

PENNIES FROM HEAVEN...WITH VERY SHORT DEADLINES

IRS Voluntary Disclosure for Offshore Accounts
and
Maryland Tax Amnesty

Caroline D. Ciralo
Rosenberg | Martin | Greenberg, LLP
Baltimore, Maryland
410.547.7852
cciralo@rosenbergmartin.com

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The IRS is looking for money hidden offshore and is giving eligible taxpayers until **October 15, 2009** to take advantage of a settlement initiative that foregoes criminal prosecution and significantly reduces civil penalties. IRS Commissioner Douglas Shulman has encouraged taxpayers with unreported offshore accounts to participate in the program, stating on March 26, 2009: “For taxpayers who continue to hide their heads in the sand, the situation will only become more dire.”

Any U.S. person having a financial interest in, or signatory or other authority over, financial accounts maintained with financial institutions in foreign countries are required to file a Report of Foreign Bank and Financial Accounts, TD F 90.22-1 (“FBAR”) if the aggregate balances of such foreign accounts exceed \$10,000 at any time during the year. The FBAR is designed to provide information for use in criminal, tax or regulatory investigations or proceedings. The information is stored on a database administered by the Financial Crimes Enforcement Network and the Internal Revenue Service, and can be accessed by various federal, state and local government agencies to assist in law enforcement efforts and in the performance of their official duties.

The FBAR is not filed with your income tax return. Instead, it must be ***received*** by the IRS in Detroit, Michigan by June 30 of the year following the calendar year in which the U.S. person is subject to the FBAR filing requirements. Because the FBAR is not a form required by the Internal Revenue Code, the mailbox rule (“timely mailing is timely filing”) does not apply.

Failure to comply with FBAR reporting and filing requirements can result in severe penalties ranging from \$10,000 for non-willful violations, to the greater of \$100,000 or 50% of the maximum value of the account for willful violations. Each failure to file or false filing is a separate offense and the IRS has up to six years after the due date of the FBAR to assess the penalty. In addition, willful offenders can face criminal charges with maximum imprisonment up to ten years, and fines up to \$500,000 per count. In this year alone, there have been four prosecutions for FBAR violations and more are on the horizon. In the most recent, John McCarthy of California pled guilty to failing to file an FBAR (statutory maximum penalty of 5 years imprisonment and fines up to \$250,000), and agreed to civil FBAR penalties equal to 50% of highest year balance in

the account and a 75% civil tax fraud penalty. *United States v. McCarthy*, CR No. 09-00784 (C.D. Calif.) (August 14, 2009).

Under the settlement initiative, taxpayers must come forward, fully cooperate with the IRS, file amended or original tax returns for the last six years (2003 - 2008), file amended or original FBARs and any other information returns required, and pay:

1. the tax on the unreported income;
2. an accuracy-related penalty equal to 20% of the tax due
3. interest due on the tax and the accuracy related penalty
4. a penalty equal to 20% of the highest aggregate balance of the undisclosed foreign accounts over the last 6 years in lieu of the FBAR civil penalties and other penalties that might otherwise apply. [a lower 5% penalty will apply in certain limited circumstances]

For those individuals that still need to be convinced, the following is list of additional, potential *civil* penalties that may be imposed on taxpayers with secret offshore accounts outside the voluntary disclosure program (IRS Memorandum, March 23, 2009, irs.gov):

1. **Civil fraud penalties** where underpayment of tax or failure to file return is due to fraud – 75% of the unpaid tax.
2. **Failure to file return penalties** – 5 percent of the unpaid tax for each month that the return is late, up to a maximum penalty of 25%. Penalty is increased to 15% per month up to a maximum penalty of 75% in cases of fraudulent failure to file.
3. **Failure to pay penalties** - .5% of the unpaid tax for each month that the tax remains unpaid, up to a maximum penalty of 25%.
4. **Accuracy related penalties** – 20% of the portion of the underpayment that is attributable to negligence, substantial understatement of tax, substantial overstatement of pension liabilities, or a substantial estate or gift tax valuation understatement. The accuracy-related penalty for substantial valuation misstatements can increase up to 40% of the underpayment based on the amount of the misstatement.
5. **Penalties for failure to file certain information returns:**

Form 5471: Information Return of U.S. Persons With Respect to Certain Foreign Corporations. U.S. persons who are officers, directors, or shareholders in certain foreign corporations (including, for example, an International Business Corporation used in an offshore scheme) must report information required by §§ 6035, 6038 and 6046, and compute income from controlled foreign corporations under §§ 951-964. The penalty for failing to file each one of these information returns is \$10,000, with an additional \$10,000 added for each month the failure continues

beginning 90 days after the taxpayer is notified of the delinquency, up to \$50,000 per return.

Form 5472: Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Reports transactions between a 25% foreign-owned domestic corporation or a foreign corporation engaged in a trade or business in the United States and a related party as required by §§ 6038A and 6038C. The penalty for failing to file each one of these information returns, or to keep certain records regarding reportable transactions, is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return.

