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## IRS Releases New Frequently Asked Questions for its Offshore Voluntary Disclosure Program and Announces Procedures to Assist U.S. Citizens Living Abroad

On Tuesday, June 26, 2012, the IRS issued two News Releases and updated Frequently Asked Questions (FAQ's) in connection with its ongoing offshore voluntary disclosure program. In the past 3+ years, the IRS has had widespread success in combating the use of offshore bank accounts to hide unreported income. The IRS boasts that it has collected more than \$5 billion in its two prior voluntary disclosure programs in 2009 and 2011. So far, more than 33,000 U.S. taxpayers have voluntarily participated in the two prior programs, agreeing to report their foreign accounts and pay all back taxes, interest, and penalties attributable to the offshore accounts. Commissioner Doug Shulman stated, "We continue to make strong progress in our international compliance efforts that help ensure honest taxpayers are not footing the bill for those hiding their assets offshore. People are finding it tougher and tougher to keep their assets hidden in offshore accounts."

With the looming implementation of the FATCA reporting obligations by foreign banks in 2013, U.S. taxpayers who have not participated in the prior voluntary disclosure programs are thinking hard about whether to participate in the 2012 Offshore Voluntary Disclosure Program (OVDP), which was announced on January 9, 2012. The IRS's new FAQs issued on June 26, 2012 offer some guidance for U.S. taxpayers and their advisors, but the FAQs also fell short of expectations. Of particular significance is the IRS's clear message in the FAQs that U.S. taxpayers will be subject to stricter eligibility requirements to participate in the OVDP than they were in the previous offshore voluntary disclosure programs. Although there is no deadline to apply to the OVDP, the new FAQs impose a short deadline for taxpayers to provide the required information once they are admitted into the OVDP.

The 2012 OVDP imposes a penalty of 27.5 percent on the taxpayer's highest foreign account and certain foreign assets during the eight year period covered under the program. Like the prior two programs, participants must file Foreign Bank Account Reports, amended tax returns and provide complete account and asset information to the IRS for the entire disclosure period. In addition, taxpayers must agree to pay a 20% accuracy-related penalty on the tax due under the OVDP.

### Challenging the Turnover of Information in Foreign Courts and Tribunals

Current law requires that U.S. taxpayers notify the U.S. Department of Justice if they challenge a foreign government's disclosure of tax information in that country's judicial system. Under the new FAQs, taxpayers who fail to comply with this notification requirement will be ineligible to participate in the 2012 OVDP.

Eligibility can also be revoked once the IRS has taken action with respect to a taxpayer's specific financial institution. According to the new FAQs, the IRS can terminate some taxpayers' eligibility to participate in the OVDP with published announcements on the IRS's website. This means that, as investigations of foreign banks progress, some taxpayers who are currently eligible to participate in the OVDP may have their eligibility revoked at some point in the future, at the IRS's discretion. Thus, if taxpayers anticipate that their foreign bank is under investigation by the IRS and want to participate in the OVDP, they will need to act quickly in order to avoid having their eligibility revoked.

As mentioned previously, the FAQs also clarified when a taxpayer's OVDP must be completed. Although there is no deadline to apply and participate in the 2012 OVDP, the IRS made clear that the program could be terminated at any time, without notice. Moreover, once a taxpayer requests admission into the OVDP and her participation is approved by the IRS, the taxpayer must provide all requested information within 90 days, with the possibility that an additional 90 day extension could be granted by the IRS for good cause. This is a noteworthy clarification because taxpayers previously believed that they would have more time to complete their voluntary disclosures under the 2012 OVDP. The list of requested documents is extensive and, therefore, taxpayers will have to work very diligently to provide a full OVDP package within the tight 90 day deadline.

### **Nonresident Relief**

Also on June 26, 2012, the IRS announced a proposed new procedure which is intended to assist U.S. citizens living abroad, as well as dual citizens with "low compliance risks" to come into compliance. Though more detailed procedures are scheduled to be released by September 1, 2012, taxpayers meeting these criteria would be required to file delinquent tax returns for the past three years, as well as past due FBARs for the past six years and pay any related federal tax and interest due. Though the IRS made no guarantee that these taxpayers would owe no penalties, the IRS stated it would evaluate the returns and will not assert penalties or audit the returns if the IRS deems the taxpayer to present a "low compliance risk." While it wasn't clear what the IRS finds to be "low compliance risk," the IRS's News Release stated that tax returns showing less than \$1,500 in tax due would be treated as low risk. Moreover, as income and assets of these taxpayers increase, or if there was "sophisticated tax planning" present, the IRS stated that these factors may rise to a level of compliance risk, warranting an audit and possibly the assertion of penalties.

Though the new procedures for U.S. citizens living abroad and dual citizens do not go into effect until September 1, 2012, more clarification regarding these filing procedures is anticipated in the upcoming months. Moreover, without any clarity as to which taxpayers may pose a "compliance risk," U.S. taxpayers living abroad may think twice about taking advantage of the IRS's new procedures. Clearly, the IRS needs to provide more clarification regarding the penalties that may be asserted in these circumstances.

### **Foreign Retirement Plans**

The IRS also announced that new procedures will allow resolution of issues related to certain foreign retirement plans, such as Canadian Registered Retirement Savings Plans. While tax treaties allow for income deferral under U.S. tax law, this tax treatment is only available for U.S. taxpayers who make a timely affirmative election, a requirement missed by many U.S. taxpayers who have foreign pensions. Thus, the IRS News Release announced streamlined procedures for "low compliance risk situations," even though U.S. taxpayers have failed to make the timely election to defer U.S. income tax on their foreign pensions. Taxpayers using the new procedures will be required to file delinquent returns, along with appropriate related information returns for the past three years

and file delinquent FBARs for the past six years. Like the procedures announced for U.S. citizens living abroad, submissions from taxpayers who have foreign pensions that pose a “higher compliance risk” will be subject to a more thorough review and a potential audit, which could cover more than three tax years.

Finally, the FAQs provide additional guidance on procedural matters, including how to count the appropriate 8-year period for disclosure purposes, how to handle delinquent FBARs when there was no tax non-compliance, and various other issues. The clarification of these matters in the new FAQs is welcome and will help put to rest some of the uncertainty that has prevailed since the 2011 program terminated.

The clear message of the new FAQs and News Releases is that it is becoming riskier and more expensive to sit on the sidelines without coming into compliance with respect to offshore assets. Taxpayers who are in this situation should consult with competent tax counsel to assess their risks and establish a strategy for dealing with these issues.

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