Practice

By Charles P. Rettig and Kathryn Keneally

Continuing IRS Guidance for the Voluntary Disclosure of Offshore Accounts

The voluntary disclosure process is a valuable tool for enhancing voluntary compliance while preserving the limited enforcement resources of the IRS. Taxpayers fall out of compliance for many reasons often ranging from a personal tragedy to a business failure to simple greed. The IRS has a long history of not referring taxpayers for prosecution to the Department of Justice who have submitted a timely voluntary disclosure involving legal source income. The Department of Justice maintains a somewhat similar voluntary disclosure practice with respect to prosecution considerations. Historically, the form of the voluntary disclosure has been substantially irrelevant. The critical elements have been the timeliness of getting back into the system and the reporting of legal source income.

In our last column, we discussed the recently released IRS Penalty Memos dated March 23, 2009, setting forth "a penalty framework" to be applied in those cases in which a taxpayer makes a timely voluntary disclosure of a previously undisclosed interest in offshore financial accounts. IRS Commissioner Doug Shulman continues to encourage taxpayers to get back into compliance and has recently stated that those with previously undisclosed interests in offshore accounts remain eligible for the benefits of the IRS voluntary disclosure program mitigating the possibility of a criminal prosecution. Any system of taxation based on voluntary compliance must focus on the benefits of encouraging future compliance rather than any desire to punish now-compliant taxpayers for their now-reported, prior tax indiscretions.

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Statement from IRS Commissioner Doug Shulman on Offshore Income

As stated in our previous column, the IRS recently created a centralized framework for the handling of civil penalties for taxpayers pursuing a timely vol-

untary disclosure of previously undisclosed offshore accounts in accordance with the provisions of IRM 9.5.11.9. On March 26, 2009, IRS Commissioner Doug Shulman issued the following statement accompanying the release of three separate memoranda dated March 23, 2009 (collectively the "Penalty Memos") regarding the processing of voluntary disclosures involving offshore accounts:

> My goal has always been clear—to get those taxpayers hiding assets offshore back into the system. We recently provided guidance to our examination personnel who are addressing voluntary disclosure requests involving unreported offshore income. We believe the guidance represents a firm but fair resolution of these cases and will provide consistent treatment for taxpayers. The goal is to have a predictable set of outcomes to encourage people to come forward and take advantage of our voluntary disclosure practice while they still can.
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> In the guidance to our people, we draw a clear line between those individual taxpayers with offshore accounts who voluntarily come forward to get right with the government and those who continue to fail to meet their tax obligations. People who come in voluntarily will get a fair settlement. We set up a penalty framework that makes sense for them—they need to pay back-taxes and interest for six years, and pay either an accuracy or delinquency penalty on all six years. They will also pay a penalty of 20 percent of the amount in the foreign bank accounts in the year with the highest aggregate account or asset value. Just to be clear, this is 20 percent of the highest asset value of an account anytime in the past six years. This gives taxpayers—and tax practitioners—certainty and consistency in how their case will be handled.
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> We have instructed our agents to resolve these taxpayers' cases in a uniform, consistent manner. Those who truly come in voluntarily will pay back taxes, interest and a significant penalty, but can avoid criminal prosecution.
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> At the same time, we have also provided guidance to our agents who have cases of unreported offshore income when the taxpayer did not come in through our voluntary disclosure practice. In these cases, we are instructing our agents to fully develop these cases, pursuing both civil and criminal avenues, and consider all available penalties including the maximum penalty for the willful failure to file the FBAR report and the fraud penalty.
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> We believe this is a firm, but fair resolution of these cases. It will make sure that those who hid money offshore pay a significant price, but also allow them to avoid criminal prosecution if they come in voluntarily. As we continue to step up our international enforcement efforts, this is a chance for people to come clean on their own. Our guidance to the field is for the next six months only, after which we will re-evaluate our options.
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> For taxpayers who continue to hide their head in the sand, the situation will only become more dire. They should come forward now under our voluntary disclosure practice and get right with the government.

The IRS Penalty Memos re: Offshore Accounts

In a memorandum from Deputy SB/SE Commissioner Faris R. Fink, Deputy LMSB Commissioner Barry B. Shott, and Deputy Chief of Criminal Investigation Victor Song, to SB/SE Examination Area Directors, LMSB Industry Directors, and CI Directors of Field Operations (the "Case Routing Memorandum"), the IRS stated that voluntary disclosures concerning offshore issues will continue to be screened in the first instance by Criminal Investigation "to determine if the taxpayer is eligible to make a voluntary disclosure." After a preliminary determination is made, "voluntary disclosure requests containing offshore issues … will now be forwarded by CI to the Philadelphia Offshore Identification Unit (POIU) for civil processing." Any voluntary disclosures that were already in process prior to March 23, 2009 are also to be forwarded to the POIU.

In a separate memorandum, from Deputy SB/SE Commissioner Faris R. Fink and Deputy LMSB Commissioner Barry B. Shott, to SB/SE Examination Area Directors and LMSB Industry Directors (the "Case Development Memorandum") the IRS stated that it was acting "to ensure that examinations with offshore transactions and/or entities continue to be emphasized and receive priority treatment during

the examination process." The memorandum stated: "Offshore cases sent to the field are work of the highest priority."

