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Recent Modifications to U.S. Offshore Voluntary Disclosure Programs

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FEATURED PERSPECTIVES

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The Internal Revenue Service announced major changes to its offshore voluntary disclosure programs on June 18. The announcement overhauls the 2012 offshore voluntary disclosure program by reshaping its terms for taxpayers seeking certainty and relief from criminal prosecution. The announcement expands the ancillary 2012 streamlined program to include resident taxpayers whose noncompliance with their U.S. tax obligations is not considered willful.

The revisions build on the IRS's success in combating offshore tax evasion — to date, the IRS programs have resulted in more than 45,000 disclosures and the collection of about $6.5 billion in taxes, interest, and penalties — by providing more flexible and balanced voluntary compliance procedures. These changes also recognize that a compliance regime that is too harsh will not produce the desired result, which is to provide a way for noncompliant U.S. taxpayers to disclose their offshore accounts, pay the tax they owe, and ''get right'' with the government.

The modified initiatives, as acknowledged in the IRS press release and Commissioner John Koskinen's statements, must be viewed in the context of the U.S. government's efforts to combat offshore tax evasion, as reflected in the investigations and programs of the Department of Justice and the implementation of the Foreign Account Tax Compliance Act. These efforts are intended to encourage compliance now and send a message to noncompliant taxpayers that if they are discovered, they could face significant civil penalties and criminal sanctions.

As a policy matter, the modifications to the expanded streamlined program represent a welcome departure from the historical voluntary disclosure programs' one-size-fits-all penalty structure by allowing noncompliant offshore account holders who have not engaged in willful conduct to opt into a more favorable penalty regime. Koskinen and his staff should be commended for acknowledging the input of the tax community and the feedback from the national taxpayer advocate in drafting these more targeted initiatives.

In a Nutshell

The program modifications provide different voluntary disclosure mechanisms for noncompliant U.S. taxpayers regarding their offshore accounts, depending on whether their failure to report, pay tax, and file all required information returns was willful or non-willful. For taxpayers whose past conduct was willful, the voluntary disclosure option continues to be available, but with more onerous compliance requirements and, in some cases, a higher penalty.

In contrast, for taxpayers whose past conduct was non-willful, the 2012 streamlined program is expanded to include U.S. taxpayers resident in the United States, who will be subject to a 5 percent penalty on the highest value of their foreign financial assets, and U.S. taxpayers resident abroad, who may qualify for the enhanced streamlined program without the imposition of a penalty even though they filed returns that did not fully disclose all income and assets.

What Is Willful Conduct?

A precondition for the expanded streamlined program for U.S. taxpayers residing outside the United States and U.S. taxpayers residing in the United States is that the taxpayer was not willful regarding his failure to report the income from, and pay the U.S. tax on, foreign financial assets. To be eligible, a taxpayer, under penalty of perjury, is required to certify as follows:

> My failure to report all income, pay all tax, and submit all required information returns, including [foreign bank account reports], was due to non-willful conduct. I understand that 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.
>
> I recognize that if the IRS receives or discovers evidence of willfulness, fraud, or criminal conduct, it may open an examination or investigation that could lead to civil fraud penalties, FBAR penalties, information return penalties, or even referral to Criminal Investigation.

The IRS will review all taxpayer certifications of non-willful noncompliance that it receives through the modified streamlined program.

While the IRS has informed taxpayers that 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,'' it has not provided guidance as to what type of conduct, actions, or omissions constitute willful conduct.[1] As such, the actions or inactions of a taxpayer, irrespective of whether he is resident outside or inside the United States, will be evaluated through the prism of U.S. law, according to which criminal conduct requires *mens rea*, that is, criminal intent.