Form 926: Return by a U.S. Transferor of Property to a Foreign Corporation. Reports transfers of property to a foreign corporation and to report information under § 6038B. The penalty for failing to file each one of these information returns is ten percent of the value of the property transferred, up to a maximum of \$100,000 per return, with no limit if the failure to report the transfer was intentional.

Form 3520: Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts. Reports various transactions involving foreign trusts, including creation of a foreign trust by a U.S. person, transfers of property from a U.S. person to a foreign trust, and receipt of distributions from foreign trusts under § 6048. This return also reports the receipt of gifts from foreign entities under § 6039F. The penalty for failing to file each one of these information returns, or for filing an incomplete return, is 35% of the gross reportable amount, except for returns reporting gifts, where the penalty is 5% of the gift per month, up to penalty of 25% of the gift.

Form 3520-A: Annual Information Return of Foreign Trust with a U.S. Owner. Reports ownership interests in foreign trusts, by U.S. persons with various interests in and powers over such trusts under § 6048(b). The penalty for failing to file each one of these information returns, or for filing an incomplete return, is 5% of the gross value of trust assets determined to be owned by the U.S. person.

Form 8865: Return of U.S. Persons With Respect to Certain Foreign Partnerships. U.S. persons with certain interests in foreign partnerships use this form to report interests in and transactions of the foreign partnerships, transfers of property to the foreign partnerships, and acquisitions, dispositions, and changes in foreign partnership interests under §§ 6038, 6038B and 6046A. Penalties include \$10,000 for failure to file each return, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the

delinquency, up to \$50,000 per return, and 10% of the value of any transferred property that is not reported, subject to a \$100,000 limit.

Taxpayers are eligible for the Offshore Voluntary Disclosure program as long as they are not involved in a civil tax examination or have not been specifically identified by the IRS for purposes of a criminal tax investigation.

The U.S. and Switzerland recently signed a historic agreement providing for the initial release of 4,450 names of U.S. persons with UBS accounts. It is expected that UBS will eventually disclose the names and account information for thousands of its U.S. customers and other Swiss banks will follow suit. The IRS recently assured taxpayers that a notice from UBS advising an account holder that their information may be provided to the IRS, in and of itself, will not prevent that individual from coming into the Offshore Voluntary Disclosure program. With that said, taxpayers with undisclosed offshore accounts and related unreported income are running out of time. **Individuals with offshore accounts are strongly advised to contact their tax professionals to discuss the option of entering the Voluntary Disclosure program.**

Maryland Tax Amnesty Program

As an added incentive for Maryland taxpayers, the Comptroller is offering a Tax Amnesty Program from **September 1, 2009 through October 30, 2009.**

The Amnesty Program applies to unpaid individual and corporate state income tax, withholding tax, sales & use tax and/or admissions and amusement tax owed on **returns due** on or before December 31, 2008. For eligible taxpayers, the Comptroller will waive all civil penalties and half of all accrued interest if the taxpayer files all missing returns and either pays the tax and one half the accrued interest between September 1 through October 30, or enters into an agreement with the Comptroller to pay the tax and the accrued interest due prior to December 31, 2010. To the extent a taxpayer enters into a payment agreement beyond October 30, interest will resume on October 31, 2009 at the statutory rate of 13%. Taxpayers accepted into the Amnesty Program will receive immunity from criminal prosecution for any charges that might arise with respect to the tax liabilities subject to Amnesty.

Eligible taxpayers do not include taxpayers that are (i) currently under a state criminal investigation, (ii) a company with more than 500 employees in the US as of September 1, 2009, or (iii) any taxpayer that was eligible for the Delaware Holding Company settlement period established by Chapter 557 of 2004, for corporate income tax settlements under *Comptroller v. SYL, Inc. and Comptroller v. Crown Cork & Seal Co., Inc.* In addition, the Amnesty Program does not apply to previously assessed fraud penalties or any taxes for which a taxpayer received amnesty under the 2001 Maryland amnesty program.

Taxpayers wishing to take advantage of the Maryland Tax Amnesty program must complete an Application and file it with their unfiled or amended returns by **October 30, 2009.**

If you wish to discuss the Voluntary Disclosure Program or the Maryland Tax Amnesty Program, or have unresolved tax liabilities, and need assistance, please contact **Caroline D. Ciralo (410-547-7852 or cciralo@rosenbergmartin.com)** or any attorney in our tax group:

Brian J. Crepeau	bcrepeau@rosenbergmartin.com
Stuart R. Rombro	srombro@rosenbergmartin.com
Jim Liang	jliang@rosenbergmartin.com
Zachary Conjeski	zconjeski@rosenbergmartin.com
Susan E. Roberto-Saidi	sroberto@rosenbergmartin.com
Julian T. Lee	jlee@rosenbergmartin.com