



IRS Announces a Third Offshore Voluntary Disclosure Initiative

On Jan. 9, 2012, the Internal Revenue Service (IRS) announced it was opening its Offshore Voluntary Disclosure Initiative (OVDI) for a third time, to allow taxpayers to avoid criminal penalties and reduce exposure to civil monetary penalties by disclosing their offshore bank accounts and other foreign assets to the government. The 2012 OVDI is similar to the previous OVDIs and came after the IRS commissioner had previously announced that there would be no further OVDI after the 2011 program closed.

The federal tax system is a voluntary system that relies on taxpayers to completely and accurately report their income and deductions, and pay their taxes. The IRS recently released a report that individuals and businesses underpay their taxes by an estimated 17 percent each year, resulting in an underpayment of almost \$450 billion. Taxpayers who intentionally under report their income, over report their deductions or fail to disclose foreign activities risk significant criminal penalties. For taxpayers who have a guilty conscience or second thoughts, the Internal Revenue Manual has a voluntary disclosure practice that allows taxpayers to voluntarily come forward to reduce the chance of a criminal investigation and prosecution.

Although an IRS voluntary disclosure does not automatically guarantee immunity from prosecution, historically the IRS has not pursued criminal charges against taxpayers who meet the requirements of the voluntary disclosure practice. A voluntary disclosure occurs when a taxpayer in a manner truthful, timely and complete notifies the IRS of issues on tax returns or other documents filed with the IRS.

Timeliness is the most important factor for a voluntary disclosure. A disclosure

is timely if it is made before the IRS has initiated a civil examination or criminal investigation of the taxpayer, or before the IRS has notified the taxpayer that it intends to commence a civil examination or criminal investigation. A disclosure is not timely if it is made after the IRS receives information from either a third party alerting the IRS to the taxpayer's noncompliance or after a criminal enforcement action, such as a search warrant or grand jury subpoena.

A taxpayer who is concerned that a third party, such as a former spouse, disgruntled employee or former business partner, may provide information to the IRS should consider making a voluntary disclosure before the third party contacts the IRS. In these situations, establishing the day, and even the time, a disclosure was made to the IRS can be critical.

The IRS has publicly announced that it does not consider a "quiet disclosure" to be a voluntary disclosure as defined by the Internal Revenue Manual. A quiet disclosure occurs when a taxpayer files amended returns and does not notify the IRS or agree to cooperate and pay any resulting tax, penalty and interest. As a result, a taxpayer making a quiet disclosure

risks exposure to a criminal investigation and possible prosecution.

In 2009, the IRS introduced a special variation of its voluntary disclosure practice, the OVDI. The 2009 OVDI allowed taxpayers who had failed to disclose to the IRS offshore activities, such as offshore bank accounts and interests in foreign entities, to disclose this information to the IRS and thereby avoid potential criminal penalties and reduce potential civil penalties.

Although the 2009 OVDI was available to all taxpayers, the genesis of the initiative was the agreement between the United States and Switzerland releasing 4,450 names of U.S. persons with accounts at the Swiss bank, UBS. Approximately 15,000 taxpayers, with bank accounts in more than 60 countries, came forward to participate in the 2009 OVDI, agreeing to pay additional tax for the years 2003 through 2008, a 20 percent penalty and interest on the additional tax due, and a penalty equal to 20 percent of the highest account balance during the years 2003 through 2008. The 2009 OVDI concluded on Oct. 15, 2009, with the IRS collecting billions in additional tax penalties and interest.

Hoping to duplicate the success of the 2009 OVDI, in early 2011, the IRS announced the 2011 OVDI. The 2011 OVDI was similar to the 2009 OVDI, but with more restrictive terms and higher civil penalties. Participants in the 2011 OVDI paid additional taxes and interest for the years 2003-2010 plus accuracy-related penalties, if applicable. The penalty framework also required an additional penalty of 25 percent of the highest aggregate account balance for the years 2003 to 2010. For offshore accounts with

an aggregate balance of less than \$75,000, there was a reduced penalty of 12.5 percent. Under limited circumstances, the penalty could be reduced to 5 percent.

The deadline for participating in the 2011 OVDI and submitting all necessary information, including all amended tax returns, was Aug. 31, 2011. Although the IRS commissioner had previously announced there would be no further OVDI after the 2011 program closed, on Jan. 9, 2012, the IRS announced it was opening the OVDI door for a third time. As of this writing, the terms of the 2012 OVDI are similar to the 2011 OVDI with a few small, but important changes. Under the 2012 OVDI, the highest penalty is 27.5 percent instead of 25 percent, with the 12.5 percent penalty and the 5 percent penalty

still available for taxpayers who meet certain criteria. In addition, the 2012 OVDI is open ended, likely in recognition of the numerous taxpayers who made post-2011 OVDI disclosures and those who would like to do so with some assurance regarding their exposure. In announcing the 2012 OVDI, the IRS cautioned that the terms of the program could be changed at any time, including increasing the penalties for some or all taxpayers, redefining the terms of the reduced penalties or redefining the class of taxpayers who are eligible for reduced penalties. The IRS also warned that the program could be terminated at any point.

Any voluntary disclosure to the government must be handled carefully, but especially a voluntary disclosure under the OVDI. In the wake of the focus on

foreign activity, the IRS has investigated and indicted numerous individual taxpayers and professional advisors. In addition, it has negotiated non-prosecution agreements with many foreign banks that include payment of large penalties and agreements for turning over the identity of U.S. taxpayers with accounts. The IRS and the Department of Justice are continuing their efforts to obtain information from foreign banks, including banks in India, Hong Kong, Israel and other jurisdictions beyond Switzerland.

The IRS is reviewing the information it has obtained from recent enforcement efforts and is looking for U.S. taxpayers to investigate and prosecute. It is critical to analyze all the risks before deciding to participate in the 2012 OVDI. ■



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