Practice

By Charles P. Rettig

IRS Offshore Voluntary Disclosure Program: Opt-Outs, a Revised FBAR and Rescissions of Pre-Clearance Letters by Criminal Investigation

Wolters Kluwer
CCH

Charles P. Rettig is a Principal with Hochman, Salkin, Rettig, Toscher & Perez, P.C. in Beverly Hills, California. Mr. Rettig is Past-Chair of the IRS Advisory Council, a member of the Advisory Board for the California Franchise Tax Board and for the California State Board of Equalization and a Regent and Elected Fellow of the American College of Tax Counsel.

For years, the IRS has been pursuing—with mixed success—the disclosure of information regarding undeclared interests of U.S. taxpayers (or those who ought to be U.S. taxpayers) in foreign financial accounts. For more than a year, numerous taxpayers with previously undisclosed interests in foreign financial accounts and assets have been seeking participation in the current IRS offshore voluntary disclosure program (the OVDP, which began in 2012), modeled after similar programs in 2009 and 2011. Taxpayers participating in the OVDP generally agree to file amended returns and file Forms 90-22.1, *Report of Foreign Bank and Financial Accounts (FBARs),* for eight tax years, pay the appropriate taxes and interest together with a 20-percent accuracy-related penalty and an "FBAR-related" penalty (in lieu of all other potentially applicable penalties associated with a foreign financial account or entity) of 27.5 percent of the highest account value that existed at any time during the prior eight tax years. The OVDP does not have a stated expiration date, but can be terminated by the IRS at any time as to specific classes of taxpayers or as to all taxpayers.

Under the Bank Secrecy Act, U.S. residents or a person in and doing business in the United States must file a report with the government if they have a financial account in a foreign country with a value exceeding $10,000 at any time during the calendar year. Taxpayers comply with this law by noting the account on their income tax return and by filing the FBAR. Willfully failing to file an FBAR can be subject to both criminal sanctions (*i.e.,* imprisonment) and civil penalties equivalent to the greater of $100,000 or 50 percent of the balance in an unreported foreign account, per year, for up to six tax years. FBARs for 2012 are due on June 30, 2013—without the possibility of an extension.

FBAR Revisions

The FBAR form is in the process of being revised with a new form likely to be released in September 2013. Practitioners should note the differences with previous forms whenever the government issues a new form. It takes considerable resources to modify a government form, and modifications are typically brought on by an analysis of missing information, ease of processing (perhaps electronically), to enhance future enforcement efforts, *etc.*

OVDP Letter Revisions

Participation in the OVDP begins by providing IRS Criminal Investigation (CI) with the taxpayer's name, address, taxpayer identification number and date of birth. No other information is required nor should additional information be provided, at least until issuance by CI of a "pre-clearance letter" indicating that the taxpayer has been pre-cleared into the OVDP. Thereafter, taxpayers proceed with a more complete disclosure in the form of a summary letter with attachments known as the Offshore Voluntary Disclosure Letter. Effective March 2013, this letter has been updated and revised into IRS Forms 14457 and 14454. A CI clearance letter is typically issued following submission of the Offshore Voluntary Disclosure Letter, and taxpayers then submit amended income tax returns, FBARs, a penalty worksheet and related account information.

Wolters Kluwer CCH

Rescissions of Pre-Clearance Letters by CI

Issuance of the pre-clearance and clearance letters within the OVDP is intended to provide a degree of assurance to the taxpayer that their voluntary disclosure has been timely and can proceed without potential for a criminal referral to the Tax Division of the Department of Justice for criminal prosecution. However, in recent months, various taxpayers who long ago received pre-clearance letters—including many who then proceeded to disclose additional information regarding their previously undisclosed interests in foreign financial accounts—have had their criminal referral clearance rescinded by CI. Many received letters indicating, "Although your client was informed that he was accepted into the Offshore Voluntary Disclosure Program (OVDP) on or about [date], upon further review it has been determined that your client is disqualified from the OVDP." Oops!

Many of these taxpayers have accounts at either Bank Leumi or Bank Mizrahi and it remains possible that such rescissions may have been issued in connection with a much larger, more ominous future investigation (of a financial institution, of an advisor, of a related taxpayer, *etc.*). Not dissimilar to the process of rounding up the potential targets in other criminal tax investigations and then figuring out which are the most culpable. So far, the government has been silent regarding the possible basis for such rescissions. However, it would seem difficult for the government to actually pursue criminal prosecutions of individuals who pre-cleared without a strong showing that such a prosecution is not based on tainted evidence.[1] Perhaps these individuals might not ultimately be afforded any civil benefits otherwise associated with participation in the IRS OVDP, *etc.* Some of these individuals may actually never hear from the government again ... time will tell.

