Link to Article on website

Popular US voluntary disclosure program is ending: should you rush to participate?

The IRS has announced that the Program will terminate on September 28th, 2018.

BY:
Seth Cohen, Regional Partner
ZHONG LUN

DURING THIS TIME OF POLITICAL VOLATILITY, the US has enacted a major overhaul of its tax law. In addition to these sweeping changes, a very successful voluntary disclosure program providing for leniency/forgiveness to those who have not followed US tax and banking reporting requirements is also being terminated. The Offshore Voluntary Disclosure Program (the "Program") provides taxpayers, who might otherwise be facing very large civil (and even criminal) penalties, the ability to receive a civil resolution within a well-defined framework of tax,

hubbis

interest and penalty payments. The catch? There must be a disclosure to the US of all compliance failures before being caught. The IRS has announced that the Program will terminate on September 28th, 2018.

The question that those with tax non-compliance issues should be asking themselves is: in light of the Program's imminent termination, should I participate? While this is a complicated question and one that can have dire consequences if answered incorrectly, frequently the answer is: "No."

Introduction

The Program is for taxpayers who have wilfully or purposely failed to report income, accounts and assets located offshore to the US. The relief it affords comes at a hefty price both in terms of the amount that must be paid plus professional fees and the information that must be given to the US. However, there are cheaper (and less invasive) alternatives under many circumstances.

HISTORICALLY, MANY HAVE BEEN LEGITIMATELY UNAWARE THAT THE US TAXES ITS CITIZENS, GREEN CARD HOLDERS AND CERTAIN VISA HOLDERS ON THEIR INCOME EARNED WORLDWIDE.

Historically, many have been legitimately unaware that the US taxes its citizens, green card holders (permanent residents) and certain visa holders on their income earned worldwide. Since the Program's inception in 2009, just after the US began focusing on the pursuit of its taxpayers who did not properly report their offshore assets and accounts, over 50,000 US taxpayers have participated. The information that has been derived from those investigations is still being reviewed by the US but those with these sorts of compliance failures should be fearful of discovery. Furthermore, the world is getting smaller thanks to the enactment of US FATCA, OECD CRS and BEPS initiatives, as increasing economic ties between countries have fostered cooperation and information sharing through agreements and treaties of all sorts.

Who should be concerned?

Generally, taxpayers who have run afoul of the US web of reporting obligations fall into two broad categories; those who live inside the US and those who live outside the US.

Those who live within the US (especially those who immigrated there), might have failed to report their income derived from offshore employment and assets, believing that since those activities occurred offshore, they would properly not be reportable to the US. A typical fact pattern: Mr. X came to the US to study and decided to stay. He has faithfully reported all of his income to the US for 40 years. Five years ago, after a health scare, his father, who resides in Beijing and has never been to the US, started gifting Mr. X shares of his successful business corporation. Further, his father has added Mr. X to several of his bank accounts should he at some point be unable to care for himself as he aged. In this case, US law will

likely require Mr. X to report his ownership of the family business and to report and pay tax on the earnings from those bank accounts.

Those who live offshore but remain subject to US taxation may not realise that they continue to bear the responsibility to file tax and information returns. As an example, Mr. X attended university in the US and after completing his degree, obtained a green card to begin his career there. After working for ten years, he returned to Shanghai and has not been back to the US. However, upon departing the US, he has failed to properly give up his green card. In this case, the US would assert that he should have been filing tax and information returns and reporting and paying tax on all of his income earned during the intervening years.

Both individuals in the above examples may have believed that the US imposes tax exclusively on earnings from US-based assets and employment compensation earned within the US. This misunderstanding of US tax law is often reasonable and innocent, since most of the world's nations impose tax based upon where income is earned. All too frequently, however, the first time one learns of their filing responsibility is when a bank sends a letter, or the US investigates.

The Program

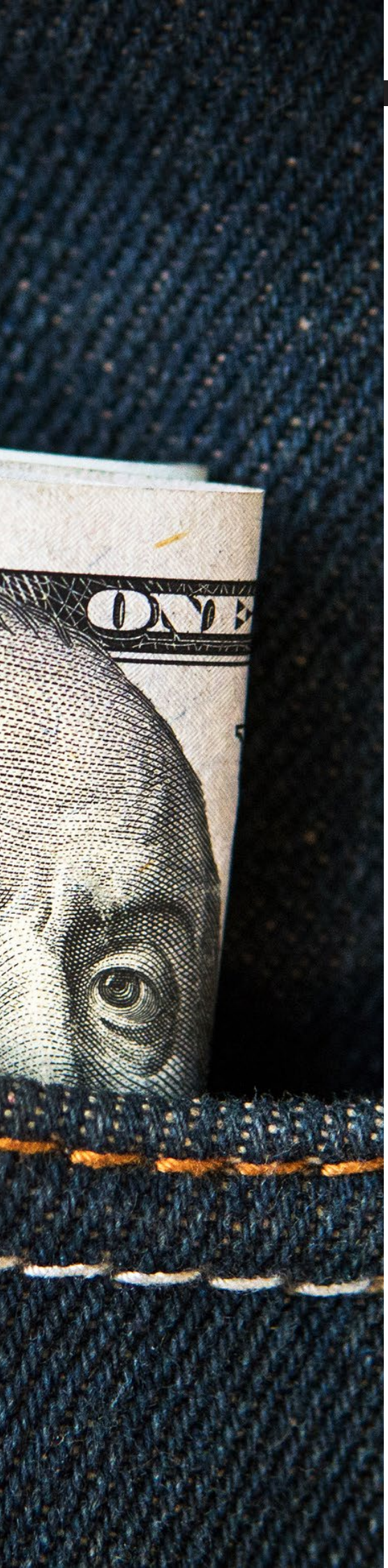
The Program is for those who have omitted foreign (and sometimes domestic) income and are unable to counter allegations made by the IRS that they wilfully failed to file informational returns on their foreign bank accounts ("FBARs"). Next to being involuntarily dragged into an investigation for wilfully failing to file FBARs, it is the most expensive way to fix these compliance issues. It is expensive in large part because of the miscellaneous penalty imposed in lieu of the FBAR and all other international information