In developing these cases, IRS examiners have been instructed to "utilize the full range of information gathering tools … with special emphasis on detecting unreported income." The Case Development Memorandum recommends "interviewing taxpayers, making third party contacts and timely issuing summonses to taxpayers and third parties" as well as requesting foreign-based information through treaties and tax information exchange agreements. Examining agents have also been instructed to "be alert to the badges of fraud and consult with Fraud Technical Advisors in developing cases for criminal referrals or for the assertion of the fraud penalty."

The Case Development Memorandum included as an attachment a summary of the penalties that may be imposed in particular circumstances concerning offshore issues. The Case Development Memorandum also identified specific information returns that may be required to be filed in certain circumstances. Finally, the Case Development Memorandum announced the termination of the "Last Chance Compliance Initiative" that had been outstanding to allow taxpayers who did not come forward during the earlier Offshore Voluntary Compliance Initiative (OVCI) for unreported accounts outside the United States an opportunity to do so by facing penalties that were higher than those offered by the previous OVCI but lower than the full range of potentially applicable penalties. Interestingly, when the OVCI was announced in 2003, of more than one million taxpayers then estimated by IRS to have an undisclosed interest in an offshore financial arrangement, OVCI applications were only received from 1,321 taxpayers.

In the third and certainly the most significant of the Penalty Memos, from IRS Deputy Commissioner for Services and Enforcement Linda E. Stiff to the LMSB Commissioner and the SB/SE Commissioner ("the Penalty Memorandum") the IRS announced a "penalty framework" for those taxpayers who come forward as part of a voluntary disclosure to address offshore issues. This penalty framework will be in place for only six months from March 23, 2009 (until September 23, 2009). For the taxpayers who have made a timely voluntary disclosure, including those who began the voluntary disclosure process before the issuance of the Penalty Memorandum, the IRS has offered to enter into closing agreements to resolve tax liabilities relating to offshore issues on the following terms:

> Hopefully, the current effort to attract those with previously undisclosed accounts will not forever damage the longstanding integrity of the IRS voluntary disclosure process set forth in IRM 9.5.11.9.

(1). The taxpayer will be required to file or amend income tax returns for six years (2003-2008) including information returns and FBARs, and tax and interest will be assessed for these six years. In cases where the offshore account was opened or the offshore entity was formed within the past six years, the IRS will require filing and payment from the earliest year in issue.

(2). The IRS will assess either a 20% accuracy-related or a 25% delinquency penalty on the income tax for each year. These penalties are based on the amount of tax determined to be due for each year with respect to the amended income tax returns. This is a lower penalty than the potentially applicable 75% civil fraud penalty.

(3). In lieu of all other potential penalties, including the FBAR penalty and other information return penalties, the IRS will assess a additional penalty equal to 20% of the amount in the offshore account or foreign entity on any day during the year with the highest aggregate account and asset value. This 20% penalty may be reduced to 5% under the following limited circumstances—if (a) the taxpayer did not open or cause any foreign accounts to be opened or foreign entities formed, (b) there has been no activity in any offshore account or entity (no deposits, withdrawals, etc.) during the period the account/entity was controlled by the taxpayer, and, (c) all applicable U.S. taxes have been paid on the funds deposited in the foreign accounts/entities (where only account/entity earnings have escaped U.S. taxation). (Many have referred to the potential 5% taxpayer as the "mythical 5% taxpayer" since few, if any; taxpayers will actually be able to demonstrate entitlement to the reduced FBAR penalty).

Frequently Asked Questions (FAQ)

On May 6, 2009 the IRS issued Frequently Asked Questions (FAQs) intended to clarify various provisions within the Penalty Memos regarding the voluntary disclosure of interests in offshore accounts. The guidance set forth within the FAQs includes several significant points designed to encourage some to come forward with a voluntary disclosure. Practitioners representing taxpayers with previously undisclosed interests in offshore accounts must carefully review the Penalty Memos and the FAQs. The FAQs state:

(1). Why did the IRS issue internal guidance regarding offshore activities now? The IRS has had a voluntary disclosure practice in its Criminal Manual for many years. Once IRS Criminal Investigation has determined preliminary acceptance into the voluntary disclosure program, the case is referred to the civil side of IRS for examination and resolution of taxes and penalties. Recent IRS enforcement efforts in the offshore area have led to an increased number of voluntary disclosures. Additional taxpayers are considering making voluntary disclosures but are reportedly reluctant to come forward because of uncertainty about the amount of their liability for potentially onerous civil penalties. In order to resolve these cases in an organized, coordinated manner and to make exposure to civil penalties more predictable, the IRS has decided to centralize the civil processing of offshore voluntary disclosures and to offer a uniform penalty structure for taxpayers who voluntarily come forward. These steps were taken to ensure that taxpayers are treated consistently and predictably.

(2). What is the objective of these steps? The objective is to bring taxpayers that have used undisclosed foreign accounts and undisclosed foreign entities to avoid or evade tax into compliance with United States tax laws. Additionally, the information gathered from taxpayers making voluntary disclosures under this practice will be used to further the IRS's understanding of how foreign accounts and foreign entities are promoted to United States taxpayers as ways to avoid or evade tax. Data gathered will be used in developing additional strategies to inhibit promoters and facilitators from soliciting new clients.

