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IRS Announces Closure of 2014 Offshore Voluntary Disclosure Program: What Comes Next?

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On March 13, 2018, the Internal Revenue Service announced it will close the 2014 Offshore Voluntary Disclosure Program (“2014 OVDP”) on September 28, 2018.¹ The announcement was accompanied by the posting of 10 frequently asked questions (the “FAQs”) to the IRS website.² The FAQs note a “significant decline in the number of taxpayers participating as well as an increase in awareness of offshore tax and reporting obligations” as the explanation for closing the 2014 OVDP.³ The announcement and the lead time are intended to allow taxpayers with undisclosed foreign assets and accounts of unreported foreign income to use the 2014 OVDP before closure of the program.

The 2014 OVDP is the fourth iteration of voluntary disclosure programs intended to encourage offshore compliance (collectively, the “OVDP Programs”).⁴ Since the initiation of the OVDP Programs in 2009, more than 56,000 taxpayers have used an OVDP Pro-

gram to address past non-compliance in reporting foreign accounts and assets or foreign-source income, and they have paid \$11.1 billion in back taxes, interest, and penalties.⁵ In announcing termination of the 2014 OVDP, the IRS reported that OVDP Program participation peaked with the 2011 Offshore Voluntary Disclosure Initiative, when approximately 18,000 taxpayers came forward voluntarily. Since then, participation has steadily declined, with only 600 disclosures in 2017. These numbers are in addition to another 65,000 taxpayers who have taken advantage of the Streamlined Filing Compliance Procedure (SFCP), which remains available to taxpayers. However, the IRS has cautioned that the SFCP could also be closed or modified in the future.

What Options Are Left?

In addition to the SFCP, taxpayers with undisclosed foreign accounts and assets or unreported income from foreign sources may avail themselves of three other programs:

- Traditional IRS-Criminal Investigation Voluntary Disclosure Practice,
- Delinquent FBAR Submission Procedures, and
- Delinquent International Information Return Submission Procedures.

The significance of closure of the 2014 OVDP can best be understood by a brief comparison with the remaining disclosure alternatives.

Streamlined Filing Compliance Procedure: The SFCP has also gone through multiple iterations.⁶ The current version generally requires taxpayers to submit three years back U.S. income tax returns and six years of unfiled Foreign Bank Account Reports (FBARs).

¹ IR-2018-52 (Mar. 13, 2018).

² See the OVDP FAQs at irs.gov.

³ FAQs, Q&A 2.

⁴ 2009 Offshore Voluntary Disclosure Program announced February 9, 2009; closed September 23, 2009. 2011 Offshore Voluntary Disclosure Initiative announced February 8, 2011; closed September 9, 2011. 2012 Offshore Voluntary Disclosure Program announced June 26, 2012. 2014 OVDP commenced June 1, 2014. See generally Robert E. Ward, *2012 Offshore Voluntary Disclosure Program: Issues and Opportunities*, 41 Tax Mgmt. Int'l J. 548 (Oct. 12, 2013), *Offshore Voluntary Disclosure Program Round Four: IRS Announces Further Changes to Encourage Broader Compliance* 43 Tax Mgmt. Int'l J. 604 (Oct. 10, 2014).

⁵ IR-2018-52 (Mar. 13, 2018).

⁶ The first SFCP was offered on September 1, 2012, and was limited to taxpayers residing outside the United States who did not show a high risk of continued non-compliance.

To be eligible for the SFCP, the taxpayer's non-compliance must be non-willful. "Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is a result of a good faith misunderstanding of the requirements of the law."⁷ Taxpayers eligible to participate in the SFCP are liable for taxes and interest on unreported income disclosed on their income tax returns submitted through the SFCP but are not liable for penalties in the case of taxpayers satisfying the nonresidency requirement of the SFCP or a 5% offshore penalty in the case of taxpayers who do not meet the nonresidency requirement.

Delinquent FBAR Submission Procedure: The Delinquent FBAR Submission Procedure is available to taxpayers who have reported all income from foreign accounts on their U.S. income tax returns but failed to file FBARs disclosing their foreign financial accounts. The FBARs are filed electronically including a statement explaining why the FBARs are filed late. Unless the taxpayer is the subject of a civil examination or criminal investigation by the IRS, or the Service has contacted the taxpayer regarding the delinquent FBARs, no penalties are imposed for the failure to file the delinquent FBARs.

