



## IRS Voluntary Disclosure Initiative

Why tax practitioners need to be concerned about the latest guidance on unreported foreign accounts issued.

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As of March 26, 2009, IRS Commissioner Douglas Shulman announced a settlement initiative for taxpayers who disclose unreported offshore accounts and pay the taxes, penalties and interest due voluntarily and in a timely manner. In addition, taxpayers taking advantage of this initiative can avoid criminal prosecution and certain penalties, such as the 75 percent fraud penalty, that might otherwise apply. The initiative is in effect for six months from March 23, 2009, with no guarantee it will be extended or if extended the terms of settlement will be the same.

Those meeting the terms of the initiative will have to file amended or delinquent returns for the previous six years including the unreported foreign account income and will have to pay back taxes and interest for each of those years together with either an accuracy or delinquency penalty. In addition for each of those years, a Report of Foreign Bank and Financial Accounts (FBAR) will have to be filed. In lieu of all other penalties that may apply, a penalty equal to 20 percent of the highest aggregate amount or value of the foreign accounts in any one year will be assessed. This penalty is reduced to five percent if, with respect to the accounts:

1. The taxpayer did not open or cause the foreign account to be opened,
2. There has been no activity with respect to the accounts during the period that the taxpayer controlled them and
3. All applicable U.S. taxes have been paid on the funds in the accounts and only the earnings have escaped U.S. taxes.

As explained in the IRS Memorandum issued March 23, 2009, initial contact will be with Criminal Investigation, which will make the preliminary determination as to whether the taxpayer is eligible to make a voluntary disclosure. If the taxpayer is eligible, the voluntary disclosure will be forwarded to the Philadelphia Offshore Identification Unit for civil processing.

#### IRS Frequently Asked Questions (FAQ) — General

On May 6, 2009, the IRS posted 30 Frequently Asked Questions (FAQs) on its Web site about voluntary disclosures regarding offshore accounts to assist taxpayers in making disclosures. The FAQs demonstrate how the initiative works, who is eligible, how to disclose and what steps need be taken. It also contains numerous warnings of the adverse consequences for failure to participate.

#### Objectives of Voluntary Disclosure Initiative

In the FAQs, the IRS restates the objectives of the settlement initiative that a voluntary disclosures enables taxpayers to become compliant, avoid substantial penalties

and generally eliminate the risk of criminal prosecution. The IRS warns that those taxpayers who do not make a voluntary disclosure run the risk of detection, imposition of substantial penalties — including the 75 percent fraud penalty — and an increased risk of criminal prosecution. The IRS supports this warning by listing the criminal and civil penalties that otherwise might apply to nonparticipating taxpayers. In addition, the FAQs provide an example of the computation of the reduced penalties with respect to a voluntary disclosure made in compliance with the initiative and compares that amount to what would be imposed if the taxpayer did not make a voluntary disclosure under the initiative. Under the facts of the example, the taxpayer would pay \$360,000 of taxes, penalties and the FBAR 20 percent penalty, plus interest, while if the taxpayer did not make a voluntary disclosure under the initiative, the taxpayer would pay \$2.3 million worth of taxes, penalties and FBAR penalties, plus be exposed to having the 75 percent fraud penalty imposed.

#### Eligibility for Voluntary Disclosure Initiative

According to the FAQs, all taxpayers, including individuals, corporations, partnerships and trusts, are eligible for relief, as long as they are not currently under a civil examination, regardless of whether it relates to undisclosed foreign accounts, and as long as the voluntary disclosure is timely, accurate and complete. Internal Revenue Service, Criminal Investigation (IRS-CI) Chief Eileen Mayer has stated that each special agent-in-charge will give a taxpayer or its representative a letter stating whether the individual is disqualified from acceptance into the voluntary disclosure initiative before actually making a voluntary disclosure. In addition, taxpayers who have properly reported and paid the taxes on their income from offshore accounts, but have not filed FBARs are not eligible for the voluntary disclosure initiative. However, the IRS advises these taxpayers to file the delinquent FBARs according to the instructions and to attach an explanation of why the reports are being filed late and counsels that the IRS will not impose a penalty for the failure to file the FBARs.

#### How to Make a Voluntary Disclosure Under the Initiative

The IRS counsels that a taxpayer making a voluntary disclosure should send a letter to the Special Agent-in-Charge, IRS Criminal Investigation, setting forth that the taxpayer wants to make a voluntary disclosure, the taxpayer's name, address, Social Security number or Taxpayer's Identification Number (TIN), passport number, date of birth and an explanation of any previously unreported or under-reported income including the reasons for the omission or error. If corrected returns, have been prepared they should be submitted with the letter. There is no specific questionnaire for the taxpayer to complete, but

the IRS may require an interview with the taxpayer depending upon the facts.

#### IRS Warning Regarding Hypothetical Situations and Quiet Disclosures

The IRS cautions against presenting hypothetical situations and against making a quiet disclosure. If the taxpayer has already made a quiet disclosure, the IRS instructs the taxpayer to send the amended or delinquent returns that were filed in making the quiet disclosure to the CI office by September 23, 2009, to take advantage of the reduced penalties and the recommendation not to prosecute. The IRS warns those taxpayers who have already made a quiet disclosure and do not send the amended or delinquent returns to CI, risk being examined and the potential of criminal prosecution for all open years. This is directly contrary to the criminal tax bar's understanding that a quiet disclosure would not lead to criminal prosecution.

#### Difficulty Obtaining Financial Information and Inability to Pay

The IRS recognizes the difficulty in obtaining financial information from foreign banks and will assist taxpayers in preparing a request that should be acceptable to the foreign bank. If a voluntary disclosure is started in a timely fashion, difficulty in obtaining the necessary documentation to complete the voluntary disclosure will not disqualify a "cooperative" taxpayer from the penalty relief. If the taxpayer is unable to pay the full amount due at the time of submitting a closing agreement, the taxpayer has the burden of working out an alternative payment schedule to be entitled to penalty relief under the initiative. Further, it is stated in no uncertain terms that the reduced penalty initiative is a package and the IRS will not negotiate different terms.

#### Conclusion

The FAQs still leave unanswered a number of questions. For example, if the fund in the account was unreported income or unreported for estate tax purposes and more than six years have elapsed, is the taxpayer eligible for the reduced penalty initiative or does the taxpayer have to file amended or delinquent returns including such amount in the amended return even though more than six years ago.

## About the Author

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