By reference to case law regarding tax cases, willfulness ''requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty.''[2] That means that the taxpayer was aware of the legal duty, but it does not go so far as to require the taxpayer to be aware of the specific statutory or regulatory provision.[3]

Further, under the concept of conscious avoidance, which is also referred to as willful blindness or deliberate ignorance, the knowledge requirement can sometimes be satisfied without direct or specific information that the underlying conduct is criminal.[4] An often-used example is a situation where one is approached to buy an expensive item at an absurdly low price. The buyer asks no questions of the seller but is later arrested for receiving stolen goods. In the example, the buyer chose to be willfully blind; that is, the buyer did not ask the seller the obvious question how such an expensive item could be purchased at such a low price. If the action or inaction of a taxpayer reflects willful blindness, that conduct likely would not be non-willful under the IRS definition referred to above.[5]

The line between negligence, inadvertence, mistake, or good faith misunderstanding of the requirements of law and the intentional disregard of U.S. tax reporting and payment obligations is one of gradation. In many instances, it will be difficult to discern the taxpayer's state of mind, which will require a close examination and understanding of the facts surrounding the omission or misstatement.

Modifications to 2012 OVDP

At first blush, the major changes made to the 2012 OVDP seem burdensome; however, on a macro basis, the upside is the parallel modification to the streamlined program allowing some taxpayers to avoid a one-size-fits-all 2012 OVDP penalty framework. The 2012 OVDP modifications include, in general, additional upfront information from taxpayers submitting preclearance applications, accelerating the payment of the overall offshore penalty amount at the time of filing the offshore voluntary disclosure submission package, and submitting all account statements at that time.

In terms of favorable developments, the modifications allow for electronic submissions instead of the voluminous hard copies and the elimination of the inequitable one-size-fits-all penalty regime for negligent

[1]The IRS has announced that it will not release guidance on willfulness. The agency thinks tax practitioners are best suited to advise clients on which disclosure option to pursue.

[2]*Cheek v. United States*, 498 U.S. 192, 202 (1991).

[3]*Ratzlaf v. United States*, 510 U.S. 135, 137 (1994).

[4]The concept permits a finding that a defendant had culpable knowledge of a fact when the evidence shows that the defendant intentionally avoided confirming that fact. *See U.S. v. Ferrarine*, 219 F.3d 145,154.

[5]A recent assertion of this doctrine is contained in the government's motion for summary judgment (at p. 4) in *United States v. Zwerner*, in which it was argued that an individual could be liable for the willfulness penalty for willfully failing to file a FBAR even if the person does not actually know of the FBAR reporting requirements. A defense that claims lack of knowledge may permit the government to assert conscious avoidance; without proof of avoidance of knowledge, there is a risk that the willful blindness doctrine could be applied because the defendant had ''not tried hard enough to learn the truth.'' *See* E. Abramowitz and B. Bohrer, ''Conscious Avoidance: A Substitute for Actual Knowledge?'' *N.Y. Law Journal*, Vol. 237, No. 83 (May 1, 2007). *See also* W. Sharp, A. Granwell, and R. Katzberg, ''The U.S. DOJ Voluntary Disclosure Program for Swiss Banks: What the Umbrella Man Can Teach Bank Counsel About Criminal Intent,'' *International Tax Review* (Feb. 13, 2014), *available at* http://www.internationaltaxreview.com/Article/3308793/.

but non-willful noncompliant taxpayers, who before the revisions would have very likely filed voluntary disclosure applications and then used the opt-out procedure to obtain a result commensurate with their past behavior.

In terms of less favorable developments, the modifications increase the 27.5 percent offshore penalty to 50 percent in some circumstances, if the relevant foreign financial institution is publicly disclosed before the preclearance request is submitted, as further discussed below.

Modifications to Streamlined Program

The June 18 IRS release notes that the modifications to the streamlined program represent ''key expansions'' to the group of eligible participants who have unreported foreign financial accounts. The IRS has abandoned the earlier limitation that allowed only nonresident nonfilers to participate in the streamlined initiative. The ''risk'' questionnaire is abandoned by the modified procedure, as are the varying degrees of IRS examination based on the tax due and the compliance risk level of the taxpayer.

Importantly, streamlined treatment is now available for noncompliant U.S. taxpayers resident in the United States if they certify that previous actions or omissions to comply with U.S. tax filing obligations were non-willful. This certification will impose an elevated due diligence burden on practitioners to carefully vet putative cases of non-willful conduct. However, if the ''non-willful conduct'' hurdle can be overcome, eligible U.S. resident taxpayers will achieve tax compliance at a cost of paying the U.S. tax and interest for the prior three years' returns and a penalty equal to 5 percent of the highest aggregate balance/value of the taxpayers' foreign financial assets that are subject to the offshore penalty during the years in the covered return period.

