

Big Changes to IRS Offshore Voluntary Disclosure Program (OVDP) for FBAR non-Filers

September 11, 2014 | 12:00-1:30pm

DENNIS N. BRAGER
CERTIFIED TAX SPECIALIST
STATE BAR OF CALIFORNIA
BRAGER TAX LAW GROUP
A PROFESSIONAL CORPORATION
10880 WILSHIRE BLVD, SUITE 880
LOS ANGELES CA 90024
(310) 208-6200 FAX (310) 478-8030
www.bragertaxlaw.com
www.taxproblemattorneyblog.com

Dennis Brager

- Ex-IRS Trial Lawyer
- State Bar Certified Tax Specialist
- 30+ Years Tax Dispute Experience with IRS, EDD, BOE, FTB Problems
- Nationally Recognized Tax Litigation Attorney



Dennis Brager



Dennis Brager is a California State Bar Certified Tax Specialist and a former Senior Trial Attorney for the Internal Revenue Service's Office of Chief Counsel. In addition to representing the IRS in court, he advised the Service on complex civil and criminal tax issues. He now has his own four attorney firm in Westwood, and has been named as a Super Lawyer in the field of Tax Litigation by Los Angeles Magazine. He has been quoted as a tax expert, by Business Week, the Daily Journal, the National Law Journal, The Daily Beast, USA Today, Palm Beach Daily News, Money Laundering, the Los Angeles Daily Journal and Tax Analyst.

Having worked for the IRS for six years, he gained valuable insight into the inner workings of that organization. This not only helps in developing the right strategies, but facilitates working with the system quickly and efficiently. Mr. Brager has limited his practice to representing clients having disputes with the IRS, the Franchise Tax Board, the State Board of Equalization and the Employment Development Department--both at trial and administrative levels.

He has appeared on ABC Television's Good Morning America show, Fox Business News, and TV One Access. He has also spoken before the California Continuing Education of the Bar, the California Society of CPAs, the UCLA Tax Controversy Institute, the California State Bar Tax Section, the Consumer Rights Litigation Conference, the California Trial Lawyers Association, the American Bar Association, the Warner Center Estate and Tax Planning Council, and the National Association of Enrolled Agents. Dennis Brager has been an instructor at Golden Gate University's Masters in Taxation Program and a guest speaker at the University of Southern California. Mr. Brager has testified as an expert witness on Federal tax matters.

His articles have appeared in the California Lawyer, Daily Journal, Taxation for Lawyers, Los Angeles Lawyer, The Consumer Advocate, Family Law News, California Tax Lawyer, Journal of Tax Practice and Procedure, and Journal of Taxation of Investments. They include "Offshore Voluntary Disclosure – The Next Generation," "Partial Offshore Tax Amnesty – Voluntary Disclosure 2.0," Anatomy of an OPR Case (Definitely Not R.I.P.)," "FBAR and Voluntary Disclosure," "The Tax Gap and Voluntary Disclosure," "Circular 230: An Overview," "Recent Developments in Tax Procedure," "Damages, Rescission and Debt Cancellation as Client Income," "Ponzi Scheme Victims May Be Able to Mitigate Losses with Tax Deduction," "Prevailing Party-Recovering Attorneys Fees From the IRS," "The Taxpayer Bill of Rights--A Small Step Toward Reining in the IRS," "Challenging the IRS Requires a Cohesive Strategy," "The Innocent Spouse Defense," "IRS Guidelines for Installment-Payment Agreements," "Expert Advice: New Rules on 1099 Forms," "Tax Brakes: The Taxpayer Bill of Rights 2," and "Expert Advice: Avoiding Payroll Taxes."

Mr. Brager received his undergraduate degree from Pace University (B.B.A., magna cum laude, 1975, Accounting/Finance), and his law degree from New York University (J.D., 1978). He is a former chair of both the Tax Compliance, Procedure and Litigation Committee of the Los Angeles County Bar Association, and the California State Bar, Tax Procedure and Litigation Committee. He is admitted to practice before the U.S. Supreme Court, the Ninth Circuit Court of Appeals, U.S. Claims Court, U.S. Tax Court, U.S. District Court and the U.S. Bankruptcy Court.