Delinquent International Information Return Submission Procedures: Eligibility for the Delinquent International Information Return Submission Procedures also depends on the lack of civil examination or criminal investigation or other contact by the IRS regarding the delinquent information returns and requires previous reporting of all income from the foreign accounts and assets to which the information returns relate on the taxpayer's previously filed U.S. income tax returns. However, the returns available for submission under this procedure include not just FBARs but any other international information returns (for example, Forms 3520, 3520-A, 5471, 8865, and 8938). The delinquent information returns are submitted with a written explanation why they are filed late. If the IRS determines the taxpayer had reasonable cause for doing so, no penalties are assessed for the late filing.

IRS Traditional Criminal Investigation Voluntary Disclosure Practice: For many years, predating the OVDP Programs, the Internal Revenue Manual (IRM) has described a practice allowing taxpayers to submit delinquent tax and information returns for consideration along with "all other factors in the investigation in determining whether criminal prosecution will be recommended."⁸ The IRM makes clear that the voluntary submission of unfiled tax and information re-

turns does not guarantee immunity from prosecution, and it cautions taxpayers not to rely on the government's failure to recommend that similarly situated taxpayers be criminally prosecuted. As with the other alternatives to address foreign non-compliance, the IRS's traditional voluntary disclosure practice requires taxpayers to make their submissions before the IRS has contacted them or initiated a civil examination or criminal investigation. In addition, the disclosure must be made before the IRS has received information from third parties regarding the taxpayer's non-compliance.⁹

What's Special About the OVDP Programs?

The most compelling feature of the OVDP Programs has been that acceptance and participation in those programs allowed taxpayers to avoid criminal prosecution. It was ideally suited to "bad actors" as long as there was no unreported income from illegal sources. Consistent with the notion that taxpayers who availed themselves of OVDP Programs had willfully attempted to evade U.S. income taxation on foreign assets and accounts, the OVDP Programs imposed an array of penalties the most significant of which was the offshore penalty. The offshore penalty is based on the highest aggregate value of the taxpayer's foreign financial accounts and foreign assets attributable to non-compliance during the six-year period (in the case of the 2009 Offshore Voluntary Disclosure Program) or eight-year period (in the case of subsequent OVDP Programs). The offshore penalty was assessed at a 20% rate on this amount in the case of the initial OVDP Program and gradually increased to 27.5% in the 2012 OVDP, unless the taxpayer's foreign accounts were with a foreign financial institution which was under investigation by the IRS, cooperating with the IRS, or the subject of a "John Doe Summons."¹⁰ Taxpayers at these financial institutions are subject to a 50% offshore penalty.

Another core distinction between the OVDP Programs and each of the remaining alternatives is certainty. Termination of the 2014 OVDP not only eliminates the voluntary disclosure option which protects taxpayers from criminal prosecution, it also eliminates the only option available to taxpayers who were uncertain as to whether their non-compliance was non-willful or qualified by reasonable cause. It is the only voluntary disclosure alternative that allows taxpayers to determine with reasonable certainty the tax and penalty obligations they will encounter. Under the

⁹ IRM §9.5.11.9(4).

¹⁰ Q&A 7.2, Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014 (Mar. 14, 2018). A list of those foreign financial institutions is available at irs.gov (Jan. 10, 2018).

⁷ Streamlined Filing Compliance Procedures (Jan. 25, 2018).

⁸ IRM §9.5.11.9(1).

SFCP, other than the simple statement above defining non-willfulness, the IRS has not provided any further guidance or even examples as to circumstances in which a taxpayer's non-compliance will be considered non-willful. In fact, taxpayers submitting income tax and information returns under the SFCP are in, at best, a "no news is good news" situation. Taxpayers who have reported all income from foreign accounts and assets but failed to file information returns are required to satisfy an even higher threshold of reasonable cause to avoid penalties. Further, the OVDP Programs were one of only two alternatives (the other being the IRS Criminal Traditional Voluntary Disclosure Practice) for taxpayers who did not qualify under the SFCP because they were regarded as U.S. resident but failed to file income tax returns.

SFCP participants get no confirmation from the IRS regarding either receipt of their returns or acceptance of their statement of non-willfulness. Similarly, taxpayers participating in the Delinquent International Information Return Submission Procedures get no confirmation of their submissions or acceptance that their non-compliance satisfies the reasonable cause standard applied by the IRS. Similar lack of notice or response afflicts the Delinquent FBAR Submission Procedures. What the IRS does confirm, however, is that taxpayers who submit income tax and information returns through the Procedures or the Traditional IRS Criminal Investigation Voluntary Disclosure Practice have no assurance they will not be the subject of criminal prosecution. In fact, the SFCP explicitly directs to the 2014 OVDP those taxpayers who seek assurance of protection from criminal prosecution.¹¹

Who Benefits From an OVDP Option?