Transition Rules

Streamlined Treatment

The IRS has extended application of the expanded modified streamlined procedures to some former and current OVDP participants. Under the new transitional rules, a taxpayer currently participating in a pending voluntary disclosure program proceeding may request treatment under the terms of the expanded streamlined program's favorable penalty structure without having to opt out of the OVDP.

Current Participation in an OVDP

Taxpayers who want to be treated as ''currently participating'' in an OVDP must mailed an offshore voluntary disclosures letter (OVDL) and applicable attachments to the IRS Criminal Investigation division before July 1 and must not have received either a fully executed IRS Form 906, ''Closing Agreement on Final Determination Covering Specific Matters,''[6] or a letter initiating an examination and enclosing the taxpayer Privacy Act Notice (Notice 609) if the taxpayer took steps to opt out of the OVDP.

Practitioners' Commentary

Practitioners should immediately review their list of pending OVDP cases. For taxpayers who have not yet received the fully executed closing agreement from the IRS, counsel should immediately contact the IRS examiner handling the OVDP and request that the examiner hold the closing agreement (most examiners and service centers are holding taxpayer-signed closing agreements, but practitioners should contact the examiners to be certain). Most opt-out matters were held for processing given the coming changes to the 2012 OVDP; however, practitioners should contact an opt-out examiner to request that the examination be held for consideration under the modified streamlined proceeding.

Transitional Treatment

Transitional treatment is not automatic. The taxpayer must request consideration under the terms of the modified streamlined program by providing the following information to the IRS examiner assigned to certify the OVDP submission (if an examiner has already been assigned) or, alternatively, to the OVDP Unit in Austin, Texas, at the address provided in Number 6 of the transition rules frequently asked questions:

- All submission documents required under the voluntary disclosure program in which the taxpayer is participating (that is, amended tax returns, original tax returns, FBARs, statute extension forms, penalty computation spreadsheets, and so forth).[7]
- ''Certificate by a U.S. Person Residing in the United States for Streamlined Domestic Offshore Procedures''[8] signed by the taxpayer under penalty of perjury certifying the taxpayer's non-willfulness with respect to all foreign activities/assets. The taxpayer must specifically describe the reasons he failed to properly report income, pay tax, and submit all required information returns (including FBARs). If the taxpayer relied on a professional adviser, he must also provide the name, address, and telephone number of the adviser and a summary of the advice received.

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[6]In our experience, a taxpayer typically receives a Form 906 countersigned by the IRS approximately two months after submitting the taxpayer-signed Form 906 to the IRS examiner.

[7]Transition Rules FAQ No. 6 provides links to the requirements for the 2009 OVDP, 2011 offshore voluntary disclosure initiative, and 2012 OVDP.

[8]A link to this form may be found in Transition Rules FAQ No. 6a.

- Full payment of tax, interest, and applicable accuracy-related (or failure to file/pay) penalties due under the terms of the OVDP (if not already paid).

Practitioners' Commentary

While at this time there is no specific timeline regarding when a practitioner must notify the IRS regarding transitional treatment for those eligible OVDP submissions made before July 1, a practitioner should begin the discussions with the IRS as soon as possible.

Determining Qualification

The IRS examiner assigned to certify the taxpayer's OVDP submission makes the initial determination (subject to the examiner's manager's approval) as to whether the taxpayer was non-willful in light of the taxpayer's specific facts and circumstances. In some cases, an IRS central review committee may also review the examiner's determination and perform a more thorough investigation to ensure the taxpayer's request for transitional treatment is consistent with the treatment of other taxpayers under similar circumstances. The findings of the IRS central review committee are final and may not be appealed. However, if the taxpayer disagrees with the findings of the central review committee, the taxpayer retains the right to withdraw from the OVDP and resolve the case within the examination process (with rights for IRS Appeals review).