The Problem

- U.S. Persons who have signatory authority over, or a financial interest in an offshore account must file an FBAR- Form FINCEN 114 (formerly Form TD F 90-22.1) for accounts with combined balances over 10k U.S. dollars.
 - U.S. Person = U.S. Citizen or U.S. “resident”
 - Currently a resident means:
 - a resident alien under IRC Section 7701(b) includes:
 - Green card test
 - Substantial presence test
 - any entity including but not limited to, a corporation, partnership, trust, or limited liability company created, organized, or formed under the laws of the United States
 - Substantial presence test may not apply prior to the issuance of latest FINCEN regulations on March 28, 2011

The Problem (Continued)

- Schedule B Question: At any time during 2013, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions.....
 - If “Yes,” are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), formerly TD F 90-22.1, to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements
- Checking the box that says "No", subjects a taxpayer to a possible criminal charge of filing a false income tax return which is a felony.

OVDP-History

- OVDP Provided for a 20% Penalty for Disclosures Prior to Oct. 16, 2009
 - OVDP Permitted a Taxpayer to argue for less than a 20% penalty without “opting out”
- OVDI 2011 Provided for a 25% Penalty for Disclosures Prior to Sept 10, 2011
- OVDP 2012 Provides for a 27.5% Penalty
 - Announced Jan. 9, 2012. IRS Notice 2012-5
- OVDP 2014 Announced June 18, 2014. Generally effective for submissions after June 30, 2014
 - 27.5% penalty continued
 - Currently there is no ending date, but IRS reserves the right to terminate the program at any time

Tax Amnesty - Offshore Voluntary Disclosure Program (OVDP)

- Who is not eligible?
 - Taxpayers under audit **whether or not** related to offshore issues
 - Taxpayers under investigation by CI (Criminal Investigation)
 - Taxpayers with illegal source of income

OVDP Penalties

- 27.5% of the highest account balance at any time during the prior 8 years.
 - The penalty base is not limited to foreign financial accounts required to be reported on an FBAR. Instead the 27.5% penalty applies to all of the taxpayer's offshore holdings that are related in any way to "tax non-compliance"
 - An accuracy related penalty of 20% of the tax due pursuant to IRC Section 6662
 - If applicable, the failure to file and failure to pay penalties under IRC Section 6651(a)(1) and (a)(2)
- The taxpayer may not argue lack of willfulness
- No reasonable cause exception

OVDP 2014 Changes

- Introduces a 50% civil penalty for taxpayers who have or had an account, or a facilitator who helped the taxpayer establish or maintain an offshore arrangement that has been publicly identified as being under investigation or as cooperating with an IRS investigation.
- FAQ 17 relating to FBAR filers who had no unreported income has been replaced
- FAQ 18 relating to the failure to file certain offshore reporting forms has been replaced
- The 12.5% and 5% penalties under old FAQ 52 and 53 have been eliminated.

OVDP 2014 Changes (cont.)

- FAQs 31 through 41 have been modified to “promote clarity, and consistency.”
- FAQ 23 now requires more information for pre-clearance letters
- The Offshore Voluntary Disclosure letter and attachment have been modified
- The timing of payment of the offshore penalty has been changed
- Documentation submission requirements have been changed

New 50% Penalty (FAQ 7.2)

- Effective for pre-clearances letters submitted after Aug. 3, 2014
- Applies to taxpayers with undisclosed accounts if at the time of the submission of the pre-clearance letter there has already been a public disclosure:
 - That the FFI, or a facilitator, is or has been under investigation by the IRS;
 - The FFI or a facilitator is cooperating with the IRS; or
 - The FFI or a facilitator has been identified in a court approved John Doe summons.
- Examples of public disclosure:
 - A filing in a judicial proceeding
 - A DOJ press release regarding a Deferred Prosecution Agreement or a Non-Prosecution Agreement

New 50% Penalty (Cont.)