THIS MISUNDERSTANDING OF US TAX LAW IS OFTEN REASONABLE... ALL TOO FREQUENTLY, HOWEVER, THE FIRST TIME ONE LEARNS OF THEIR FILING RESPONSIBILITY IS WHEN A BANK SENDS A LETTER, OR THE US INVESTIGATES.

penalties. The final relief granted takes the form of a Closing Agreement that will be signed by both the taxpayer and the IRS, thus, the taxpayer can be confident that all issues relating to the noncompliance are concluded (except under limited circumstances involving fraud or malfeasance).

Participation in the Program generally involves:

- Filing 8 years of amended tax returns
- Paying all properly calculated tax, interest and applicable non-FBAR penalties
- Filing all required FBARs
- In lieu of imposing FBAR and other international penalties, paying a



27.5% or 50% “miscellaneous” penalty based upon the highest aggregate account balances in a year
- Cooperating in all parts of the voluntary disclosure including potentially giving testimony against others if requested

Many entered the Program because of the stiff (read: draconian) penalties that are available to the US under the tax and banking law. US law contains penalties that can total many times the amounts held in unreported foreign banks. The failure to report a foreign account can by itself,

THE FAILURE TO REPORT A FOREIGN ACCOUNT CAN BY ITSELF, UNDER LAW, BE PENALISED AT 50% OF THE TOTAL BALANCE OF SUCH FOREIGN ACCOUNTS FOR ALL THOSE YEARS THAT REMAIN ON THE SIX-YEAR STATUTE OF LIMITATIONS.

under law, be penalised at 50% of the total balance of such foreign accounts for all those years that remain on the six-year statute of limitations. In some cases, FBAR penalties alone could amount to as much as three times the value of the account balance.

Importantly, there is a procedurally well-defined but potentially risky option where if a taxpayer believes that she would fare better in an IRS FBAR focused examination/audit than in the OVDP, she can “opt-out” and hope for a more beneficial audit result. Taking this option is fraught with risk and should not be taken without careful assessment and reassessment. Opting-out can be a harrowing ordeal taking more than one year to resolve. I have recommended it to only a small percentage of my clients. However, those clients that have done so have been very well rewarded.

To participate in the Program or not

The flow of Program participants has recently slowed. In part, because many taxpayers have already come forward to fix their problems, but also because the calculation as to whether to enter the Program has drastically changed in a taxpayer friendly way.

AS THE PROGRAM EVOLVED, THE US CAME TO THE REALISATION THAT EACH VIOLATION OF TAX AND BANK REPORTING RULES WAS NOT EQUAL.

First, as the Program evolved, the US came to the realisation that each violation of tax and bank reporting rules was not equal. This is especially important for those whose mistakes were inadvertent, innocent, “less

guilty" or "non-wilful." For these people, the voluntary disclosure of previously unreported assets and accounts comes with relatively small or no penalties (aside from attorney and accountant fees) as it would be outside of the Program.

Second, in 2015, the IRS announced a policy where it would limit the assertion of penalties to less than the law allows. As a result, the IRS will "only" seek to impose one or two years of 50% penalties for a wilful failure to report a foreign bank account. After practicing for many years in an environment where the US may assess six years of FBAR penalties, this is truly a relief and has resulted in my recommendation that fewer people enter the Program (but still disclose in some other manner). It should be noted that this is a US policy shift not a change in the law, thus, this treatment may change at any time.

The decision as to whether to enter the Program should be made with the above thoughts in mind and participation should be left to those who are wilful and who would definitely benefit from the civil penalty structure of the Program. It is strongly advised that taxpayers who may have been noncompliant obtain professional assistance to: calculate their exposure to tax, interest and/or penalties; determine the cost of "fixing" their noncompliance; and then make an informed decision as to which (if any) path to compliance to embark upon.