5 Percent Offshore Penalty

If the taxpayer is granted transitional treatment under the modified streamlined program, the taxpayer will pay an offshore penalty of 5 percent of the highest aggregate balance/value of the taxpayer's foreign financial assets (instead of the 20 percent, 25 percent, or 27.5 percent offshore penalty under the preceding voluntary disclosure programs). Because the taxpayer's case is resolved within the OVDP, the taxpayer receives a closing agreement that incorporates the 5 percent streamlined penalty into the terms of the closing agreement.

Practitioners' Commentary

The IRS has not provided guidance for taxpayers who may have made an advance payment of the offshore penalty under the OVDP. Presumably, the IRS would refund the difference between the offshore penalty computed under the preceding OVDP and the streamlined penalty. If not, tax practitioners should consider filing a protective claim for refund within two years of payment of the offshore penalty to request the IRS to move the offshore penalty to an open statute year.

The New and Improved OVDP Regime

By far, the most striking change, and the one likely to have the most impact, is the broadening of the streamlined option. The IRS has made other adjustments, as well; however, the modified streamlined option will significantly alter the calculus for taxpayers considering OVDP as an option for regularizing their foreign account noncompliance.

One modification certain to have a significant impact is the increase in the miscellaneous offshore penalty from 27.5 percent to 50 percent, which will apply when a taxpayer who submits the pre-clearance letter after August 1, 2014, has an undisclosed account that is with a foreign financial institution or is managed by a facilitator that has been publicly disclosed to be under one of several forms of DOJ or IRS scrutiny.[9] The IRS has published a list of 10 such banks and facilitators, with more certainly to follow. This penalty increase will apply not only to the account that a taxpayer has with the publicly disclosed foreign financial institution but also to undisclosed offshore accounts with financial institutions that are not publicly disclosed as well as to the other assets of the taxpayer that are subject to the penalty.

Practitioners' Commentary

The IRS has announced that beginning on August 4, any taxpayer who has an undisclosed foreign financial account will be subject to the 50 percent penalty if, at the time of submitting the preclearance letter to CI, an event has already occurred that constitutes a public disclosure as discussed above. In connection with the DOJ non-prosecution agreement and non-target letter program, category 2 banks (those that have reason to believe they may have committed tax-related or monetary transaction offenses) may request a non-prosecution agreement that the DOJ announced in its June 5 comments will be made public. Thus, to the extent these agreements are made public by the time a taxpayer submits his pre-clearance letter, the taxpayer apparently will be subject to the 50 percent penalty. Taxpayers considering the new OVDP regime would be well advised to promptly submit their pre-clearance letter.

Following are other material adjustments the IRS made:

- The elimination of FAQs 17 and 18, which provided an avenue for penalty-free relief when

[9]According to FAQ No. 7.2, these include when (a) the foreign financial institution where the account is held, or another facilitator who assisted in establishing or maintaining the taxpayer's offshore arrangement, is or has been under investigation by the IRS or the DOJ in connection with accounts that are beneficially owned by a U.S. person; (b) the foreign financial institution or facilitator is cooperating with the IRS or the DOJ in connection with accounts that are beneficially owned by a U.S. person; or (c) the foreign financial institution or facilitator has been identified in a John Doe summons. Examples of a public disclosure include a public filing in a judicial proceeding and a public disclosure by the DOJ of a deferred prosecution agreement or non-prosecution agreement. For purposes of the application of the 50 percent penalty, it is the announcement by the DOJ, such as a John Doe summons announcement, that controls.

FBARs or foreign information returns were omitted absent any underreporting of income. These former options are no longer necessary in light of new guidance posted on the IRS website addressing the issue outside the OVDP context.

- Additional information required at the time of pre-clearance application, presumably allowing the IRS to screen applications that may be ineligible because of summons activity or treaty requests.
- The elimination of the reduced 5 percent and 12.5 percent penalties, which are now moot in light of the broadened streamlined process.

Modified Streamlined Program

Changes to the Program

The modified streamlined program includes two subcategories, one for U.S. taxpayers residing abroad (the streamlined foreign offshore procedures, or SFOP) and one for U.S. taxpayers residing in the U.S. (the streamlined domestic offshore procedures, or SDOP). Therefore, unlike the streamlined program announced on August 31, 2012, the modified program applies to eligible taxpayers residing in the United States.