(3). Why should I make a voluntary disclosure? Taxpayers with undisclosed foreign accounts or entities should make a voluntary disclosure because it enables them to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution. Making a voluntary disclosure also provides the opportunity to calculate, with a reasonable degree of certainty, the total cost of resolving all offshore tax issues. Taxpayers who do not submit a voluntary disclosure run the risk of detection by the IRS and the imposition of substantial penalties, including the fraud penalty and foreign information return penalties, and an increased risk of criminal prosecution.

[**Note.** Many of these accounts were inherited or were funded by individuals long before they immigrated to the United States. Further, the unreported income generated from the undisclosed foreign accounts is often fairly insignificant, especially when offset by the administrative fees associated with the account. Although the Penalty Memos provide certainty in the voluntary disclosure process, the stated 20-percent FBAR penalty "of the highest account value" fails to account for the fact that many taxpayers and their representatives were completely unaware of the FBAR (and, thus did not "willfully" violate the provisions of 31 USC §§5314 and 5321) and fails to account for the reasonable cause exception to the FBAR penalty.

The "one size fits all" approach regarding the automatic application of the FBAR penalty may become the downfall for this initiative. Many taxpayers otherwise desiring to come into compliance have discovered that the economic consequences of doing so may approach or exceed their current account balance. For elderly taxpayers who may have funded the offshore account while fleeing a hostile government wrecking havoc in Europe or the Middle East, losing what is often their sole remaining financial resource under this initiative is not a viable option. It is beyond belief that the United States would prosecute an elderly Holocaust survivor under these circumstances. To them, it is similarly beyond belief that the United States would penalize them under the guise of the FBAR statutes for setting aside their "nest egg" as a protective

measure against the possibility that past horrors could somehow be repeated against them or their families.]

(4). What is the IRS's Voluntary Disclosure Practice? The Voluntary Disclosure Practice is a longstanding practice of IRS Criminal Investigation of taking timely, accurate, and complete voluntary disclosures into account in deciding whether to recommend to the Department of Justice that a taxpayer be criminally prosecuted. It enables noncompliant taxpayers to resolve their tax liabilities and minimize their chances of criminal prosecution. When a taxpayer truthfully, timely, and completely complies with all provisions of the voluntary disclosure practice, the IRS will not recommend criminal prosecution to the Department of Justice.

(5). How do I make a voluntary disclosure and where should I submit my voluntary disclosure? A voluntary disclosure is made by following the procedures described in I.R.M. 9.5.11.9. Tax professionals or individuals who want to initiate a voluntary disclosure, should call their local CI office. For a list of CI offices, visit: http://www.irs.gov/compliance/enforcement/article/0,,id=205909,00.html. Taxpayers with questions may call the IRS Voluntary Disclosure Hotline at (215)516-4777, visit www.irs.gov, or contact their nearest CI office.

(6). What form should my voluntary disclosure take? You should send a letter to the nearest Special Agent in Charge, IRS Criminal Investigation, stating that you wish to make a voluntary disclosure. Ideally, the letter should contain all your identifying information, including name, address, Social Security Number or other Taxpayer Identification Number, passport number and date of birth, and should also include an explanation of any previously unreported or under-reported income or incorrectly claimed deductions or credits related to undisclosed foreign accounts or undisclosed foreign entities, including the reason(s) for the error or omission. It should also include a power of attorney (Form 2848), if you are represented, and daytime contact information for you or your representative. If you have already completed the amended or delinquent returns, those should be submitted with the letter, but it is not necessary to include them with the initial submission if you are unable to do so. At a minimum, however, the initial submission must include the taxpayer's name and identifying information described above. IRS Criminal Investigation will follow up on the facts and circumstances to assess the timeliness, completeness, and truthfulness of the voluntary disclosure.

(7). I'm currently under examination. Can I come in under voluntary disclosure? No. If the IRS has initiated a civil examination, regardless of whether it relates to undisclosed foreign accounts or undisclosed foreign entities, the taxpayer will not be eligible to come in under the IRS's Voluntary Disclosure Practice.

[**Note.** It would seem that FAQ 7 is misplaced. Taxpayers currently under examination for which issues involving undisclosed foreign accounts or undisclosed foreign entities should be encouraged to disclose such interests. The overall benefit of possibly punishing these taxpayers if such interests are somehow discovered is easily overcome by the benefits of bringing them and likely many others into compliance.

The IRS does not have a stellar history of identifying such interests during an examination. There are many taxpayers with interests in offshore accounts not involving the few Swiss institutions presently under the spotlight or in accounts completely outside Europe. Finding these accounts through the examination process is likely impossible. Encouraging these taxpayers to get into compliance and then having them remain in compliance is incredibly important to the future of our system of taxation. Many of these taxpayers want to come forward and repatriate their offshore funds. Why close the door?]

(8). I have an offshore merchant account upon which I have not reported all of the income. Can I come in under the IRS's voluntary disclosure practice? Taxpayers with unreported income from an offshore merchant account can make a voluntary disclosure.