- The current list:
 - 1. UBS AG
 - 2. Credit Suisse AG, Credit Suisse Fides, and Clariden Leu Ltd.
 - 3. Wegelin & Co.
 - 4. Liechtensteinische Landesbank AG
 - 5. Zurcher Kantonalbank
 - 6. swisspartners Investment Network AG, swisspartners Wealth Management AG, swisspartners Insurance Company SPC Ltd., and swisspartners Versicherung AG
 - 7. CIBC FirstCaribbean International Bank Limited, its predecessors, subsidiaries, and affiliates
 - 8. Stanford International Bank, Ltd., Stanford Group Company, and Stanford Trust Company, Ltd.
 - 9. The Hong Kong and Shanghai Banking Corporation Limited in India (HSBC India)
 - 10. The Bank of N.T. Butterfield & Son Limited (also known as Butterfield Bank and Bank of Butterfield), its predecessors, subsidiaries, and affiliates

New 50% Penalty (Cont.)

- Once the 50% penalty applies to one account it applies to all accounts, and assets wherever located
- It may take a few days for the IRS to update its published list, but if the event has already occurred the fact that the IRS hasn't updated the list doesn't avoid the 50% penalty if the public disclosure has occurred.
- Practice tip: Make sure to tell each of your new clients that if they don't file a pre-clearance today it may be significantly more expensive tomorrow.

FAQ 17 Superseded

- OLD FAQ 17. If all taxable income was reported then the taxpayer could file the delinquent FBAR with an explanation, and no penalty would be imposed.
- New Delinquent FBAR Submission Procedures: Very similar.

FAQ 18 Eliminated.



Possibly Very bad news.

- Old FAQ 18. A taxpayer who has failed to file tax information returns, such as Form 5471 for controlled foreign corporations (CFCs) or Form 3520 for foreign trusts but who has reported, and paid tax on, all their taxable income with respect to all transactions related to the CFCs or foreign trusts, could file delinquent information returns. No penalty.
- New Delinquent International Information Return Submission Procedures. A statement of reasonable cause with a statement of all facts establishing reasonable cause for the failure to file must be submitted.
- Must include a certification that the entity for which the return is being submitted did not engage in tax evasion.
- But c.f. OVDP FAQ 32 and 35 excepting from penalties accounts and assets which generated no gross income.

Streamlined Procedures

- Greatly expands, and supersedes old streamlined procedures announced Aug. 31, 2012
 - Eliminates compliance risk evaluation
 - Opens the program to U.S. citizens and residents
 - Eliminates the non-filer requirement for non-U.S. citizens and residents
 - Creates a different program for U.S. taxpayers residing outside the U.S., and those residing in the U.S.
 - Elimination of the \$1,500 tax threshold
- General Eligibility Requirements
 - Only for individual taxpayers, including estates of individual taxpayers
 - The failure to file FBARs, the failure to report all income, and the failure to submit all required information returns must be “non-willful.”
 - Not available to taxpayers who are currently under audit, or criminal investigation by the IRS
 - Taxpayers who have submitted full voluntary disclosure letters after June 30, 2014 are not eligible
 - Taxpayers who have finalized form 906 under prior OVDPs are not eligible

Streamlined Procedures (Cont.)

- The Benefits
 - Only three years of tax returns need to be filed vs. eight for OVDP
 - 5% offshore penalty for domestic taxpayers
 - No offshore penalty for “foreign” taxpayers
 - No accuracy related penalty
 - No FBAR penalties
 - Less documentation than OVDP

Downsides of Streamlined Compliance Procedure

- No protection from the risk of criminal prosecution
- Once a submission is made if the IRS determines that the Streamlined Compliance Procedure is not appropriate, the taxpayer may not participate in the OVDP
- Signing the non-willful certification opens the taxpayer to potential prosecution for submitting a false statement
- It is not a DIY project, and will require substantial legal and accounting fees to produce:
 - 3 years of tax returns and 6 years of FBARs
 - A sworn certification of non-willfulness to be submitted under penalty of perjury, and preparation of attached statement of specific reasons
 - An analysis to determine whether or not the client's actions were wilful.

