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Recent IRS Interim Guidance Provides That It Is Not Too Late For Your Willful Clients To Voluntarily Disclose Their Offshore Accounts, But Penalties Abound

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The Internal Revenue Service has had a long-standing practice of providing taxpayers with potential criminal exposure a means to come into compliance with the law and potentially avoid criminal prosecution through the making of a voluntary disclosure of their domestic or offshore noncompliance. With regard to offshore noncompliance, that “means” was set forth as the IRS Offshore Voluntary Disclosure Program (“OVDP”). My clients greatly benefitted from the OVDP and its predecessors going all the way back to the program’s inception in 2009. Many benefitted even further in 2012, when the Streamlined Filing Compliance Procedures were introduced. The Streamlined Procedures provided clients lacking willfulness with reduced or even zero penalties. But for those clients unable to meet the non-willfulness requirement of the Streamlined Procedures, OVDP was the only means to come into compliance with near surety that a criminal action would be foreclosed.

As all good things seem to come to an end, in late September 2018 the OVDP sunsetted. That result was not unexpected given that over time the reporting penalties steadily increased, and by large margins—there were fewer self-motivated nonwillful taxpayers left out there and those who dawdled were penalized. Now that OVDP has made its long journey into night, many clients have asked whether the only remaining option is to make a “quiet disclosure” to the Service Center, and live fingers-crossed that criminal enforcement would not come knocking while the statute of limitations slowly clicked away. For nearly two months, practitioners were left in the dark as to any other options, but the IRS has recently released Interim Guidance Memo LB&I-09-1118-014 setting forth procedures and penalties by which your clients may make a willful disclosure limiting their criminal exposure.

Similar to the prior OVDP, the Interim Guidance has taxpayers make a preclearance request on the newly updated Form 14457, which seeks the same types of preclearance information about account values and unreported income as before (with a 6-year lookback, but which can be shorter or longer as needed), and will now add a narrative of the facts and circumstances, which will likely be akin to the Form 14653 and 14654 used for the Streamlined Procedures. Once the client is precleared, the disclosure packet with returns will be sent to the field for civil examination.

Yes, unlike OVDP or Streamlined Disclosure, all voluntary disclosures handled by examination will now be subject to standard examination procedures. And penalties abound! Exam will assess tax, penalties and interest as follows:

- For the tax year showing the highest liability, the 75% penalties under Section 6663 for fraud or Section 6652(f) for the fraudulent failure to file will apply.
- If there is no agreement to the tax liability, the examiner may apply the foregoing penalty to up to six years, and even beyond.
- The willful FBAR penalties will be imposed, up to 50% of the value of the account or \$100,000 *per account, per year*. For your clients with many offshore accounts, this will be an important area of negotiation. You are permitted to seek the Section 6662 20% accuracy-penalty instead of the 75% civil fraud penalties, and the nonwillful FBAR penalties of a maximum of \$10,000 per account, per year instead of the willful penalties. In order to receive that lesser penalty regime, the taxpayer must present convincing evidence to justify such a departure. The IRS notes that the granting of such requests will be made only in exceptional cases.
- The penalties for the failure to file informational returns will not be automatically imposed, but may be imposed when the total penalties imposed are taken into account.
- Penalties relating to excise taxes, employment taxes, estate and gift tax, and other taxes will be handled based upon the facts and circumstances.
- Taxpayers will now have the right to request an appeal with the Office of Appeals.

While the penalties have markedly increased from the now-closed OVDP, the procedures set forth under the Interim Guidance remain the only way to obtain any surety against or limitation of criminal liability for the failure to have properly reported offshore assets and accounts. A “quiet disclosure” at the Service Center does not provide any such surety or limitation. But waiting this long has its consequences, with penalties that have far exceeded those imposed under the OVDP.