(9). I have properly reported all my taxable income but I only recently learned that I should have been filing FBARs in prior years to report

my personal foreign bank account or to report the fact that I have signature authority over bank accounts owned by my employer. May I come forward under the voluntary disclosure practice to correct this? The purpose for the voluntary disclosure practice is to provide a way for taxpayers who did not report taxable income in the past to voluntarily come forward and resolve their tax matters. Thus, if you reported and paid tax on all taxable income but did not file FBARs, do not use the voluntary disclosure process.

For taxpayers who reported and paid tax on all their taxable income for prior years but did not file FBARs, you should file the delinquent FBAR reports according to the instructions and attach a statement explaining why the reports are filed late. Send copies of the delinquent FBARs, together with copies of tax returns for all relevant years, by September 23, 2009, to the Philadelphia Offshore Identification Unit at: Internal Revenue Service, 11501 Roosevelt Blvd. South Bldg., Room 2002 Philadelphia, PA 19154 Attn: Charlie Judge, Offshore Unit, DP S-611

The IRS will not impose a penalty for the failure to file the FBARs.

[**Note.** FAQ 9 eliminates the stated 20-percent FBAR penalty for those who have properly reported all of their taxable income but failed to file the FBARs. This is significant and seems to deviate from a technical reading of the Penalty Memos. However, the IRS is to be commended for this approach, especially given the overwhelming number of taxpayers and practitioners who have historically been completely unaware of the mere existence of the FBAR. Penalties should be designed to punish conduct that society has deemed to be statutorily unbecoming. Efforts to punish taxpayers on an "at will" basis should be unbecoming to us all.]

(10) What if the taxpayer has already filed amended returns reporting the additional unreported income, without making a voluntary disclosure (i.e., quiet disclosure)? The IRS is aware that some taxpayers have attempted so-called "quiet" disclosures by filing amended returns and paying any related tax and interest for previously unreported offshore income without otherwise notifying the IRS. Taxpayers who have already made "quiet" disclosures may take advantage of the penalty framework applicable to voluntary disclosure requests regarding unreported offshore accounts and entities. Those taxpayers must send previously submitted documents, including copies of amended returns, to their local CI office by September 23, 2009. (See FAQ 5).

Taxpayers are strongly encouraged to come forward under the Voluntary Disclosure Practice to make timely, accurate, and complete disclosures. Those taxpayers making "quiet" disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years. The IRS has identified, and will continue to identify, amended tax returns reporting increases in income. The IRS will be closely reviewing these returns to determine whether enforcement action is appropriate.

[**Note.** FAQ 10 states "taxpayers making 'quiet' disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years." Richard Speier, the former Acting National Chief of IRS Criminal Investigation following a lifelong career within IRS Criminal Investigation recently stated, "I'm unable to envision a scenario involving legal source income where CI recommends prosecution on someone who has filed accurate amended returns and accurate FBAR's prior to the initiation of an investigation."

Current and future compliance is significantly enhanced by encouraging taxpayers to "get right" with their filing and payment obligations. Practitioners are unaware of any situation in the history of the IRS where such a referral for criminal prosecution has occurred following submission of complete and truthful amended returns for legal source income and FBARs prior to the initiation of any examination or investigation by the IRS. Any effort to subject a taxpayer to a criminal investigation or for the Department of Justice to actually prosecute a taxpayer who made either a timely "quiet" or "noisy" voluntary disclosure would effectively be the end of the voluntary disclosure process in the United States. Responsible tax administration dictates that those running the trains encourage people to get on

board rather than threatening to run them over in the process.]

(11). Is a taxpayer who sought relief under the IRS's Voluntary Disclosure Practice before this internal guidance was issued, eligible for the terms described in this internal guidance? Yes. If a taxpayer sought relief under the IRS's Voluntary Disclosure Practice before this internal guidance was issued he or she may be eligible, as long as the voluntary disclosure has not yet resulted in an assessment.

[Why? Those who came in early under the IRS's Voluntary Disclosure Practice should have the ability to get on board. Assumedly, their penalties may have exceeded those under the Penalty Memos. Every IRS initiative serves as the foundation for taxpayer responses to future initiatives. What lesson are we providing for future initiatives? Stay away until we get this straightened out or simply stay away. Some benefit should be conferred upon those who made an early effort to come into compliance as compared to those standing on the doorstep waiting to see if the rain is actually going to fall before knocking.]

(12). How does the penalty framework work? Can you give us an example? Assume the taxpayer has the following amounts in a foreign account over a period of six years. Although the amount on deposit may have been in the account for many years, it is assumed for purposes of the example that it is not unreported income in 2003.

Year	Amount on Deposit	Interest Income	Account Balance
2003	$1,000,000	$50,000	$1,050,000
2004		$50,000	$1,100,000
2005		$50,000	$1,150,000
2006		$50,000	$1,200,000
2007		$50,000	$1,250,000
2008		$50,000	$1,300,000

[**Note.** This example does not provide for compounded interest, and assumes the taxpayer is in the 35-percent tax bracket, files a return but does not include the foreign account or the interest income on the return, and the maximum applicable penalties are imposed.]

If the taxpayer comes forward and has their voluntary disclosure accepted by the IRS, they face this potential scenario: They would pay $386,000 plus interest. This includes:

- Tax of $105,000 (six years at $17,500) plus interest,
- An accuracy-related penalty of $21,000 (i.e., $105,000 x 20%), and
- An additional penalty, in lieu of the FBAR and other potential penalties that may apply, of $260,000 (i.e., $1,300,000 x 20%).