Streamlined Foreign Offshore Procedures (SFOP)

- **Eligibility:**
 - Must meet the general eligibility provisions for all taxpayers
 - Have failed to report income from a foreign financial asset, and pay tax as required, and MAY have failed to file FBARs
 - The failures must be non-willful
 - Meet the applicable non-residency requirements
 - For joint filers both spouses must meet the non-residency requirements
- **Non-residency requirements applicable to U.S. citizens and green card holders.**
 - In any one of the 3 most recent prior years for which the return due date (or extended return due date) has passed, the individual did not have a U.S. abode, AND
 - The individual was outside of the U.S. for at least 330 full days
 - IRC Section 911 applies for the purposes of these procedures

Streamlined Foreign Offshore



Procedures (Cont.)

- Non-residency requirements applicable to individuals who are not U.S. citizens or green card holders.
 - In any one of the 3 most recent prior years for which the return due date (or extended return due date) has passed the individual did not meet the substantial presence test of IRC section 7701(b)(3)

Streamlined Foreign Offshore



Procedures (Cont.)

- Scope and effect
 - Qualifying taxpayers will not be subject to FBAR penalties, late filing penalties, accuracy penalties, information return penalties, or a miscellaneous offshore penalty
 - Qualifying taxpayers will be provided retroactive relief for failure to timely elect income deferral on certain foreign retirement accounts if otherwise permitted by applicable treaty.
 - Generally Canadian retirement plans
 - Covered taxpayers must:
 - File amended or original tax returns for the past 3 years including all required information returns such as Form 5471, 3520, and 8938
 - The full amount of the tax and interest due must be submitted with the returns
 - Electronically file 6 years of FBARs
 - Complete IRS Form “Certification by U.S. Person Residing Outside of the U.S. for SFOP”
 - The Certification must include a statement that the failure to report all income, pay all tax, and submit all required information returns including FBARs was due to non-willful conduct
 - The Certification must set forth “specific reasons” for the failure to report etc.

Streamlined Domestic Offshore Procedures (SDOP)

- Eligibility:
 - Must meet the general eligibility provisions for all taxpayers
 - Failed to meet the non-residency requirement for SFOP
 - Have failed to report income from a foreign financial asset, and pay tax as required, and MAY have failed to file FBARs
 - The failures must be non-willful
 - Have “previously” filed a U.S. tax return (if required) for each of the most recent 3 years for which the U.S. tax return due date (or properly applied for extended due date) has passed.
 - Thus non-filers are ineligible for the SDOP (unlike SFOP or OVDP)

Streamlined Domestic Offshore Procedures (cont.)

- Scope and effect
 - A 5% one-time miscellaneous offshore penalty
 - Qualifying taxpayers will not be subject FBAR penalties, late filing penalties, accuracy penalties, information return penalties.
 - Qualifying taxpayers will be provided retroactive relief for failure to timely elect income deferral on certain foreign retirement accounts if otherwise permitted by applicable treaty.
 - Generally Canadian retirement plans
 - Covered taxpayers must:
 - File amended or original tax returns for the past 3 years including all required information returns such as Form 5471, 3520, and 8938
 - The full amount of the tax and interest due must be submitted with the returns
 - The full amount of the 5% offshore penalty must also be submitted with the returns
 - There is no apparent provision for payment arrangements unlike under OVDP
 - If the taxpayer has PFICs the modified mark to market method of calculating tax is not available as it would be under the OVDP
 - Electronically file 6 years of FBARs
 - Complete the Certification by U.S. Person Residing in the U.S. for SDOP on a form provided by the IRS
 - The Certification must include a statement that the failure to report all income, pay all tax, and submit all required information returns including FBARs was due to non-willful conduct
 - The Certification must set forth “specific reasons” for the failure to report etc.

