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Is OVDP Still Such a Good Deal?

A fresh look at the Offshore Voluntary Disclosure Program

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In the five years since the Internal Revenue Service announced the first Offshore Voluntary Disclosure Program (OVDP) in March 2009, almost 45,000 taxpayers have elected to participate and IRS has collected $6.5 billion.

On June 18, the IRS announced major changes to the terms of the OVDP. These apply to all persons not already participating on that date. In some cases, the changes make compliance less onerous but, for other taxpayers, the ante has been significantly raised.

Many taxpayers appear to be still thinking about whether OVDP is for them or not.

Recent IRS and DOJ Activity

On May 19, several years of rumors about an impending guilty plea by Credit Suisse became a reality when Credit Suisse AG pleaded guilty in U.S. District Court in the Eastern District of Virginia to conspiracy to defraud the U.S. by assisting U.S. taxpayers in hiding funds in Switzerland. Credit Suisse also agreed to pay a $2.6 billion fine and to cooperate by helping IRS to identify its U.S. customers.

Numerous other foreign banks are said to be under investigation by IRS and the Department of Justice (DOJ).

In August 2013, the DOJ announced what amounts to an OVDP for offshore banks that are not already targets of criminal investigations. Under that "Bank Program," the banks can enter into negotiations with the department, disclose the extent of their business dealings with U.S. taxpayers and obtain either a nonprosecution agreement (NPA) or nontarget letter (depending on the level of such business) in return for the bank paying penalties of between 20-50 percent of the highest balance in the U.S. taxpayers' accounts.

Interestingly and, most telling, the Bank Program provides the banks an opportunity to avoid paying penalties entirely on accounts of their U.S. taxpayers if the taxpayers were either compliant in their reporting of the accounts *or* have entered into the OVDP.

This seemingly is designed to force the banks to (at the very least) encourage their U.S. customers to enter the OVDP by letting them know that the bank will turn over their account records.

The DOJ has indicated that at least 106 Swiss banks have entered into negotiations for NPAs, and a significant number of other Swiss banks have reportedly sought to obtain nontarget letters prior to the June 30 deadline. Some agreements have reportedly been concluded.

New Reporting Requirements and Audit Scrutiny

Starting in 2011, in addition to being required to file an annual Foreign Bank Account Report (FBAR) each June 30th, U.S. taxpayers are required to make detailed disclosures of foreign accounts and some other assets on their tax returns on a new Form 8938, which must be attached to their Form 1040 every year. If not attached, the statute of limitations does not start to run.

In 2013, the Treasury Department instituted mandatory electronic filing of FBARs (a move seen as indicative of increasing IRS interest in cross-referencing current filers against prior years' FBAR filings).

U.S. taxpayers who have been identified as having foreign accounts but who have not participated in one of the prior OVDP have been targeted for audit. The auditors are issuing pointed Information Document Requests (IDRs) and then demanding the taxpayers appear for in-person interviews. Several of these cases have been referred to the Criminal Investigation Division and steep civil penalties (50 percent of the foreign account's highest balance *per year*) have been levied in others.

In late May 2014, a Florida jury upheld a 150 percent FBAR penalty (three years at 50 percent/year) against a Swiss bank customer who (the government claimed) attempted a "quiet disclosure" rather than entering the 2009 OVDP. *United States v. Zwerner*, Civ. No. 13-22082 (S.D. Florida 2014).

As if this were not enough, the provisions of FATCA (Foreign Account Tax Compliance Act) start to take effect in 2014 and require foreign banks to enter into agreements with the IRS which would disclose their U.S. customers or face 30 percent gross withholding on every transaction they conduct in the U.S.

What Advantages Does OVDP Offer?

OVDP must be distinguished from both other formalized, IRS-sanctioned methods of coming into compliance announced on June 18, 2014, *i.e.* the Streamlined Filing Compliance Procedure (SFCP) *and* informal ones used by some taxpayers such as "quiet" or "semi-quiet" disclosure.

Only the OVDP offers what amounts to amnesty from criminal prosecution to an entire group of noncompliant taxpayers. The door is closed only to those who are either already under IRS audit, those engaged in illegal activity to produce the unreported income and to the promoters of the use of offshore tax avoidance schemes and others whose names IRS already knew.

