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IRS Revises Voluntary Self-Disclosure Policies for Previously Unreported Offshore Assets

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The Internal Revenue Service (IRS) announced last week that it was further incentivizing the self-disclosure by U.S. taxpayers of offshore financial assets and accounts not previously reported. Specifically, the IRS modified the 2012 Overseas Voluntary Disclosure Program (OVDP) effective July 1, 2014, drastically reducing penalties for certain non-wilful, non-disclosure of foreign financial accounts. This move appears to be aimed at motivating taxpayers to come clean on incomplete returns and follows on the coattails of the phase-in of the U.S. Foreign Account Tax Compliance Act (FATCA). FATCA places strict measures on non-U.S. financial institutions failing to report accounts they maintain for U.S. taxpayers.

In its various inceptions, the OVDP allows taxpayers to pay a preset penalty (the actual amount has varied based on the program) on offshore assets and accounts previously not reported on the Report of Foreign Bank and Financial Accounts (commonly referred to as the FBAR and FinCen 114) in order to avoid criminal prosecution. In exchange for thorough and accurate disclosures, the IRS's Criminal Investigation division will recommend to the U.S. Department of Justice that the disclosing taxpayer not be prosecuted.

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Revised and Reduced Penalties

A key point to notice when comparing the revised "2014" OVDP against its 2012 predecessor is the dramatic reduction in the penalty percentages. Effective July 1, 2014, participants in the 2014 OVDP can benefit from a 5% penalty for non-wilful non-disclosure of foreign bank accounts. Previous penalties have typically been above 20%. While the penalty for non-disclosure of bank accounts is 5%, they can vary for various other types of non-disclosures. To illustrate the benefit of the revised OVDP, those who do not participate in the OVDP program can face penalties for wilful non-disclosure equal to the greater of $100,000 or 50% of the total balance of the account at issue. Notably there are various penalties for other related violations, such as failure to file a Form 8938 (Statement of Specified Foreign Financial Assets) or Form 3520 (Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts).

Increased Penalties for Accounts at Select Foreign Financial Institutions

Although the new revisions to the OVDP allow for reduced penalty amounts for certain non-wilful failures to disclosure, there currently exists a 50% penalty upon disclosure of accounts at foreign financial institutions under investigation for failure to report accounts.

Types of Accounts Covered

The IRS's reporting requirements cover both bank accounts (including both individual and commercial) as well as certain assets overseas. Notably, if an individual is currently under investigation for a given year, that year's reporting will not be eligible for the 2014 OVDP. Additionally, the IRS calculates the penalty amount based on the exchange value at the end of a given taxable year. However, those cases that have been submitted to the IRS and not yet considered are eligible for consideration under the new terms.

How to Proceed

Taxpayers seeking to take advantage of the revised OVDP must be approved by the IRS. This involves obtaining an initial preclearance approval. Upon approval, the taxpayer has 45 days to make the formal disclosure, although taxpayers may request an extension of up to 90 days. This entails a letter with certain attachments which will be reviewed by the IRS's Criminal Investigation division. Importantly, these submissions should include amended and delinquent filings.

It should be noted that even if the taxpayer cannot pay all the sums due under an OVDP self-disclosure, he or she can request that the IRS arrange an alternative payment plan.

Bearing in mind that the IRS can look back to the previous eight (8) years of returns, it is vital that self-disclosures be filed in good faith and diligently.

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Conclusion

The new program affords those who have not filed or adequately filed their FBAR disclosures with a powerful incentive to do so. Although eligibility and non-prosecution are not guaranteed, the revised OVDP presents a unique opportunity for taxpayers who have non-wilfully failed to file adequate and complete reports on certain foreign assets to disclose with minimal penalty. Furthermore, while certain penalties have been drastically abated, the complexities of the program highlight the need for taxpayers to pay particular attention to compliance going forward. Although holding foreign bank accounts and assets is not something unique to a select few, however, doing so without the sophistication of understanding one's legal requirements can be the source of substantial civil and criminal liability under U.S. laws and regulations.