax must be paid on this amount with interest. On top of that is an accuracy related penalty under 26 U.S.C. Section 6661 of 20 percent of the unpaid tax for the years 2003 to 2010. Late filing penalties and late payment penalties under 26 U.S.C. Section 6651(a)(1) and (2) will also be imposed where applicable. In return, those who make a voluntary disclosure will generally be safe from criminal prosecution, and will avoid potential civil penalties that can completely wipe out the entire account, and more.

For those account holders whose combined offshore account balances never exceeded \$75,000 at any time from 2003 to 2010, the 25 percent penalty is reduced to 12.5 percent, but all other terms remain the same. A 5 percent penalty is available in two very limited situations. To qualify for the first category, the taxpayer must: not have opened or caused 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); have exercised minimal, infrequent contact with the account (e.g. to request the



account balance or update account holder information such as a change in address, contact person, or e-mail address); have, except for a withdrawal closing the account and transferring the funds to an account in the United States, not withdrawn more than \$1,000 from the account in any year covered by the voluntary disclosure; and be able to establish that all applicable U.S. taxes have been paid on funds deposited to the account (only account earnings have escaped U.S. taxation). This category is intended to apply to persons who inherit the foreign bank accounts.

**T**he other category is what some have called the “coma exception.” If a taxpayer is a foreign resident, but unaware that he or she was a U.S. citizen, that person is entitled to the 5 percent penalty. Of course, someone in this situation would not have willfully failed to file an FBAR due to reasonable cause, and would not be subject to the 50 percent penalty. This underlines the major criticism of the Offshore Voluntary Disclosure Initiative — it does not allow a taxpayer to argue that there should be no penalty because there is reasonable cause for the failure to file, or that the penalty should be limited to \$10,000 per violation under 31 U.S.C. Section 5321(a)(5)(A) because the failure to file the FBAR was not willful, but merely negligent.

Because FBARs are filed with the IRS, there is a good deal of confusion since tax practitioners assume that the procedures applicable under tax law will apply to FBAR violations; however, that is not necessarily the case. For example, if a tax return is not filed the IRS has an unlimited amount of time to assess additional taxes and penalties. If an FBAR is not filed the IRS has only six years to assess penalties.

Another important distinction is that FBARs are not filed with the tax return. They are filed separately in Detroit, and are due on June 30. The extension for filing a tax return does not extend the time to file an FBAR, and there is no extension of time available under the statute.

Most people have never noticed but when they file their personal income tax return, the Schedule B (where interest and dividends are reported) contains the following question: At any

time during 2008, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See page B-2 for exceptions and filing requirements for Form TD F 90-22.1.

Checking the box that says “No,” subjects a taxpayer to a possible criminal charge of filing a false income tax return, which is a felony pursuant to 28 U.S.C. Section 7206(1) punishable by up to three years in jail and a \$100,000 fine, or both.

There is a general assumption that all of this is a problem only for rich tax cheats. In fact, we have discovered it is a very big problem for immigrants who have come here, but have left money behind in the old country. Most of them have not the vaguest idea that they are supposed to be filing FBARs, checking the box on Schedule B, or for that matter reporting income on their foreign accounts on their U.S. tax returns. The almost universal belief is that if the money was not earned here, tax is not due until it is brought into the United States. Unfortunately that is not the law — U.S. citizens and residents are generally taxed on their worldwide income when it is earned.

Offshore bank accounts became the focus of public attention in June 2008 when the IRS announced it had filed a “John Doe Summons” seeking an order from a federal court in Miami, Fla., permitting the IRS to request information from Swiss banking giant UBS AG about U.S. taxpayers who might be using Swiss bank accounts to commit tax evasion. Ultimately UBS turned over the names of about 4,500 account holders despite the vaunted Swiss bank secrecy. In March 2009, the IRS announced a limited amnesty for FBAR non-filers, which applied to those making voluntary disclosures by Oct. 15, 2009. Approximately 15,000 individuals stepped forward with bank accounts in over 60 countries. Since then, an additional 3,000 taxpayers have made voluntary disclosures.

Taxpayers who fail to file FBARs due to a lack of awareness are left with an unenviable dilemma. Either enter the program and pay steep penalties, or refuse to step forward and if discovered, risk being wiped out financially and going to jail if the IRS can prove that the failure to file was willful. Unfortunately, a sophisticated analysis of the facts and circumstances of each individual’s situation is necessary to guide taxpayers in making this choice, and even then there are few clear answers. Lawyers representing clients who are in this situation should understand that the IRS has taken a very aggressive stance, and views a taxpayer’s failure to report the offshore income, and to check the yes box on the Schedule B, as strong indications of willfulness.



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