

**OFFSHORE ACCOUNT?
ONE MORE CHANCE (AND IT MAY BE YOUR LAST)!!**

IRS 2011 Offshore Voluntary Disclosure Initiative

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Following on the success of the 2009 Offshore Voluntary Disclosure Program (“2009 OVDP”), which brought in 15,000 taxpayers with accounts in more than 60 countries, on February 8, 2011 the IRS announced a second – and perhaps final – opportunity to come forward with undisclosed offshore accounts. The 2011 Offshore Voluntary Disclosure Initiative (“2011 OVDI”) ends **August 31, 2011** and imposes rigid requirements that must be met prior to the deadline.

With the announcement of the program, IRS Commissioner Douglas Shulman issued a stern warning: “As we continue to amass more information and pursue more people internationally, the risk to individuals hiding assets offshore is increasing.” He explained that the 2011 OVDI responds to the “continued interest from individuals looking to get back into the tax system” and that there are “more people out there . . . will come forward if we provide certainty.” Since the conclusion of the 2009 OVDP, more than 3,000 taxpayers have come forward with offshore accounts.

For those taxpayers who willfully failed to disclose offshore accounts and report income on those assets, the 2011 OVDI may be the last chance to come in from the cold and avoid criminal prosecution. For those taxpayers who did not act willfully or can demonstrate other relevant circumstances that rise to the level of reasonable cause sufficient to challenge any criminal prosecution and/or civil penalties, the decision to participate should be made only after a full review of the terms of the 2011 OVDI and consultation with a tax professional experienced with offshore disclosures.

The Legal Framework

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 (i.e., “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 of up to 10 years, and fines up to \$500,000 per count.

There have been more than 30 prosecutions since the IRS increased its focus on offshore assets and more are on the horizon. On February 4, 2011, Mauricio Cohen Assor, 77, and his son, Leon Cohen-Levy, 46, each with residences in Miami Beach, were sentenced to 10 years for conspiring to defraud the United States and filing false tax returns based on failure to disclose offshore accounts and assets. Both defendants were detained since their arrest on April 15, 2010, and ordered to pay significant restitution.

2011 Offshore Voluntary Disclosure Initiative

Taxpayers are eligible for the 2011 OVDI 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 IRS has established a uniform pre-clearance procedure under which the taxpayer can request confirmation from the IRS that they are not currently under examination or investigation before the taxpayer provides detailed information regarding their offshore accounts.

Eligible taxpayers must come forward, fully cooperate with the IRS, and by **August 31, 2011**, complete the following:

1. Submit required forms disclosing all facts related to the offshore accounts and income producing assets and extending limitations on assessment;
2. Provide copies of previously filed original (and, if applicable, previously filed amended) returns for 2003-2010;
3. File complete and accurate original and/or amended income tax returns and FBARs for 2003-2010;
4. Pay all tax due on the unreported income;
5. Pay accuracy-related penalties equal to 20% of the tax due or delinquency penalties for failure to file and/or failure to pay;
6. Pay interest due on the tax and penalties; and
7. Pay a miscellaneous penalty equal to 25% of the highest aggregate balance of undisclosed foreign accounts and income producing assets over the last 8 years in lieu of the FBAR and other penalties that might otherwise apply.

In very limited circumstances, a lower miscellaneous penalty of 5% (for certain inherited accounts with little or no activity, or taxpayers who are foreign residents and were unaware that they were U.S. citizens) or 12.5% (for offshore accounts or assets that did not exceed \$75,000 in any year under the 2011 OVDI) will apply.

If a taxpayer is unable to pay the amounts due, and can prove that fact through the full disclosure of all domestic and offshore assets and income sources under the taxpayer's control, the IRS will discuss a payment arrangement.

If a taxpayer failed to file FBARs or failed to file other required information returns (see list of potential information returns below), but does not have unreported income, the taxpayer can participate in the 2011 OVDI and avoid all penalties by simply filing the required FBARs and information returns by August 31, 2011. U.S. persons are subject to annual disclosure requirements and must file information returns if they:

- are officers, directors or shareholders in foreign corporations or partnerships,
- engaged in transactions with a 25% foreign-owned domestic corporation or a foreign corporation engaged in a trade or business in the U.S.
- transferred assets to foreign corporations, partnerships or foreign trusts,
- are grantors or beneficiaries of a foreign trust,
- are beneficiaries of a foreign estate, or
- received gifts of more than \$100,000 from a non-U.S. person.

In determining whether the 25% (or 5% or 12.5%) miscellaneous penalty is a good deal, taxpayers and their representatives should carefully review and consider the list of potential civil tax and information return penalties – in addition to the significant FBAR penalties – that may be imposed by the IRS outside the 2011 OVDI:

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%.
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 underpayment attributable to negligence, substantial understatement, substantial overstatement of pension liabilities, or a substantial estate or gift tax valuation understatement. The penalty for substantial valuation misstatements can increase to 40% 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 an International Business Corporation) must report information required by IRC §§ 6035, 6038 and 6046, and income from controlled foreign corporations under IRC §§ 951-964. The penalty for failing to file each information return is \$10,000, with \$10,000 added for each month the failure continues beginning 90 days after notification 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 U.S. and a related party as required by IRC §§ 6038A and 6038C. The penalty for failing to file each information return, or keep records regarding reportable transactions, is \$10,000, with \$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 information under IRC § 6038B. The penalty for failing to file each one of these information returns is 10% 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 IRC § 6048. This return also reports the receipt of gifts from foreign entities under IRC § 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 IRC § 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 IRC §§ 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.

The 2009 OVDP obtained much of its momentum from the U.S./Switzerland agreement that provided for the release of 4,450 names of U.S. persons with UBS accounts, leading to the evisceration of Swiss bank secrecy. In announcing the 2011 OVDI, Commissioner Shulman made it clear that the IRS has obtained, and expects to receive, account information from many other foreign financial institutions around the world. Those taxpayers who believed that they would escape detection because their accounts are in India, Israel, Hong Kong, the Cayman Islands and other non-Swiss jurisdictions should seriously consider participation in the 2011 OVDI.

Individuals with offshore accounts are strongly advised to contact their tax professionals to discuss the option of entering the Voluntary Disclosure program.

If you wish to discuss the 2011 OVDI, or have unresolved tax liabilities or pending federal or state tax disputes, and need assistance, please contact an attorney in our Tax Controversy and Litigation group at (410) 727-6600 or by e-mail at:

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