If the taxpayer didn't come forward and the IRS discovered their offshore activities, they face up to $2,306,000 in tax, accuracy-related penalty, and FBAR penalty. The taxpayer would also be liable for interest and possibly additional penalties, and an examination could lead to criminal prosecution. The civil liabilities potentially include:

- The tax and accuracy-related penalty, plus interest, as described above,
- FBAR penalties totaling up to $2,175,000 for willful failures to file complete and correct FBARs (2003—$100,000, 2004—$100,000, 2005—$100,000, 2006—$600,000, 2007—$625,000 and 2008—$650,000),
- The potential of substantial additional information return penalties if the foreign account or assets is held through a foreign entity such as a trust or corporation and required information returns were not filed. Note that if the foreign activity started more than six years ago, the Service may also have the right to examine additional years.

[**Note.** FAQ 12 erroneously calculated the FBAR penalty for the nonvoluntary disclosure example by misapplying the pre–American Jobs Creation Act of 2004 ceiling for an FBAR penalty of $100,000 to tax years 2004 and 2005 understating the FBAR penalty by $975,000. The IRS is aware that the FBAR penalty in FAQ 12 should be $3.2 million and not $2,175,000.

The example does not reflect reality for most taxpayers having significant losses in their offshore accounts. Further, the nondisclosure example assumes a "willful" failure to file the FBAR. "Willfulness" requires a determination regarding "a voluntary intentional violation of a known legal duty" to file the FBAR. For a somewhat related

analysis, *see W. Ratzlaf,* SCt, 94-1 USTC ¶50,015, 510 US 135 (1994). Cases involving willful FBAR violations will generally have to rely on circumstantial evidence overcoming the inherent difficulty of proving, or disproving, a state of mind (willfulness) at the time of a violation. Further, the simple fact is that, until recently, most taxpayers (and their representatives) were completely unaware of the FBAR requirements.].

(13). What years are included in the 6-year period? A taxpayer is expected to file correct delinquent or amended tax returns for tax year 2008 back to 2003.

(14). What are some of the criminal charges I might face if I don't come in under voluntary disclosure and the IRS finds me? Possible criminal charges related to tax returns include tax evasion (26 U.S.C. § 7201), filing a false return (26 U.S.C. § 7206(1)) and failure to file an income tax return (26 U.S.C. § 7203). The failure to file an FBAR and the filing of a false FBAR are both violations that are subject to criminal penalties under 31 U.S.C. § 5322.

A person convicted of tax evasion is subject to a prison term of up to five years and a fine of up to $250,000. Filing a false return subjects a person to a prison term of up to three years and a fine of up to $250,000. A person who fails to file a tax return is subject to a prison term of up to one year and a fine of up to $100,000. Failing to file an FBAR subjects a person to a prison term of up to ten years and criminal penalties of up to $500,000.

(15). What are some of the civil penalties that might apply if I don't come in under voluntary disclosure and the IRS finds me? How do they work? The following is a summary of potential reporting requirements and civil penalties that could apply to a taxpayer, depending on his or her particular facts and circumstances.

(a) A penalty for failing to file the Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts, commonly known as an "FBAR"). United States citizens, residents and certain other persons must annually report their direct or indirect financial interest in, or signature authority (or other authority that is comparable to signature authority) over, a financial account that is maintained with a financial institution located in a foreign country if, for any calendar year, the aggregate value of all foreign accounts exceeded $10,000 at any time during the year. Generally, the civil penalty for willfully failing to file an FBAR can be as high as the greater of $100,000 or 50 percent of the total balance of the foreign account. See 31 U.S.C. § 5321(a)(5). Nonwillful violations are subject to a civil penalty of not more than $10,000.

(b) A penalty for failing to file Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. Taxpayers must also report various transactions involving foreign trusts, including creation of a foreign trust by a United States person, transfers of property from a United States person to a foreign trust and receipt of distributions from foreign trusts under section 6048. This return also reports the receipt of gifts from foreign entities under section 6039F. The penalty for failing to file each one of these information returns, or for filing an incomplete return, is 35 percent of the gross reportable amount, except for returns reporting gifts, where the penalty is five percent of the gift per month, up to a maximum penalty of 25 percent of the gift.

(c) A penalty for failing to file Form 3520-A, Information Return of Foreign Trust With a U.S. Owner. Taxpayers must also report ownership interests in foreign trusts, by United States persons with various interests in and powers over those trusts under section 6048(b). The penalty for failing to file each one of these information returns or for filing an incomplete return, is five percent of the gross value of trust assets determined to be owned by the United States person.

(d) A penalty for failing to file Form 5471, Information Return of U.S. Person with Respect to Certain Foreign Corporations. Certain United States persons who are officers, directors or shareholders in certain foreign corporations (including International Business Corporations) are required to report information under sections 6035, 6038 and 6046. 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 a maximum of $50,000 per return.

(e) A penalty for failing to file Form 5472, Information Return of a 25% Foreign- Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Taxpayers may be required to report transactions between a 25 percent 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 sections 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.

(f) A penalty for failing to file Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation. Taxpayers are required to report transfers of property to foreign corporations and other information under section 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.

