

2011 OFFSHORE VOLUNTARY DISCLOSURE INITIATIVE

Federal/International Tax Alert
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On February 8, 2011, IRS Commissioner Douglas Shulman announced that the IRS is implementing a second offshore voluntary disclosure program. The 2011 Offshore Voluntary Disclosure Initiative (OVDI) offers reduced penalties for taxpayers who failed to report non-U.S. financial accounts and assets on an FBAR (IRS Form TD F 90-22.1—Report of Foreign Bank and Financial Accounts) and who failed to report income from those accounts and assets on their U.S. income tax returns but who come forward now.

In 2009, the IRS offered a similar voluntary disclosure program for such taxpayers that ended on October 15, 2009. The IRS received thousands of additional voluntary disclosures after the end of the 2009 program. The 2011 OVDI is in response to the success of the 2009 program and the thousands of additional voluntary disclosures that the IRS received after the end of the 2009 program.

The look-back period for the 2011 OVDI is eight years (2003 through 2010). The penalty scheme under the 2011 OVDI is as follows: (1) a one-time 25 percent penalty on the highest aggregate annual balance in the unreported accounts in the look-back period (an increase from the 20 percent penalty under the 2009 program) and (2) a 20 percent accuracy-related penalty or delinquency penalties on the amount of U.S. income tax that should have been paid on any unreported income from the non-U.S. accounts in the look-back period. However, a taxpayer with offshore accounts or assets that, in the aggregate, did not surpass \$75,000 in any calendar year covered by the 2011 OVDI will qualify for a new 12.5 percent rate. No such reduction was provided in the 2009 program, but the IRS has indicated that taxpayers who came forward under the 2009 program can apply for retroactive application of the 12.5 percent rate, if eligible. A 5 percent rate may also apply in certain limited circumstances. Notably, it appears that the IRS will allow the reduced 5 percent penalty for certain foreign residents who were unaware that they were U.S. citizens. The 2011 OVDI also offers a modified mark-to-market election for taxpayers with interests in passive foreign investment companies (e.g., foreign mutual funds) to determine the income from such investments.

The 2011 OVDI is available to those taxpayers who came forward after October 15, 2009 and will be available through August 31, 2011. Taxpayers participating in the 2011 OVDI must submit all original and amended tax returns and information

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returns (including FBARs) and must pay (1) back taxes, (2) interest, (3) the applicable one-time penalty on the highest aggregate annual balance in the unreported accounts, and (4) the 20 percent accuracy-related penalty or delinquency penalties, all by the August 31, 2011, deadline.

The IRS launched a new section on www.irs.gov that includes the full terms and conditions of the 2011 OVDI, including an extensive set of questions and answers to help taxpayers and tax professionals. The website also contains information about the new streamlined procedure for making a voluntary disclosure.

Under the 2011 OVDI, the IRS is forgoing other potentially applicable penalties—for example, for civil fraud (75 percent of unpaid tax), for failure to file various information returns (e.g., Form 5471), and for willful failure to file the FBAR (the greater of \$100,000 and 50 percent of the foreign account balance), all of which apply annually. Moreover, those who come forward by August 31, 2011, mitigate their risk of criminal prosecution. In announcing the 2011 OVDI, Commissioner Shulman warned that “IRS efforts in the international area will only increase as time goes on.”