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New IRS Offshore Account Policy, Bigger Penalties For Secret Accounts

It has been ten years since the IRS started winning big in foreign bank account cases. Some people have gone to prison, but the vast bulk of offshore accounts have been disclosed under the IRS programs designed for taxpayers to come forward. In fact, the IRS has collected over $10 *billion* in taxes and penalties, and more keeps coming in. The biggest and longest running of the amnesty programs, the Offshore Voluntary Disclosure Program, or OVDP, closed on September 28, 2018, unless you filed your initial papers before that deadline. If you did not file by then, you could still enter the Streamlined program, but you have to consider streamlined audits. Now, the other offshore shoe has fallen in this IRS memorandum. The new rules are effective for all disclosures after September 28, 2018. And the possible penalties have gone up quite significantly. Here are the major differences between the old OVDP and the new practice.

The IRS says taxpayers will be required to request preclearance (which used to be optional). The criteria for preclearance are unaffected. Therefore, a taxpayer denied preclearance under the old OVDP would probably also be denied preclearance under the new disclosure program.

As with the old OVDP, preclearance and an initial submission are to be made to the IRS Criminal Investigation office in Philadelphia. The initial submission will continue to involve the filing of a Form 14457. However, the Form 14457 will be revised, and will require applicants to provide a narrative statement about their circumstances. The narrative statement will require taxpayers to

disclose the facts and circumstances of their assets, entities, related parties, and any professional advisors involved in the tax noncompliance in order for the taxpayer to be preliminarily accepted into the new program.

Unlike the old OVDP, taxpayers will *not* submit documents to the Austin, Texas IRS office after being preliminarily accepted into the program. The Austin office will no longer be collecting and assembling the large submission of documents required under FAQ #25 of the old OVDP. Instead, the Austin office will route disclosures to a field agent. The disclosure process, document submission, and payment will occur directly with an IRS field agent. Nevertheless, if taxpayers want to stop interest accruing on their underpayments, they can choose to submit payments to the Austin office before a field agent is assigned.

The IRS field agent is supposed to follow standard examination procedures for assembling and reviewing disclosures, rather than the more informal compliance check model that field agents used to review OVDP submissions.

Disclosures will generally involve a *six-year* disclosure period, reduced from OVDP's 8 years. But penalties are the big development. The new program allows IRS field agents much more discretion to assert penalties. The flat penalty structure appears to be gone. Perhaps the new discretionary penalty structure is an attempt to reduce the number of "opt-outs," taxpayers who left OVDP because they thought the flat penalty was too rigid and their facts

mitigated toward a lower penalty. Nevertheless, the IRS memorandum does provide some guidance on what possible penalties may be applied.

Penalties will generally be asserted "under existing laws and procedures." This suggests that field agents will need to support any penalty asserted for civil fraud or willfulness based on the specific facts of a disclosure. Therefore, in many cases, the new program will not offer a significant reduction in *civil* penalties compared to a disclosure outside of the new disclosure program.

Nevertheless, there are a potential benefits the new disclosure program may provide. For example, the field agent may assert penalties for civil fraud under IRC § 6663 or § 66651(f), generally equal to 75% of the underpaid tax. In the new program, if the agent asserts the civil fraud penalty, the penalty will generally be applied to only the single year with the highest tax liability, and not to all six years. However, this benefit is not absolute. The field agent can "in limited circumstances" choose to apply it to *more* than one tax year in the disclosure period, and can even extend the penalty beyond the six-year disclosure period if the taxpayer "fails to cooperate and resolve the examination by agreement." In the old OVDP, the IRS did not have much recourse if a taxpayer refused to sign a closing agreement and chose instead to opt out. In the new program, it appears the IRS can assert higher penalties for non-cooperative taxpayers.

The 50% willful FBAR penalties can also be applied. The IRS guidance so far does not say if this penalty will be applied to one year or to multiple years. However, it says that the FBAR penalties will be applied in accordance with the penalty guidelines under these Sections of the Internal Revenue Manual: 4.26.16 and 4.26.17. That probably means the penalty would be applied to the year with the highest aggregate balance. Many taxpayers who choose to disclose their foreign assets outside of the Streamlined program do so because they have indicia of willfulness (*e.g.*, partial or inconsistent prior reporting). Therefore, the 50% "willfull" FBAR penalties may turn out to be fairly common.

Nevertheless, the new program's flexibility (or unpredictability) may offer some relief to taxpayers whose facts indicate non-willfulness, but who cannot disclose through Streamlined because of a more technical issue. For example, original tax returns cannot be filed through Streamlined by taxpayers who reside in the United States. In the old OVDP, these taxpayers would be subject to the flat 27.5% penalty, even though their noncompliance was non-willful. Under the new program, non-willful taxpayers in the U.S. who need to file original returns may be able to disclose through the new program and qualify for lower penalties than taxpayers whose noncompliance was willful.

Even if the field agent asserts the 75% civil fraud penalties and 50% willful FBAR penalties, taxpayers can *request* that the penalties be mitigated to the lower 20% accuracy-related penalty, and to non-willful FBAR penalties. However, the IRS expects that the reduction of penalties will be "exceptional," at least where the taxpayers' facts support the higher penalties.

The IRS retains discretion to impose additional penalties for failure to file information returns, such as Forms 8938 or Forms 5471. These penalties were abated in the old OVDP in lieu of the 27.5% flat penalty. The IRS says that these penalties will not be automatically imposed, but it does not say that these additional penalties are expected to be exceptional. Thus, whether or not they are imposed may come down to the field agents' discretion.

If a taxpayer disagrees with the penalties the field agent imposes, the taxpayer can appeal to the IRS's Office of Appeals. This appeals procedure also brings the disclosure process in closer conformity to the procedures a taxpayer would find in a quiet disclosure or in an opt-out case under the OVDP.

Overall, this disclosure program seems significantly less predictable and considerably more severe than the OVDP, at least for taxpayers who do not have sympathetic facts. It might end up being primarily attractive to taxpayers who are worried about their *criminal* exposure, since the disclosure may not offer material reduction in civil penalties over a quiet disclosure or a disclosure under the Internal Revenue Manual.