(g) A penalty for failing to file Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships. United States 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 sections 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 a maximum of $50,000 per return, and ten percent of the value of any transferred property that is not reported, subject to a $100,000 limit.

(h) Fraud penalties imposed under sections 6651(f) or 6663. Where an underpayment of tax, or a failure to file a tax return, is due to fraud, the taxpayer is liable for penalties that, although calculated differently, essentially amount to 75 percent of the unpaid tax.

(i) A penalty for failing to file a tax return imposed under section 6651(a)(1). Generally, taxpayers are required to file income tax returns. If a taxpayer fails to do so, a penalty of 5 percent of the balance due, plus an additional 5 percent for each month or fraction thereof during which the failure continues may be imposed. The penalty shall not exceed 25 percent.

(j) A penalty for failing to pay the amount of tax shown on the return under section 6651(a)(2). If a taxpayer fails to pay the amount of tax shown on the return, he or she may be liable for a penalty of .5 percent of the amount of tax shown on the return, plus an additional .5 percent for each additional month or fraction thereof that the amount remains unpaid, not exceeding 25 percent.

(k) An accuracy-related penalty on underpayments imposed under section 6662. Depending upon which component of the accuracy-related penalty is applicable, a taxpayer may be liable for a 20 percent or 40 percent penalty.

(16). Why did the IRS pick 6 months? The March 23, 2009 memorandum communicating the approved penalty framework for resolving the civil side of offshore voluntary disclosures is effective for 6 months because the Service intends to re-evaluate the framework at that time. Six months is a reasonable time to close out a number of voluntary disclosures, evaluate our experience and the feedback from the practitioner community, and decide whether or how to continue the practice going forward.

(17). What happens at the end of 6 months? Will I get a better deal if I wait to see what the IRS does at the end of 6 months? Taxpayers should not wait until the end of the 6-month period to make their voluntary disclosures as there is no guarantee that the taxpayer will still be eligible or that the current penalty terms will be available after 6 months. Taxpayers who wait until the end of the 6-month period run the risk that they will be disqualified from the Voluntary Disclosure Practice. The IRS has stepped up its enforcement efforts, including the use of John Doe summonses, to identify taxpayers using offshore accounts and

entities to avoid tax. In addition, the IRS continues to receive information from whistleblowers and other taxpayers making voluntary disclosures. If the IRS receives specific information about a taxpayer's noncompliance before the taxpayer attempts to make a voluntary disclosure, the disclosure will not be timely and the taxpayer will not be eligible for the criminal and civil penalty relief available under the voluntary disclosure practice. Finally, taxpayers run a substantial risk that the uniform penalty structure described in the internal guidance will not be available past the 6-month deadline or that the terms will be less beneficial to taxpayers.

(18). What should I do if I am having difficulty obtaining my records from overseas? Our experience with offshore cases in recent years is that taxpayers are successful in retrieving copies of statements and other records from foreign banks when they genuinely attempt to do so. If assistance is needed, the agent assigned to a case will work with the taxpayer in preparing a request that should be acceptable to the foreign bank. The penalty framework described in the March 23 memorandum will apply to all voluntary disclosures in process within the 6-month timeframe, so difficulty in completing a voluntary disclosure started during that period will not disqualify a cooperative taxpayer from the penalty relief. The key is to notify the Service of your intent to make a voluntary disclosure as soon as possible, and in any event, by September 23, 2009.

[**Note.** FAQ 18 states, "Our experience with offshore cases in recent years is that taxpayers are successful in retrieving copies of statements and other records from foreign banks when they genuinely attempt to do so." Use of the term "genuinely" seems to telegraph an unwarranted degree of skepticism when applied to taxpayers who have already made the decision to come into compliance. Many taxpayers are experiencing extreme delays in retrieving information regarding their offshore accounts, especially capital gain/loss information.]

(19). Are entities, such as corporations, partnerships and trusts eligible to make voluntary disclosures? Yes, entities are eligible to participate in the IRS's Voluntary Disclosure Practice.

(20). Does the twenty percent penalty apply to entities? Does the twenty percent penalty apply only to cash and securities held in foreign accounts or entities or to tangible and intangible assets as well? The twenty percent penalty applies to entities. The twenty percent penalty applies to all assets (or at least the taxpayer's share) held by foreign entities (e.g., trusts and corporations) for which the taxpayer was required to file information returns, as well as all foreign assets (e.g., financial accounts, tangible assets such as real estate or art, and intangible assets such as patents or stock or other interests in a U.S. business) held or controlled by the taxpayer.

(21). Are taxpayers required to complete a questionnaire as part of the voluntary disclosure practice? There is no specific questionnaire for taxpayers to complete.

(22). Is there a list of questions taxpayers are expected to answer as part of the voluntary disclosure process? There is no standard list of questions for these cases. The Service may require an interview with the taxpayer making a voluntary disclosure, depending on the facts of each case.

[**Note.** However, as set forth in detail below, there are a series of questions commonly asked by CI to taxpayers pursuing a voluntary disclosure in this context.]

(23). When determining the highest amount in each undisclosed foreign account for each year or the highest asset balance of all undisclosed foreign entities for each year, what exchange rate should be used? Convert foreign currency by using the foreign currency exchange rate at the end of the year. In valuing currency of a country that uses multiple exchange rates, use the rate that would apply if the currency in the account were converted into United States dollars at the close of the calendar year. Each account is to be valued separately.