The modified program eliminates the $1,500-per-year unpaid tax limitation, which was a source of confusion. Stated as an absolute requirement of the original streamlined program, further IRS guidance on the issue made the $1,500 less of an absolute in practice and more of a significant risk factor. As the streamlined program was originally drafted, ''high compliance risk'' taxpayers would be subject to further examination. However, in the 22 months since August 31, 2012, during which the 2012 streamlined program has been available, practitioners have received little to no feedback as to when such examinations would occur and what such examinations would entail.

If strictly enforced, the $1,500-per-year unpaid tax limitation would prevent several otherwise ''low compliance risk'' taxpayers from being eligible for streamlined treatment. One common reason for taxpayers to exceed the $1,500 threshold related to a disconnect regarding the deductibility of foreign pension payments, as explained below.

In many jurisdictions, as in the United States, contributions to pension funds are tax deductible. However, for U.S. taxpayers resident abroad, the deductibility of these foreign pension contributions depends on the applicable tax treaty. In many cases, taxpayers residing in otherwise high-tax jurisdictions would owe a significant amount of U.S. tax in years that pension contributions were made, as foreign tax credits were not available to offset the tax due on such contributions. The elimination of the arbitrary, and often inequitable, tax threshold is a major improvement.

In addition, the modified streamlined program replaces the risk assessment process with one that requires taxpayers to certify that their failure to file was not a result of willful conduct. The IRS announced that it plans to review all taxpayer certifications of non-willful noncompliance that it receives through the modified streamlined protocol.

The modified streamlined program is available for individual taxpayers, including estates of individual taxpayers, but is unavailable if the IRS has initiated a civil examination of a taxpayer's returns for any tax year, regardless of whether the examination relates to undisclosed foreign financial assets. A taxpayer being investigated by CI is ineligible to use the streamlined process.

Taxpayers who enter the new OVDP are not eligible for the modified streamlined program. That means OVDLs submitted on or after July 1 under the new OVDP will disqualify taxpayers from participating in the modified streamlined program. However, as discussed above, under the transitional rules, a taxpayer eligible for the modified streamlined program, who has previously entered but has not yet completed any of the prior OVDPs (for example, has not received the fully executed closing agreement from the IRS), can still request the IRS to incorporate the streamlined penalty terms in the OVDP closing agreement.

The modified streamlined procedures for U.S. resident taxpayers provide a favorable alternative to the opt-out procedures under prior OVDPs; thus, before entering the new OVDP, taxpayers and their advisers must closely examine the client's willfulness, or lack thereof, in order to determine whether the new OVDP or the modified streamlined program is the best option for the taxpayer.

For taxpayers participating in an OVDP, the transition to the streamlined program does not require an opt-out of the OVDP; rather, the taxpayer must make the required certification as to non-willfulness, as explained in the transitional rules FAQ section, discussed above.

Further, the IRS announced that it will not hold a previous ''quiet disclosure'' against an otherwise non-willful taxpayer who has made a quiet disclosure in the past; these taxpayers are eligible to enter the modified streamlined program. Notably, any penalties resulting from the quiet filing may not be abated.

Tax returns submitted under the modified streamlined program will be processed similar to other returns submitted to the IRS; such returns will not be automatically subject to IRS Examinations, but under existing IRS audit selection procedures they could be flagged for audit. In contrast to submissions made under the OVDP, for returns submitted under the modified streamlined program no acknowledgement will be sent to the taxpayer, and no Form 906 or other closing agreement will be provided. As with the earlier version of the streamlined program, there will be no specific closing procedure to notify the taxpayer that his streamlined submission has been accepted and is not subject to a further review.

However, given the significant financial savings represented by the modified streamlined program, the lack of formal closure may be an acceptable risk given the significant reduction in penalties under the newly expanded program.

Taxpayers will no longer be subject to failure-to-file and failure-to-pay penalties, accuracy-related penalties, information return penalties, or FBAR penalties, even if selected for audit, unless there is a finding of fraudulent intent or willfulness. However, any previously assessed penalties will not be abated, and any additions to tax and penalties relating to that additional deficiency may apply.