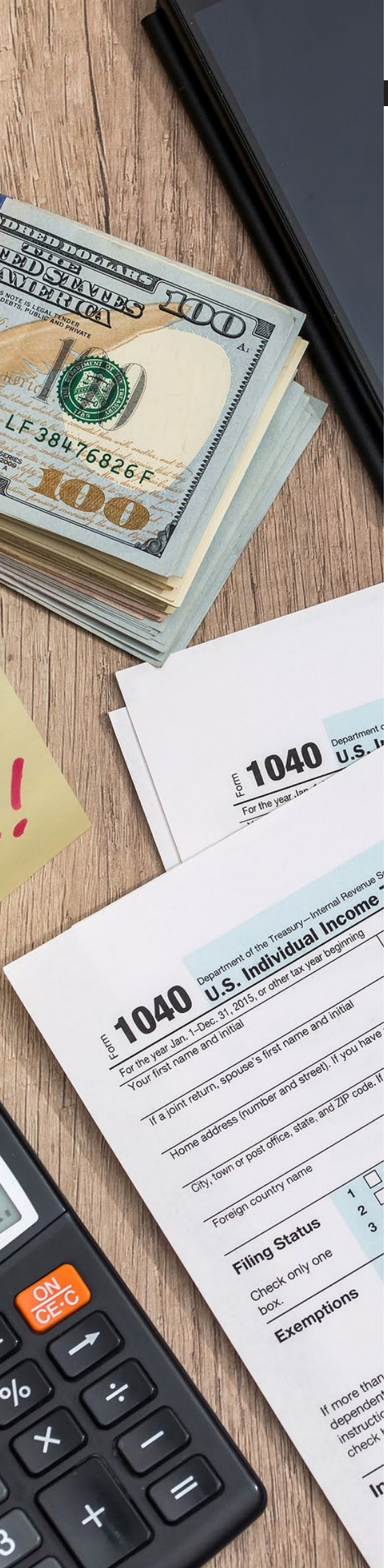
... IN A SHIFT THAT MAY MEAN TROUBLE FOR THOSE PEOPLE RESIDING IN AND/OR MAINTAINING THEIR FINANCIAL ASSETS IN ASIA, INDICATIONS ARE THAT THE US IS SHIFTING ITS FOCUS TO THE AREA.

Why do anything?

There is genuine cause for concern, especially considering both an increase in US aggression in its investigations outside of its borders and the staggering volume of information that the US now possesses and continues to acquire from: individual and bank information disclosures; whistle-blowers; criminal prosecutions; and intergovernmental agreements that provide for greater transparency and increased cooperation.

Eight years ago, US investigators were concentrated on those taxpayers and their advisors that utilised the Swiss banking system. However, most of those investigations have been concluded and in a shift that may mean trouble for those people residing in and/or maintaining their financial assets in Asia, indications are that the US is shifting its focus to the area.

The best example of increasing aggression and focus on Asia may be found in a recent attempt to pierce the Singapore bank secrecy law, United States v. UBS AG (S.D.Fla.) (UBS AG). Briefly, the US was investigating a Chinese citizen/resident that had declared he was also a US citizen. However, after residing in the US for some time, the taxpayer had permanently returned to China but held an account at UBS Singapore. During an investigation of the taxpayer, the US determined that it needed the information related to that account.



Generally, the US cannot serve a party with a summons (which is a tool that forces compliance with a US request) outside of its borders in the absence of an agreement with the nation where the party is located. However, in UBS AG the US served what is known as a Bank of Nova Scotia summons on a UBS location in Florida, in order to compel the production of account information that was held in Singapore and thereby subject to its bank secrecy laws.

The UBS AG case is significant because although the US has vigorously pursued offshore investigations for the past 8 years, it had not previously resorted to the use of this extra-jurisdictional investigative tool that had been available to it since the 1980s. While the UBS AG case has ended without a judicial decision because the taxpayer agreed to allow the bank to produce the information, the US willingness to utilise this type of summons should not be ignored when determining the inherent risk of the US obtaining potentially damaging information.

THE BAD NEWS IS THAT ONCE THE US HAS INITIATED AN INVESTIGATION, YOU CAN NO LONGER UTILISE ANY OF THE VOLUNTARY DISCLOSURE PROGRAMS.

Conclusion

The bad news is that once the US has initiated an investigation, you can no longer utilise any of the voluntary disclosure programs. In that circumstance, you must retain competent and experienced counsel and ensure that the US investigation is taken very seriously as criminal and enormous civil penalties are possible.

Further, experienced tax counsel will ensure that the strong attorney-client confidentiality provisions of the US law remain in effect. As expected, attorney's fees and penalties imposed by the US dramatically increase in these situations.

The good news is that when determining appropriate penalties, the US places a great deal of weight upon a taxpayer coming forward voluntarily and will generally provide commensurate leniency to those that do so.

In its least costly form, fixing compliance errors may be attained with NO penalties or tax owed, and a minimum of information disclosed to the US. Conversely (for those who are wilful), the Program requires payments of what can be a large penalty and tax/interest and the provision of what may be sensitive information on offshore activities.

The determination as to which (if any) path to become compliant is appropriate is of paramount importance because the wrong path can be too expensive and/or not provide the protection sought. In considering how to handle these issues, now is the best time to determine what your issues are and how much it will cost to ameliorate them. In this way, you may decide to either disclose or not to disclose with all options still available and eyes wide open as to all possibilities. ■