The OVDP incorporates elements of the prior civil settlement initiatives IRS had used effectively to resolve abusive tax shelter cases and caps the taxpayer's civil tax exposure. This gives the taxpayer a predictable financial cost for "fessing up" and avoiding criminal prosecution.

What Are the Disadvantages?

Unlike the tax shelter initiatives, the current OVDP "look back" period requires amending tax returns for eight years, well beyond the normal three-year civil statute of limitations for assessment. In addition to paying eight years of tax due, participating taxpayers must pay a 20 percent "accuracy" penalty on the tax due plus interest on both and, a 27.5 percent "miscellaneous" or "FBAR-related" penalty computed on the highest value of their noncompliant foreign assets in the eight-year period (including investments other than bank accounts). Under the changes made to OVDP on June 18, all of this must be paid at the time of the submission whereas, previously, the "miscellaneous" 27.5 percent penalty on the highest balance (typically the largest piece of the amount due) was not due until after the IRS had reviewed the submission and approved it. This often was a year or more later.

After August 3, for those whose banks or advisors have been publicly identified as under IRS investigation, the 27.5 percent penalty is increased to 50 percent on *all* foreign accounts or assets (even if only one bank out of several is so identified).

The program is a "take it or leave it" proposition. IRS examiners have no authority to reduce the penalties due under the OVDP or limit their application in any way.

Is Opting Out of OVDP a Good Idea?

With the recent changes to the OVDP and SFCP, OVDP now is largely only for those who cannot (or should not) certify that their noncompliance was "nonwillful."

Opting out should be a carefully thought-out decision. The decision is irrevocable. Opting out does not mean the IRS's commitment not to pursue criminal prosecution is in jeopardy; however, the IRS will conduct an audit. The taxpayer and his or her original return preparer will be interviewed and closely questioned about whether the CPA asked about foreign income and assets and what the taxpayer said. The examiner may also probe the reasons other required information reporting forms were not filed (such as Forms 3520 or 5471), and penalties other than FBAR penalties may be considered. In addition, per year "willful" (50 percent) FBAR penalties could be asserted in some cases, as the "cap" on penalties available under OVDP is lost by opting out. Moreover, to the extent additional foreign assets or issues that were not part of the original disclosure are uncovered, the case could wind up back in the hands of the Criminal Investigation Division.

What Is the New Streamlined Filing Compliance Procedure?

SFCP was initially announced in June 2012 and was only available to U.S. citizens or permanent residents who resided outside the U.S., have not filed U.S. tax returns since at least 2009 and were fully compliant in their country of residence.

However there was, unlike OVDP, no protection against criminal prosecution.

The June 2014 changes expand SFCP to a somewhat larger group of nonresidents, including those who filed U.S. returns but did not report foreign income or assets.

More importantly, the new SFCP rules allow taxpayers who are U.S. residents who did not report foreign income or assets but who certify that their noncompliance was not "willful" to correct the problem under the SFCP by filing only three years of amended returns and six years of FBARs (rather than eight years of each as required under OVDP). No income-tax penalty and only a 5 percent FBAR-related penalty are due (as opposed to the 20 percent income-tax penalty and 27.5 percent FBAR-related penalty under OVDP).

However, there is no protection against criminal prosecution if the IRS finds the taxpayer's certification of nonwillful conduct not to be true. Moreover, the taxpayer will by then be ineligible to participate in OVDP.

What About Some Type of Quiet Disclosure?

Some have elected to forgo participation in the prior OVDPs and instead did "quiet" disclosures by amending several years of back tax returns either one at a time or as a group but without any explanation. These taxpayers paid the tax and interest only. However, most taxpayers and their advisors seem to have been dissuaded from pursuing that option by the veiled threat that IRS would seek to identify those who made quiet disclosures and deal with them harshly.

While not all quiet disclosures are likely to arouse the ire of the IRS or be seen as an attempt to circumvent the OVDP and its penalty structure, taxpayers should carefully think about whether their conduct can withstand close scrutiny if the IRS does identify their quiet or even "semi-quiet" disclosure. It remains to be seen whether the IRS will view a semi-quiet disclosure as an end-run around the expanded SFCP process.

As noted above, the IRS has been aggressive in asserting multiple-year 50 percent per year FBAR penalties against taxpayers who attempted quiet disclosures or did nothing when the facts suggested an intent to conceal motivated the original nonfiling of FBARs. In at least one recent case (*Zwerner*), a jury agreed and imposed a 150 percent penalty. Quiet disclosure should be viewed cautiously given these developments.