For taxpayers in SDOP, an additional Title 26 miscellaneous offshore penalty equal to 5 percent will apply, as described below (nonresident taxpayer participants in the SFOP will not be subject to a similar penalty). This reduced penalty for U.S. resident taxpayers whose noncompliance is non-willful should increase participation in the program. Many practitioners have historically encountered taxpayers for whom the formal OVDPs were not appropriate. An example is recent immigrants who are unaware of the worldwide implications of the U.S. tax system and have failed to report interest and other income earned on bank accounts in foreign jurisdictions. The modified streamlined procedures for such taxpayers present a welcome alternative to the complete uncertainty of a quiet filing without the extensive costs associated with an OVDP and opt-out under the previous programs.

Finally, under the modified streamlined procedure, all tax returns must have a valid taxpayer identification number, which for citizens, resident aliens, and others is a valid Social Security number. For individuals who are not eligible for a Social Security number, an individual taxpayer identification number (ITIN) is a valid TIN. Returns submitted without a valid Social Security number or ITIN will not be processed under the streamlined procedures.

Practitioners' Commentary

In some cases, neither streamlined procedure may apply. For example, take the case of ''snowbirds,'' U.S. citizens who have lived in Canada for the past 30 years but who have an apartment in the U.S. and visit the U.S. for two or three months each year and have not filed U.S. returns. Those taxpayers would be ineligible for the SFOP because they have a U.S. abode, and they would be ineligible for the SDOP because they have not filed U.S. tax returns.

Streamlined Foreign Offshore Procedures

Under the SFOP, in addition to meeting the general eligibility criteria summarized above, the taxpayer must meet the new nonresidency requirement and have failed to report the income from a foreign financial asset and the required information reports, such as an FBAR.

A citizen or a lawful permanent resident (that is, a green card holder) satisfies the nonresidency requirement if, in any one of the most recent three years for which the U.S. tax return was due, the taxpayer did not have a U.S. abode (that is, where the taxpayer maintains his economic, family, and personal ties)[10] and was physically outside the United States for at least 330 full days. Recent immigrants to the U.S. who are noncitizens and non-green-card holders can also participate under the SFOP rules if in any one or more of the last three years the individual did not meet the substantial presence test of section 7701(b)(3).

For taxpayers who made streamlined submissions before July 1, their returns will be processed without regard to the risk assessment if they have not been notified of a risk determination. This is more welcome news for taxpayers and their advisers who have previously made a streamlined submission with some risk factors; as noted above, little to no feedback has been provided regarding risk assessment in the past 22 months. As a practical note, practitioners may have encountered taxpayers who qualified under the previous incarnation of the streamlined program but who may not qualify for certification of non-willfulness. For all such pending cases, the alternative would be to enter the new OVDP if filing a streamlined submission before July 1 was not possible.

Taxpayers eligible to use the SFOP must file delinquent or amended income tax returns for the most recent three years for which the U.S. tax return due date (or properly filed extension) has passed, often with delinquent FBARs for the past six years and any other foreign information reports.[11]

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[10]*See* IRS Publication 54. Issues may arise as to whether a taxpayer has a U.S. abode. *See Bujol v. Commissioner*, 53 T.C. Memo. 762, 763 (CCH 1987) (''Abode has been variously defined as one's home, habitation, residence, domicile or place of dwelling''). *Black's Law Dictionary* (5th ed. 1979). While an exact definition of the word ''abode'' depends on the context in which it is used, it clearly does not mean one's principal place of business. Thus, ''abode'' has a domestic rather than vocational meaning and contrasts ''tax home'' as defined for purposes of section 162(a)(2). The section 911 regulations provide that the temporary presence of an individual in the U.S. does not necessarily mean that the individual's abode is in the U.S.; also, the maintenance of a dwelling in the U.S. by an individual, regardless of whether that dwelling is used by the individual's spouse and dependents, does not necessarily mean that the individual's abode is in the U.S. See reg. section 1.911-2(b). In evaluating whether a taxpayer has a U.S. abode, one should examine the time spent in the U.S., as well as other factors, such as a U.S. bank account, U.S. driver's license, and U.S. voter registration, and whether the taxpayer had strong familial, economic, and personal ties in the U.S., and compare those ties with ties to a foreign country.