SDOP: Calculating the 5% Penalty



- The penalty is 5 percent of the highest aggregate balance/value of the taxpayer's foreign financial assets that are subject to the miscellaneous offshore penalty during the years in the covered tax return period and the covered FBAR period
- The highest value is calculated using year end values
- A foreign financial asset is included in a given year in the covered FBAR period if the asset should have been, but was not, reported on an FBAR
- A foreign financial asset is subject to the 5-percent miscellaneous offshore penalty in a given year in the covered tax return period if the asset should have been, but was not, reported on a Form 8938 for that year.
- A foreign financial asset is also subject to the 5-percent miscellaneous offshore penalty in a given year in the covered tax return period if the asset was properly reported for that year, but **gross** income in respect of the asset was not reported in that year.
- It does not appear to include non-income assets which would be considered "tainted" under OVDP because it was purchased with non-compliant assets
- The literal language appears to include accounts over which the taxpayer had signatory authority, or which were otherwise not non-tax compliant.
 - This would seem unfair because the penalty base would then be broader than under OVDP

What is Non-Willful Conduct?

- Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake; or conduct that is the result of a good faith misunderstanding of the requirements of the law.
- Failure to submit this statement, or submission of an incomplete or otherwise deficient statement, will result in returns being processed in the normal course without the benefit of the favorable terms of these procedures.
- In public statements IRS personnel have referred to “existing case law” as the standard for determining wilful conduct.
 - *i.e. Zwerner, Williams 110 AFTR 2d 2012-5298 (CA-4, 2012), and McBride 110 AFTR 2d 2012-6600 (DC Utah, 2012)*

Unknown

- What level of scrutiny will be applied to streamlined filings?
 - Returns submitted under either the Streamlined Foreign Offshore Procedures or the Streamlined Domestic Offshore Procedures will not be subject to IRS audit automatically, but they may be selected for audit under the existing audit selection processes applicable to any U.S. tax return and may also be subject to verification procedures in that the accuracy and completeness of submissions may be checked against information received from banks, financial advisors, and other sources
 - IRS personnel have stated publicly that they will review EVERY certification of non-willfulness submitted and determine whether or not there should be further follow up.

Transitional Relief: Eligibility

- Taxpayers who are “currently participating” in OVDP may elect transitional treatment.
 - Only those taxpayers who before July 1, 2014 had mailed their full voluntary disclosure letter, and attachments
 - Taxpayers who already had received a fully executed Form 906 are not eligible
 - Taxpayers who opted out of OVDP, but not yet received a letter starting an exam, and a Notice 609 are eligible.
 - Taxpayers who had been removed from OVDP by the IRS are not eligible
 - Taxpayers must meet the eligibility requirements of either the SFOP or the SDOP

Transitional Relief: Benefits

- Allows for two bites at the apple. Taxpayers who do not receive transitional treatment remain in the OVDP, and will either receive the “normal” OVDP penalty, or still have the opportunity to opt-out of the OVDP entirely.
- Unlike other taxpayers who must elect between streamlined or OVDP under transitional relief a taxpayer may remain in OVDP, but obtain the benefit of the streamlined penalty

Transitional Relief: Penalty Structure

- No offshore penalty, or a 5 percent penalty depending upon whether the taxpayer qualifies under the SDOP, or SFOP
- The 20% accuracy penalty continues to apply
- Failure to file, and failure to pay penalties continue to apply
- The 8 year disclosure period remains the same
- Protection from criminal prosecution continues to apply
- Payment of tax is still due for all 8 years
- The alternative mark to mark PFIC calculations are available (unlike “regular” SDOP or SFOP)

Obtaining Transitional Relief



- Opt-out of the OVDP is not required
- All submissions which are required under OVDP must still be provided
- A certification of non-willfulness in the same form as would be submitted under SFOP or SDOP must be submitted
- Every request for transitional relief will be reviewed to determine eligibility including the non-willfulness certification
- The case will be reviewed by the examiner, and the examiner's manager
- Some cases will be reviewed by a "central committee" for consistency
- There are no appeal rights from a determination that transitional relief is unavailable

Clarifications & Modifications to OVDP

- FAQ 32, 33, 35, and 36 previously provided that if there was any amount of unreported income from an account (or a non-financial asset) it had to be included in the penalty base. Now the reference is to GROSS income. This is consistent with IRS practice.
 - Example. Foreign account generates interest of \$1,000, but charges fees of \$1,500. The account is included in the penalty base.
- FAQ 50 previously provided that in “no circumstances” will a taxpayer pay more under OVDP than outside of the OVDP. This has been modified so that the comparison is for all years in the disclosure period, thus making a comparison without regard to the fact that outside of the OVDP the statute of limitations could limit the amounts due.
- FAQ 35.1 prohibits applying valuation discounts such as a marketability discount, or minority interest discount to assets held through entities, or holding as a tenant in common

Clarifications & Modifications to OVDP (Cont.)