Participating in the OVDP and Opting Out

There are various considerations before a taxpayer should determine whether to pursue a voluntary disclosure of prior tax indiscretions through the OVDP or through amending returns or in some other manner. When reviewing the OVDP, many look to whether the taxpayer might be considered a realistic candidate for a criminal prosecution referral by the IRS or prosecution by the Department of Justice. (If so, the determination to participate was relatively quick and easy.) Is there a possibility of reducing that prospect by filing amended or delinquent returns and FBARs in lieu of a direct participation in the OVDP? What would be the potentially applicable penalties upon an examination of such returns and FBARs? Could the government actually carry their burden of demonstrating that the taxpayer "willfully" violated the FBAR filing requirements? Since the OVDP asserts an offshore penalty based on foreign financial accounts *and* asset valuations, for many with smaller financial account values, the aggregate offshore penalty determination, even for multiple years, is actually less outside the OVDP.

The IRS has recently afforded those indicating a desire to opt out with the opportunity to provide a "reasonable cause letter" explaining why they should be subjected to some lesser penalty set forth in the OVDP. The decision to opt out must take into account all relevant facts and circumstances as well as

©2013 CCH Incorporated. All Rights Reserved.

the possibility of expansive IRS discretion to perform examinations over a lengthy period of time. Before opting out, taxpayers should carefully review the recent court decisions in *Williams* and *McBride* on the issue of determining "willfulness" for assertion of the more significant FBAR penalties (of up to 50 percent of the account balance, per year).[2] Although the underlying facts in each case were not the best, the courts might not lightly view those with considerable financial resources who fail to inquire about their potential reporting requirements associated with various interests in foreign financial accounts.

Participants in the OVDP should consider the possibility of "opting out" of the program, but only if their facts are unique. Having inherited funds in a foreign financial account, without more, might not be considered deserving by the IRS of some lesser penalty regime. Opt-out considerations often include the source and amount of funds, how long the account has been maintained, whether there were withdrawals or deposits into the account or the account was moved to another foreign financial institution at some point, whether the taxpayer's advisors had some degree of knowledge about the account, the sophistication and education of the taxpayer, whether foreign entities were involved as accountholders, *etc.* Remaining in the OVDP can be economically oppressive given the penalty structure but it avoids exposure to numerous additional penalties associated with the income tax returns and various required foreign information reports, a detailed examination, and limits the number of tax years at issue while also providing certainty with respect to the avoidance of a referral for criminal tax prosecution.

Taxpayer Interview Questions

Numerous taxpayers having previously undisclosed interests in foreign financial accounts have been interviewed by representatives of the IRS as well as many having been interviewed by prosecutors associated with the Tax Division of the Department of Justice. Questions relating to the opening of the account often inquire about who advised and assisted in opening the account; whether the advisor was a bank employee or an employee of an outside asset management company; where did the account opening(s) take place; how often the taxpayer traveled to the foreign institution or their advisor and for what reason; documents provided by the taxpayer to open the account (*i.e.*, passport(s), identification card, *etc.*; note that it is not a good fact for a taxpayer having dual passports to open an account with their non-U.S. passport); whether the taxpayer was asked to sign any documents or forms, including Form W-9; and identification of the advisors and representatives involved at the foreign financial institution and all communications with such individuals.

Additional questions relate to the use of foreign entities to hold title to the account(s). Specifically, why the entity was created (*i.e.,* insurance products, trust, foundation, corporation, annuity, *etc.*); who formed the entity; who managed the entity; and whether the entity is still in existence. The taxpayer will be asked to disclose all communications with their domestic and foreign advisors, including when, where and in what form the communications took place; who was present and/or participated in the communications; what communications were had with the representative about the IRS OVDP; communications, if any, that occurred regarding bank secrecy, taxation and/or disclosure of any foreign accounts; and whether letters, postcards or other personal mailings were ever sent or received.

The government will inquire about various services offered by the foreign institution and/or client advisor, including whether the creation of a foreign company, entity or foundation was ever recommended; was a credit card or debit card linked to the offshore account ever offered; was there ever a recommendation to repatriate funds to the United States using a foreign relative or entity; were there any offers to deliver or accept currency in the United States; was there any advice given on how to transport currency into the United States; were calling cards or cell phone services ever provided; and whether there were offers to move assets to another institution.