(24). Will I have to file or amend my old tax returns? Yes. Any tax return not filed during the previous 6-year period that was otherwise required to be filed by law, must be filed by the taxpayer. In addition, any inaccurate returns for any of the 6 years must be amended by the taxpayer.

(25). Besides federal income tax returns, what forms or other returns must be filed?

(a) Copies of original and amended federal income tax returns for tax periods covered by the voluntary disclosure;

(b) Complete and accurate amended federal income tax returns (or original returns, if not previously filed) of the taxpayer for all tax years covered by the voluntary disclosure;

(c) An explanation of previously unreported or underreported income or incorrectly claimed deductions or credits related to undisclosed foreign accounts or undisclosed foreign entities, including the reason(s) for the error or omission;

(d) If the taxpayer is a decedent's estate, or is an individual who participated in the failure to report the foreign account or foreign entity in a required gift or estate tax return, either as executor or advisor, complete and accurate amended estate or gift tax returns (original returns, if not previously filed) necessary to correct the underreporting of assets held in or transferred through undisclosed foreign accounts or foreign entities;

(e) Complete and accurate amended information returns required to be filed by the taxpayer, including, but not limited to, Forms 3520, 3520-A, 5471, 5472, 926 and 8865 (or originals, if not previously filed) for all tax years covered by the voluntary disclosure, for which the taxpayer requests relief; and

(f) Complete and accurate Form TD F 90.22-1, Report of Foreign Bank and Financial Accounts, for foreign accounts maintained during calendar years covered by the voluntary disclosure.

(26). If I had an FBAR reporting obligation for years covered by the voluntary disclosure, what version of the Form TD F 90-22.1 should I use to report my interests in foreign accounts? Taxpayers should use the current version of Form TD F 90-22.1, (revised in October 2008), to file delinquent FBARs to report foreign accounts maintained in prior years. The taxpayer may, however, rely on the instructions for the prior version of the form (revised in July 2000) for purposes of determining who must file to report foreign accounts maintained in 2007 and prior calendar years. Under both versions of the form, citizens and residents must file.

(27). If I don't have the ability to full pay can I still participate in the IRS's Voluntary Disclosure Practice? Yes. The March 23, 2009 guidance requires the taxpayer to fully pay all taxes and interest for all years covered, and the Voluntary Disclosure penalty, as well as all other unpaid, previously assessed liabilities, when the signed closing agreement is returned to the Service. However, it is possible for a taxpayer who is unable to make full payment at that time to submit a request that includes other payment arrangements acceptable to the IRS. The burden will be on the taxpayer to establish inability to pay, to the satisfaction of the IRS, based on full disclosure of all assets and income sources, domestic and offshore, under the taxpayer's control. Assuming that the IRS determines that the inability to fully pay is genuine, the taxpayer must work out other financial arrangements, acceptable to the IRS, to resolve all outstanding liabilities, in order to be entitled to the penalty relief set forth in the March 23, 2009 guidance.

(28). If the taxpayer and the IRS cannot agree to the terms of the closing agreement, will mediation with Appeals be an option with respect to the terms of the closing agreement? No. The penalty framework and the agreement to limit tax exposure to the most recent 6 years are package terms. If any part of the penalty framework is unacceptable to the taxpayer, the case will be examined and all applicable penalties may be imposed. Any tax and penalties imposed by the Service on examination may be appealed, but not the Service's decision on the terms of the closing agreement applying the penalty framework.

(29). I have a client who may be eligible to make a voluntary disclosure. What are my responsibilities to my client under Circular 230? The IRS expects taxpayers to seek qualified legal advice and representation in connection with considering and making a voluntary disclosure. If a taxpayer seeks the advice of a tax practitioner but nonetheless decides not to make a voluntary disclosure despite the taxpayer's noncompliance with United States tax laws, Circular 230, section 10.21, requires the practitioner to advise the client of the fact of the client's noncompliance and the consequences of the client's noncompliance as provided under the Code and regulations.

(30). Can I talk to the IRS without revealing my client's identity? Hypothetical situations present a potential for misunderstanding that exists when there is no assurance that the hypothetical contains all relevant facts. In addition, tax practitioners should be aware that posing a situation as a hypothetical does not satisfy the requirements of making a voluntary disclosure. If the IRS receives information relating specifically to the taxpayer's undisclosed foreign accounts or undisclosed foreign entities while the hypothetical question is pending, the taxpayer may become ineligible to make a voluntary disclosure. If practitioners have questions about the terms of the voluntary disclosure program, they should contact the IRS Voluntary Disclosure Hotline at (215) 516-4777, visit www.irs.gov, or contact their nearest CI office with questions. For a list of CI offices, visit: http://www.irs.gov/compliance/enforcement/article/0,,id

On June 24, 2009, the IRS issued additional FAQs regarding the Penalty Memos. Practitioners are encouraged to submit their questions and concerns regarding the Penalty Memos to the IRS Voluntary Disclosure Hotline (215) 516-4777 or to the representatives referenced in the Penalty Memos. The responsibility of bringing taxpayers into compliance is shared by practitioners and by the government.