- Estate and gift tax returns must be included with a submission where appropriate. FAQ 25
- If a taxpayer is having difficulty obtaining foreign records she must “carefully document” this problem. For phone conversations the date, time, and duration of the call should be recorded, along with the full name of the employee at the FFI. The documentation should be provided to the IRS. FAQ 30.
- Copies of all account statements must be submitted without regard to the size of the account. Previously only taxpayers with an aggregate balance of \$500,000 or more were required to submit the statements. FAQ 25
- The 27.5% offshore penalty must be tendered at the time of submission of the full package. FAQ 25.11
- Statement on Abandoned Entities is required at the time of the submission of the full package. FAQ 25.10. The form requires certification that the entity was already dissolved at the time the form is signed.

Electronic Submissions



Limited: FAQ 25.2

- Only professional firms with “established record retention policies” may submit documents on a CD or flash drive. Everyone else must submit paper documentation.
- Firms must submit on paper an original signed “Agreement for Digital Submission of OVDP Documentation.”
- The agreement provides that the firm will retain all “original client documents required for the OVDP” for a minimum of two years, and to promptly provide them to the IRS upon request.

Pre-Clearance Letters Require More Information than Before

- Complete names, dates of birth, tax identification numbers, addresses, and telephone numbers
- *Identifying information of all financial institutions at which undisclosed OVDP assets were held. This includes complete names (including all DBAs and pseudonyms), addresses, and telephone numbers.*
- *Identifying information for all foreign and domestic entities through which the undisclosed OVDP assets were held*

Various Lower Offshore Penalty Provisions Have Been Withdrawn. See Below for Old Provisions

- ~~For accounts that do not exceed \$75,000 the penalty is 12.5% of the highest aggregate balance~~
 - ~~All other terms remain the same~~
 - ~~Non-financial assets are taken into account for determining the \$75,000 threshold~~

- ~~5% Penalty~~
 - ~~Category 1 “Inherited” Accounts~~
 - ~~Taxpayer did not open the account~~
 - ~~Minimal Infrequent Contact~~
 - ~~Did not withdraw more than \$1k in any one year~~
 - ~~Prove that all taxes were paid on the principal balance going back to Jan. 1, 1991.~~

 - ~~Category 2. The Brain Dead Citizen~~
 - ~~Taxpayers who are foreign residents and who were unaware they were U.S. citizens.~~

Limited OVDP Relief (Continued)

- ~~○ Category 3. Foreign Residents Who Meet All of the Following Conditions:
 - ~~● Taxpayer resides in a foreign country~~
 - ~~● Has made a “good faith showing” that she has timely complied with all tax reporting and payment requirements in the country of residence; and~~
 - ~~● Has \$10,000 or less of U.S. source income each year~~~~

- ~~● Category 3 taxpayers may exclude the value of non-financial assets from the penalty base.~~

- ~~● Category 3 did not exist under the 2009 OVDP, and therefore qualifying taxpayers may reopen their cases with the IRS.~~

Brager Tax Law Group

Tax Litigation & Tax Controversy Services We Provide

Los Angeles

10880 Wilshire Boulevard, Suite 880
Los Angeles, California 90024
Phone: 310.208.6200
Toll Free: 800.380.TAX LITIGATOR
Fax: 310.478.8030

www.bragertaxlaw.com

www.taxproblemattorneyblog.com

- Criminal Tax Defense
- FBAR and Offshore Account Problems
- Office of Professional Responsibility (OPR) Defense
- Tax Audits & Tax Appeals
- Tax Fraud Defense
- Tax Preparer Penalty Defenses
- Innocent Spouse Defenses
- California Sales Tax Problems
- IRS and California Payroll Tax Problems
- Offers in Compromise
- Installment Payment Agreements



@TaxProblemEsq