Management and administration of the foreign financial account is always of interest to the government. Taxpayers should anticipate questions regarding any instructions received regarding contacting the bank or the representative; instructions or advice received regarding receiving mail from the bank; instructions or advice received regarding taking bank statements or other bank documents from the bank; instructions or advice received regarding withdrawing funds; instructions or advice received regarding the formation of a foreign entity to hold the account and who to contact regarding formation of an appropriate entity.

Deposits and withdrawals to the foreign account can reveal intentions and knowledge of

various individuals involved. The government can be expected to inquire about the manner in which deposits and/or withdrawals were made to/from the foreign account(s); the mechanics of how deposits/withdrawals were made; the form in which deposits/withdrawals occurred (*i.e.,* cash, check, wire, travelers' check, *etc.*); amounts that were withdrawn/deposited each time; when such deposits/withdrawals occurred; where such deposits/withdrawals occurred; whether there were there limitations on the amounts that could be deposited/withdrawn; and documents received a deposit/withdrawal occurred (*i.e.,* receipt, credit memo, debit memo, *etc.*). There will also be inquiries into the documentation received by or shown to the taxpayer regarding their accounts (*i.e.,* account statements, account opening documents, *etc.*); whether such documents contained names of entities or the financial institution or account numbers; and whether the taxpayer retained the documentation.

Lastly, taxpayers should anticipate the government inquiring as to whether the foreign accounts remain open and if not, where the funds were transferred when the account(s) were closed. Some taxpayers closed accounts and wire transferred the funds directly to a domestic account. Others closed accounts and transferred the funds through various means to other foreign accounts. Further questions often lay within the responses to each of the foregoing questions. Decisions regarding opting out should be carefully considered depending upon the taxpayers responses to each of the foregoing questions.

Wolters Kluwer CCH

Waiting Is Not a Viable Option

Appropriately, the ability of a U.S. taxpayer to maintain an undisclosed, "secret" foreign financial account is fast becoming nonexistent. There are regular reports of sizable amounts of information regarding foreign accountholders being delivered to the government. Foreign account information is flowing into the IRS under tax treaties, through submissions by whistleblowers, from others who participated in previous offshore voluntary disclosure programs who have been required to identify their bankers and advisors. Additional information is becoming available as the government mines information received under the Foreign Account Tax Compliance Act (FATCA) and from Foreign Financial Asset Reporting (Form 8938).

Within the past few months, foreign institutions in Asia, the Middle East and elsewhere have advised their account holders to consult U.S. tax advisors regarding the IRS voluntary disclosure program and their U.S. tax reporting relating to their foreign financial accounts. It is reasonable to assume that such institutions will take whatever action is necessary to avoid being indicted, beginning with the delivery of information regarding account holders to the U.S. government. Taxpayers having undisclosed interests in foreign financial accounts must consult competent tax professionals before deciding to participate in the OVDP. Some may decide to risk detection by the IRS and the imposition of substantial penalties, including the civil fraud penalty, numerous foreign information return penalties, and the potential risk of criminal prosecution.

Tax advisors have long preached the numerous economic benefits of getting into compliance ahead of any government inquiry. Those who come into compliance would add a significant noneconomic benefit, commonly referred to as the "sleep at night" factor. With the OVDP, the IRS has provided yet another opportunity for formerly noncompliant taxpayers to improve their future U.S. investment and business opportunities. If discovered before any voluntary disclosure submission, the results can be devastating. Waiting is not a viable option.

Endnotes

[1] *See Kastigar*, SCt, 406 US 441 (1972).

[2] *B. Williams*, CA-4, 2012-2 USTC ¶50,475, 489 FedAppx 655; *McBride*, DC-UT, 2012-2 USTC ¶50,666.

This article is reprinted with the publisher's permission from the Journal of Tax Practice & Procedure, a bi-monthly journal published by CCH, a part of Wolters Kluwer. Copying or distribution without the publisher's permission is prohibited. To subscribe to the Journal of Tax Practice & Procedure or other CCH, a part of Wolters Kluwer Journals please call 800-449-8114 or visit CCHGroup.com. All views expressed in the articles and columns are those of the author and not necessarily those of CCH, a part of Wolters Kluwer or any other person.

©2013 CCH Incorporated. All Rights Reserved.