Prior to announcing closure of the 2014 OVDP, on February 23, 2018, the IRS requested comments on the 2014 OVDP specifically directed at the collection of information required for taxpayers to participate.¹² In response, the Civil and Criminal Tax Penalties Committee of the American Bar Association's Section of Taxation organized a comment project which is currently underway. Preliminary comments encourage the IRS to initiate a replacement program that is fair to the 56,000 taxpayers who have previously disclosed under the OVDP Programs. Changes will likely involve some increase in penalties.

The closure announcement included statements by Don Fort, Chief, IRS Criminal Investigation: "The IRS remains actively engaged in ferreting out the

identities of those with undisclosed foreign accounts with the use of information resources and increased data analytics. . . . Stopping offshore tax non-compliance remains a top priority of the IRS." Perhaps even more ominously, the announcement observed that termination of the 2014 OVDP "also reflects advances in third-party reporting and increased awareness of U.S. taxpayers of their offshore tax and reporting obligations." One might surmise from these statements that the IRS has run out of patience with taxpayers who have not taken advantage of the OVDP Programs and other opportunities to address foreign non-compliance.

The reality is that not only do taxpayers need an OVDP alternative in the universe of possible offshore voluntary disclosure options, so does the IRS. Offshore non-compliance remains rampant. The U.S. Department of State estimated there were approximately 9 million U.S. citizens living abroad in 2016. However, in that year the United States received only 1.2 million FBARs.¹³ This author's own purely anecdotal experience from conducting a U.S. tax practice in Vancouver, British Columbia, since 2006 is that the majority of U.S. citizens living in Canada do not file U.S. tax or information returns, despite increasing knowledge of the obligation to do so.

There are compelling reasons to believe the IRS is well aware of the level of foreign non-compliance. It receives information regarding non-compliant taxpayers from a multitude of sources: information gathered through the OVDP Programs since 2009, whistleblowers, the Swiss Bank Voluntary Disclosure Program, information exchange agreements with other governments, and, since September 2015, information regarding foreign accounts and assets of U.S. persons through the Foreign Account Tax Compliance Act.¹⁴ Decreased funding for the IRS has left the Service with reduced personnel and limited resources with which to examine individual taxpayers. The IRS needs an OVDP Program not only to *encourage* compliance, but also to *manage* compliance.

In Sum . . .

The first OVDP Program was initiated by the IRS in 2009 after media attention surrounding Bradley Birkenfeld's disclosure of UBS and other Swiss bank practices soliciting U.S. citizens to open Swiss bank accounts to evade U.S. tax and reporting obligations. This was followed by enactment of FATCA in 2010

¹¹ Streamlined Filing Compliance Procedures (Jan. 25, 2018).

¹² See 83 Fed. Reg. 8734 (Feb. 23, 2018). The FAQs also solicit "suggestions to provide the IRS on procedures relating to the IRS' voluntary disclosure practice after the 2014 OVDP closes."

¹³ National Taxpayer Advocate Blog, *An Analysis of Tax Settlement Programs as Amnesties: Discussion of Belated Alternatives to the Offshore Voluntary Disclosure Program and Recommendations for Further Improvements* (Part 3 of 3) (Mar. 30, 2018).

¹⁴ See generally Robert E. Ward, *FATCA, the U.S.-Canada IGA, and Trusts*, 43 Tax Mgmt. Int'l J. 255 (May 9, 2014).

and three subsequent OVDP Programs. However, OVDP Program submissions peaked in 2011. It is this practitioner's view that the reason non-compliance persists, particularly in the U.S. citizen community living abroad, is there is no fear of enforcement. As expressed to me by a local tax professional in Vancouver, "The only people I know who pay U.S. taxes are the ones who came forward voluntarily." Despite the massive amount of information the U.S. government has received regarding its citizens with unreported foreign accounts and unreported income from foreign accounts and assets, it has never sent those taxpayers

a letter asking for their unfiled U.S. income tax and information returns. There is nothing that the IRS could do that would be more effective than this simple measure. However, if such an effort is to be made, it will be necessary to have programs in place to process taxpayers who respond. Because of the limitations of the other alternatives, an OVDP Program is needed for taxpayers whose non-compliance is not so clearly non-willful or lacks reasonable cause, or who simply seek assurance that they will not be prosecuted criminally.