Commonly Asked Questions in the Voluntary Disclosure Process

When approached regarding a voluntary disclosure in the context of a previously undisclosed offshore account, the IRS may require a taxpayer interview and can be expected to ask some or all of the following questions:

1. Is the taxpayer currently the subject of a criminal investigation?
2. Has the IRS notified the taxpayer that they are under a civil or criminal audit?
3. Is the taxpayer the subject of an investigation by any federal or state agency?
4. Does the taxpayer have reason to believe that the United States has obtained information about the taxpayer's liability?
5. Was any of the money obtained through illegal purposes?
6. Has a Bank or the Swiss Government notified the taxpayer that the IRS has requested information about the taxpayer?
7. What prompted you to come into Voluntary Disclosure program?
8. Where are the funds held regarding the disclosure?
9. Do you have any records? If not, are you working with the bank to obtain these records?
10. When was the account opened?
11. How was the account opened; what was the process?
12. Who assisted you with the opening of the account(s)?
13. Who told you about the Bank and how to initiate opening an account?
14. Do you have a Trust established relating to the account or the funds?
15. How did you deposit the money and withdraw the money from the account?
16. Did you have any credit or debit cards associated with this account?
17. How did you correspond with the Bank and did you retain any records relating to this correspondence?
18. Who is your point of contact with the Bank?
19. Did you ever meet face-to-face with anyone from the Bank; and if so, where and when?
20. Did you travel outside the U.S. to conduct business relating to your account or tax activities?
21. Where were your bank statements sent?
22. Who has access to this account; is it a joint account?
23. What is the source of these funds?
24. Have you filed tax returns for the years this account was open?
25. Have you prepared amended tax returns? If so, have they been submitted to IRS?
26. Who prepared the tax returns?
27. When were your returns prepared?
28. When the returns were initially prepared, did the tax preparer know about these overseas bank accounts?
29. Did you file FBARs? If not, what was the reason?
30. Does this involve an inherited bank account?
31. Did you trade U.S. or foreign securities with this account?
32. Have you controlled, directly or indirectly, any foreign entities and did you file any required returns for them?
33. If a UBS client, have you been notified that the U.S. has requested information regarding your account?
34. What countries do you have accounts in?

Moving Forward

Recent law enforcement efforts and the changing environment concerning bank secrecy may lead the IRS to many—but certainly not all—taxpayers having previously undisclosed interests in offshore accounts. In the context of voluntary disclosures concerning offshore issues, the IRS has taken the position that, to qualify for treatment under the Penalty Memos, a taxpayer will be required to make a full disclosure at the outset of his or her name, taxpayer identification information, and the facts surrounding the offshore issue. IRS field personnel are authorized to enter into closing agreements within the guidelines of the Penalty Memos and can be expected to interpret the Penalty Memos as their "marching orders." The IRS is committed to enforcement concerning offshore accounts, and can be expected to continue to enhance these efforts.

The Penalty Memos provide a degree of certainty regarding the civil penalties to be applied to the specified tax years. Those not participating in this offshore penalty initiative retain the ability to argue against penalties based on reasonable cause, nonwillfulness, *etc.* To protect the integrity of the Penalty Memos it could be difficult for the IRS to later administratively agree to lesser penalties. However, a lower FBAR penalty could statutorily apply where there was no willfulness and/or where there was reasonable cause and the other information penalties could be excused where there was reasonable cause. The IRS could look beyond the stated six tax years if there were a determination of civil fraud and it could look to enforce various information return penalties that have historically been ignored.

The Penalty Memos will work for some, but certainly not all. For most taxpayers facing these issues, the Penalty Memos may result in the loss of a significant amount of the offshore funds, but will still leave some funds available. For some, however, the Penalty Memos are unduly harsh. For example, the amount in such an account at its highest point in the past six years is typically significantly greater than the amount in the account today. By attaching the 20-percent FBAR penalty to the year with the highest account value, the IRS appears to have missed the mark of encouraging many other taxpayers to come into compliance.

In many countries, "estate planning" takes the form of adding family members to financial accounts. When some family members relocate to the United States, they unknowingly become subject to the FBAR filing requirements even though they may have no actual present economic interest in the offshore accounts. Similar situations exist for those having a power of attorney over a family member's offshore account but not having any present economic interest in the account. Finally, the vast majority of individuals (and many practitioners) have historically been completely unaware of the existence of the FBAR. Especially for these individuals, the automatic 20-percent FBAR penalty may be the deciding factor.

The IRS has long encouraged participation in the voluntary disclosure process for all taxpayers, those with interests in offshore accounts and otherwise. In the context of undisclosed offshore accounts, the process has presently been formalized, at least through September 23, 2009. It is difficult to determine the potential administrative resolution of civil penalties for those who do not participate in the framework set forth in the Penalty Memos.

Hopefully, the current effort to attract those with previously undisclosed accounts will not forever damage the longstanding integrity of the IRS voluntary disclosure process set forth in IRM 9.5.11.9. Any effort to subject a taxpayer to a criminal investigation or for the Department of Justice to actually prosecute a taxpayer who, in good faith reliance upon statements of many within the IRS and otherwise, made either a timely "quiet" or "noisy" voluntary disclosure would effectively be the end of the voluntary disclosure process in the United States. Lessons learned in Vietnam and Iraq dictate that we not destroy the village in our efforts to save it ...