[11]It is important to note that delinquent FBARs should not be included in this submission and should be filed electronically. The taxpayer should submit payment of all tax due on amended and delinquent returns (with applicable statutory interest), and include his Social Security number on the check. All documents

(Footnote continued on next page.)

Additionally, the taxpayer must certify that he is eligible for the SFOP, that all required FBARs have been filed, and that the failure to report all income, pay all tax, and submit all required information returns, including FBARs, resulted from non-willful conduct.

For returns filed under this procedure, retroactive relief will be provided to taxpayers for failure to timely elect income deferral on certain retirement and savings plans where deferral is permitted by the applicable treaty. Taxpayers seeking this relief must also request an extension to make the election and identify the specific treaty provision. The taxpayer is also required to submit a sworn statement about events that led to the failure to make the election, the discovery of the failure, and whether the taxpayer relied on a professional adviser.

Streamlined Domestic Offshore Procedures

As part of the June 18 revisions to the streamlined filing compliance procedures, a new section (Streamlined Domestic Offshore Procedures) has been added for U.S. taxpayers residing in the United States. The original streamlined program was limited to U.S. taxpayers residing abroad. The IRS expanded the program to include domestic residents because for many U.S. citizens or residents, the existing OVDP penalties were too harsh or restrictive. The expansion of the streamlined program, along with the elimination of the risk assessment process and of the $1,500 annual tax cap on streamlined candidates, is a testament to the program's popularity and success.

The modified streamlined procedures allow domestic U.S. taxpayers, who failed to report gross income from foreign assets or file an FBAR because of a non-willful oversights, to seek relief outside the harsh confines of the OVDP. A domestic U.S. taxpayer is eligible under the SDOP if, in addition to meeting the non-willfulness requirement, such taxpayer has previously filed a U.S. tax return (if required) for each of the most recent three years and has failed to report gross income from foreign financial assets and pay tax on such income or failed to file an FBAR or one or more other international information returns.

The SDOP requires the taxpayer to file amended returns for the three most recent years for which the U.S. tax return due date has passed, along with delinquent FBAR filings for the past six years. As an addendum to each amended return, the taxpayer must submit a new certification form (available on the IRS website) certifying that the failure to report foreign income or file FBARs was non-willful.

One factor distinguishing the domestic streamlined procedures from the foreign streamlined procedures is the imposition of a new Title 26 miscellaneous offshore penalty for taxpayers using the SDOP, as discussed above. This penalty reflects the increased culpability of a domestic U.S. taxpayer's failure to report. The new penalty is equal to 5 percent of the highest aggregate balance or value of the taxpayer's foreign financial assets during the past six years. This penalty, along with the tax due on amended and delinquent returns, must be submitted with the certification form and amended returns. The taxpayer will not be subject to any accuracy-related penalties, information return penalties, or FBAR penalties, unless a subsequent examination finds that the original returns were fraudulent or the FBAR violations were willful.

The penalty imposed is significantly less than the 27.5 percent or 50 percent penalty that would result from participating in the OVDP. However, the success of the modified streamlined procedures rests with the non-willful actions or omissions of the taxpayer. This requires the IRS to accept that the failure was due to negligence, inadvertence, mistake, or good-faith conduct resulting from a misunderstanding of the law. This determination is highly fact sensitive, and failure to qualify under the procedures could expose taxpayers to a greater level of risk than if they had participated in the OVDP from the beginning.

Conclusion

Noncompliant U.S. taxpayers face new options on how to comply with their U.S. tax obligations. Assuming they are eligible for the newly announced voluntary compliance procedures, their choice will depend on whether their past actions or omissions were willful or non-willful. This will require taxpayers and their advisers to carefully consider all the facts and consequences. What is certain is that noncompliant taxpayers will face a greater risk of disclosure through the multiple means the U.S. government has to identify noncompliant taxpayers. If they are discovered, the outcome will not be pleasant. Thus, noncompliant U.S. taxpayers should quickly and seriously consider the benefits of the new U.S. voluntary disclosure programs. ◆

(excluding FBARs) should be submitted in hard copy to the Internal Revenue Service in Austin, Texas.