Is 2012 OVDP (as Modified in 2014) a Good Deal for Your Client?

The 2012 OVDP essentially incorporated the same terms as the 2011 OVDP except that the "offshore" penalty was raised from 25 to 27.5 percent of the highest value of the undisclosed foreign assets in the eight-year OVDP period. The June 2014 change kept these basic rules in place but increased the 27.5 percent penalty to 50 percent for taxpayers whose accounts are with banks already publicly identified as under IRS investigation or who used certain similarly identified financial advisors. This increases the penalty for those the IRS feels have had more than enough time already to come into OVDP but did not. *In order for those taxpayers who fall under this category to avoid the 50 percent penalty, they must complete the more detailed preclearance filing procedures before August 3*.

A taxpayer considering whether to participate (whether at the 27.5 or 50 percent penalty rate) should consider at least the following things:

First, the OVDP exacts a significant financial cost in exchange for peace of mind. That cost can be well over 35 percent of the value of the undisclosed foreign assets when the total cost of the tax for eight years, a 20 percent accuracy-related penalty on the tax due for each year, interest on both and a 27.5 or 50 percent FBAR-related penalty on the highest value of the taxpayer's undisclosed foreign assets over the eight-year OVDP period are added to the professional fees that the taxpayer will pay to hire a lawyer and a CPA.

Second, as the FBAR-related penalty due as part of the OVDP is the largest part of the cost of participation, taxpayers need to clearly understand that it applies to more than foreign bank accounts. It applies to *any* foreign asset that generated *any* foreign income (including gains from disposition of an inherited Monet or a vacation apartment). The taxpayer must carefully analyze what the "worst case" cost might be. It must all be paid up front with the amended returns and FBARs.

A taxpayer who is tempted to claim his noncompliance was nonwillful to avoid these penalties must ask himself some hard questions about his own prior conduct including:

- Have I used the foreign assets for the purpose of avoiding or evading U.S. tax *or* could my aictions lead the IRS to believe I did?
- Is the amount (value) of my foreign assets suggestive of such an intent?
- Is the amount of income earned from my foreign assets suggestive of such an intent?
- Was the source of the funds used to acquire my foreign assets previously never reported to the United States?
- Have I filed FBARs for some foreign accounts but not others?
- Have I moved my account from one bank to another rather than disclose it under one of the earlier OVDP programs?
- Have I done anything, either in bringing the funds to the foreign country or bringing them back, that suggests I am attempting to hide my foreign holdings (*e.g.*, cash deposits or withdrawals under $10,000, using others to bring in the funds for me, etc.)?
- Am I in a profession or position where I might be held to a higher standard (*e.g.*, a lawyer or CPA or public figure)?
- Have I knowingly falsely answered one or more questions about whether I have a foreign account on either my tax returns or a "tax organizer" questionnaire from my accountant? What would my accountant say if questioned?

The IRS has chosen not to define or give examples of what it considers to be "willful" conduct and has said they will determine the taxpayer's intent by evaluating all of the facts and circumstances.

If the honest answer to one or more of those questions is "yes," the taxpayer should seriously consider participating in the OVDP and, as shown by the recently decided *Zwerner* case in Florida (where a number of the answers to the above questions were "yes"), avoid anything that might be perceived as quiet disclosure or, worse, disclosure going forward.

Those considering using the SFCP procedure and certifying nonwillful conduct should beware. They should seek out counsel knowledgeable about criminal tax issues, engage that counsel in a candid discussion of their conduct and make a carefully considered decision. That decision is irrevocable. Once SFCP is applied for and the nonwillful certification is rejected, the taxpayer is ineligible to apply for OVDP. The decision should not be uncounseled or based on advice from someone not familiar with handling matters involving potential criminal tax fraud.

Doing nothing is *not* an option. Accurate advice is imperative.

Finally, the 2014 OVDP still does not have an end date. However, the IRS has reserved the right to close the program entirely at any time and, more importantly, to periodically close it to particular groups of taxpayers, including customers of particular banks or persons who have initiated litigation overseas to try to prevent disclosure of information to the IRS.

The time to make a decision is becoming increasingly short and is getting shorter every day.

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