



# The IRS's Updated Voluntary Disclosure Procedures for Offshore Accounts and Assets

By Usman Mohammad

**O**n November 20, 2018, the IRS published an Interim Guidance Memo concerning voluntary disclosures, captioned “Updated Voluntary Disclosure Practice” (<http://bit.ly/2UHHdLm>). The memo sets forth the IRS’s current policy for handling voluntary disclosures (both offshore and domestic) following the closing of the IRS’s formal Offshore Voluntary Disclosure Program (OVDP) on September 28, 2018.

From March 2009 through September 28, 2018, the IRS has had one form or another of a formal voluntary disclosure program that permitted U.S. taxpayers to report to the IRS their

1, 2014 to September 28, 2018—a taxpayer making an offshore voluntary disclosure would need to file eight years of amended tax returns and FBARs and pay a fixed miscellaneous offshore penalty of 27.5% of the aggregate value of the previously unreported foreign accounts, sometimes increased to 50% depending upon the banks at issue in the voluntary disclosure.

The November 20, 2018 Interim Memo has changed the procedures and the terms for offshore voluntary disclosures going forward, and there are several features of these procedures that practitioners should keep in mind.

## What Has Changed

First, under the new voluntary disclosure procedures, a taxpayer may have to disclose far more information than they would have under the OVDP. The memo provides that a taxpayer wishing to make a voluntary disclosure must first make a preclearance request to the IRS’s Criminal Investigation Division (CID), and thereafter make a detailed submission to the CID, “including a narrative providing the facts and circumstances, assets, entities, related parties and any professional advisors involved in the noncompliance” (emphasis added).

Second, the new voluntary disclosure procedures may result in more tax years being subject to civil examination than under the OVDP. Under the prior OVDP, taxpayers were required to submit eight years of amended tax returns—a period that was fixed and prevented the IRS from going back and auditing earlier tax years. Under the new voluntary disclosure procedures, it is “expected” that IRS civil examiners will be able to resolve most cases through the “examination of the most recent six tax years,” but IRS examiners have “discretion to expand the scope to include the full duration of the noncompliance.” Thus, under the new procedures, there is not necessarily a fixed cap on the number of years that can be the subject of the civil examination.

Third, the new voluntary disclosure procedures remove the fixed miscellaneous offshore penalty that was a key feature of the previous program. While many practitioners lamented that the OVDP program’s fixed 27.5% miscellaneous account balance penalty (or 50%, depending on the bank involved) created a one-size-fits-all approach that did not properly take into account mitigating facts in individual cases, that approach did create certainty regarding the amount of the offshore penalty. Under the new voluntary disclosure procedures, there is no



interest in previously undisclosed foreign bank accounts. As part of the program, taxpayers would receive protection from criminal prosecution for failing to previously report their foreign accounts and the income from those foreign accounts, or for filing tax returns that were allegedly false due to those failures. In exchange, taxpayers would be required to file several years of amended returns; pay the additional tax, penalties on tax, and interest reflected on those amended returns; file several years of Reports of Foreign Bank and Financial Accounts (FBAR); and pay a miscellaneous offshore penalty on the aggregate value of their previously unreported foreign accounts. During the most recent iteration of the formal voluntary disclosure program—the OVDP, which was in effect from July

fixed miscellaneous offshore penalty; instead, the new procedures provide that “willful FBAR penalties will be asserted in accordance with existing IRS penalty guidelines under IRM [Internal Revenue Manual] 4.26.16 and 4.26.17.” Taxpayers will, however, be permitted to request the imposition of “non-willful FBAR penalties instead of willful penalties.”

Under the IRM, willful FBAR penalties will be “the greater of \$100,000 or 50% of the amount in the account at the time of the violation,” and for cases “involving willful violations over multiple years, examiners may recommend a penalty for each year for which the FBAR violation was willful.” [IRM 4.26.16.6.5.3 (11-06-2015) (Penalty for Willful FBAR Violations-Calculation)]. The IRM also notes that while examiners “may recommend a penalty that is higher or lower than 50 percent of the highest aggregate account balance of all unreported foreign financial accounts,” it is expected that “in no event will the total penalty amount exceed 100 percent of the highest aggregate balance of all unreported foreign financial accounts during the years under examination.” Nonwillful FBAR penalties “for each year [are] limited to \$10,000,” and examiners are expected to use “their discretion in each case to determine whether a lesser penalty amount is appropriate” [IRM 4.26.16.6.4.1 (11-06-2015) (Penalty for Nonwillful Violations-Calculation)]. Thus, the new voluntary disclosure procedures may result in a wide degree of variation in the offshore penalties that may be imposed.

Fourth, the new voluntary disclosure procedures *require* the imposition of a civil fraud penalty. Under the prior OVDP program, taxpayers were required to pay 20% accuracy-related penalties under Internal Revenue Code (IRC) section 6662(a) on the full amount of their offshore-related underpayments of tax for all years, as well as any applicable failure-to-file penalties under IRC section 6651(a)(1) or failure-to-pay penalties under IRC section 6651(a)(2). There was,

however, no civil fraud penalty imposed. Under the new voluntary disclosure procedures, taxpayers *must* pay either the “civil penalty under IRC section 6663 for fraud or the civil penalty under IRC section 6651(f) for the fraudulent failure to file income tax returns” for at least one tax year at issue, and IRS examiners have the authority to assert the civil fraud penalty for multiple tax years in particularly egregious cases. The civil fraud penalty will essentially amount to 75% of the unpaid tax. Although the new voluntary disclosure procedures permit taxpayers to argue in any particular case that the civil fraud penalty should be replaced with a lesser accuracy penalty, the new procedures provide that the civil fraud

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penalty will only be waived in “exceptional” circumstances.

Fifth, unlike the prior OVDP, taxpayers will now have the right to appeal the liabilities imposed in connection with a voluntary disclosure to the IRS Office of Appeals.

#### Other Disclosure Options

Offshore voluntary disclosures (which must now be made under the auspices of the updated voluntary disclosure procedures) are meant for taxpayers whose

unreported foreign accounts are associated with either large amounts of unreported income or large account balances, or as to whom there may be some indicia of willfulness in failing to report their foreign accounts, making it important to protect these taxpayers against the risk of criminal prosecution.

In order to address less serious instances of unreported foreign accounts, the IRS instituted two other programs. The first is a Streamline Filing Compliance Procedure, which was instituted in 2012 (Streamline Program) and is still in effect. Under the Streamline Program, taxpayers submit a certification that their failure to report their foreign accounts and foreign account income was “nonwillful,” simultaneously submit amended or delinquent tax returns and FBARs, and, for taxpayers residing in the United States, pay a 5% miscellaneous offshore penalty. The second is the Delinquent FBAR Submission Procedures, which is for taxpayers who failed to file FBARs for their foreign account but do not have any unreported income from those accounts, either because the accounts did not generate any income or because the taxpayers properly reported any such income on timely filed tax returns. Under the Delinquent FBAR Submission Procedures, taxpayers file delinquent FBARs together with an explanation for the delinquent filing. That program is also still in effect.

By announcing a new framework for taxpayers to voluntarily disclose offshore noncompliance, the IRS has continued to make available different programs and procedures for noncompliant taxpayers, with differing penalty levels based on the taxpayer’s purported degree of culpability. Taxpayers and their CPAs or other tax or financial advisors should carefully evaluate the different programs before choosing the one in which to participate. □

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