

Client Alert.

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IRS Considers New Partial Amnesty Program for Offshore Accounts: Strategic Considerations for Taxpayers

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Taxpayers who hold any interest in, or signature authority over, a foreign bank account are required to indicate that on Schedule B of the Form 1040, and also file with the Treasury a Report of Foreign Bank and Financial Accounts, Form TD F 90-22.1 (the "FBAR" form). Those who fail to declare the accounts and file the forms can be subject to criminal prosecution as well as harsh civil penalties.

Last December, the Commissioner of Internal Revenue announced that the Internal Revenue Service may institute a second Voluntary Disclosure Program for taxpayers with undeclared foreign bank accounts, allowing them to avoid criminal prosecution upon full and complete disclosure of the accounts along with the payment of back taxes on undeclared income and penalties. And earlier this week, an IRS spokesman confirmed that formal announcement of the program was coming "very shortly."

The first voluntary disclosure initiative for offshore accounts, effective from March through October of 2009, elicited disclosures from about 15,000 taxpayers. Those taxpayers avoided criminal prosecution and possible prison time by generally paying six years of back taxes (with interest) on the declared income in those foreign accounts as well as the accuracy-related penalty for underpayment of taxes, if mathematically applicable. In addition, they paid a penalty of 20% of the highest value in the undeclared foreign account during the six-year period.

Another 3,000 or so taxpayers have made voluntary disclosures of foreign bank accounts since the first amnesty program expired on October 15, 2009. They face undetermined penalties, but have greatly reduced the likelihood that they would be criminally prosecuted.

Now that the IRS has announced its consideration of a new partial amnesty program, it raises questions for taxpayers about: what the penalties would likely be under such a program; what the penalties may be for taxpayers who disclosed after the first program but before the second; and what are the strategic considerations for taxpayers with undeclared foreign bank accounts who have not yet made any voluntary report. It is possible that taxpayers who disclosed after the first program will be swept into the new program.

Taxpayers who did not avail themselves of the special voluntary disclosure program with respect to foreign bank accounts that ended in October of 2009 have some new considerations. For any taxpayer who thought (wrongly) that IRS inquiries would be limited to taxpayers with accounts at a prominent Swiss bank that has been in the news frequently during the last few years, they should note that the IRS has emphasized that it will pursue other banks for information on U.S. account holders. At least two candidates have been named as likely candidates for such actions, one being another well-

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known Swiss bank and one being an Asian bank. We understand that the Justice Department is also including smaller Swiss cantonal banks in its ever-widening investigation. One thing is clear, the mere fact that a taxpayer's bank has not yet been the subject to IRS inquiries, does not mean that it will not be.

Also, the new Foreign Account Tax Compliance Act ("FATCA") ensures that more information about foreign accounts will become available to U.S. enforcement authorities. FATCA will make it much more likely that any foreign financial institution, and non-financial foreign entities, will either require detailed information on U.S. account holders or stop serving U.S. customers. Absent such steps, a 30% withholding tax would apply to certain U.S.-source payments made to such entities. Not to mention that FATCA imposes new disclosure requirements on U.S. taxpayers who have certain specified foreign financial assets (which could include not just foreign bank accounts, but any interest in a foreign entity) worth over \$50,000. Section 6038D of the Internal Revenue Code will require that information about such foreign accounts or assets be filed with the IRS on an information return that would be filed with the Form 1040. With the current emphasis on international transparency and global enforcement, taxpayers must assume that the IRS will continue to pursue information on foreign accounts, with more tools at its disposal.

What, then, does a taxpayer do if he or she missed the first special voluntary disclosure program? One answer is that a taxpayer could still make a voluntary disclosure under the general voluntary disclosure rules set forth in 9.5.11.9 of the Internal Revenue Manual. Of course, the taxpayer would need to meet all the requirements for such a voluntary disclosure, including that he or she has not been previously identified by the IRS and that relevant income not be from illegal sources. The taxpayer must also cooperate completely with the IRS and make arrangements to pay, in full, any tax, penalties, and interest the IRS determines are due.

One concern of taxpayers using the general voluntary disclosure procedure is that there is no guidance on the penalties they may be assessed with respect to unreported foreign bank accounts. Indeed, penalties range up to 50% of the maximum account value for each year in which the account was not reported. Under the first special voluntary disclosure program, one penalty at the rate of 20% of the maximum account value for the six-year period preceding the voluntary disclosure (generally 2003 – 2008) was imposed. This gave taxpayers certainty, rather than a wide range of potential penalties.

We do not know what penalties will apply under any new partial amnesty program for offshore accounts. We think any new program is likely to follow the same approach of providing certain penalties for all participants. One reasonable surmise is that a second program might have enhanced understatement penalties and/or higher penalties on account values — perhaps in the range of 30-35%. But this is only a surmise and taxpayers should discuss their own situations with an advisor before making decisions. IRS Deputy Commissioner for Services and Enforcement, Steve Miller, described the new program as "somewhat similar" to the prior program.

Of course, taxpayers have indeed used the general voluntary disclosure procedure under IRM 9.5.11.9 since October 15, 2009. Those taxpayers have exhibited their good faith and cooperation as part of their voluntary disclosure. Having done so, they should not be in a worse position than those who come forward late under any new special voluntary disclosure program. Rather, their candor (exercised without certainty surrounding the level of penalties that will be imposed) should arguably entitle them to more favorable treatment. In addition, there is an incentive to treat persons who voluntarily disclosed under the general voluntary disclosure program in a uniform manner, at least if their voluntary disclosure related solely to a previously unreported foreign bank account. A new voluntary disclosure program would be a time when the IRS could come forward with such a uniform approach.

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Certain taxpayers, of course, may have facts that preclude them from utilizing the general voluntary disclosure program, or personal circumstances that are more complex than the simple maintenance of a foreign bank account. We at Morrison & Foerster advise taxpayers in voluntary disclosures, criminal tax matters, and complex civil tax controversies and examinations.

This Client Alert is an update to a previous Alert dated January 25, 2011, which can be found [here](#).

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