IRS Offshore Amnesty Program v. Reasonable Cause Defense

by Manuel "Mike" Garcia

There are 285,061 Hawaii residents today who were born outside the U.S. and over half first entered the U.S. in 1990 or later. A large number of these foreign born Hawaii residents may have foreign bank accounts. Unfortunately, having a financial interest, or even just signatory authority, over a foreign bank account creates the yearly obligation to report these foreign accounts to the IRS under the Bank Secrecy Act. The failure to file this report results in draconian penalties.

Since 2012, the IRS has operated an amnesty program involving undeclared offshore bank accounts. Any U.S. taxpayer with an unreported foreign bank account or other financial account should seriously consider whether it makes sense to participate in this IRS offshore amnesty program.

Many people may not know that merely owning or having signatory authority or other control over one or more foreign financial accounts whose aggregate value exceeds $10,000 during any portion of the year creates an obligation to file Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts ("FBAR") every year under threat of confiscatory penalties. This form is not part of the U.S. income tax return and it must be filed separately and received by the Department of Treasury on or before June 30th of the year immediately following the calendar year being reported.[1]

Failure to file the FBAR form every year is very serious. If the failure to file this FBAR form is deemed to be "willful," the person would be exposed to criminal penalties of up to $250,000 and/or 5 years imprisonment in addition to civil penalties of the greater of $100,000 or 50% of the amount in the account at the time of the violation. If the failure is deemed to be non-willful, the civil penalty is limited to $10,000 for each violation.

For example, if a Hawaii resident had $300,000 (USD) in a bank account in Hong Kong since 2010 and failed to file the FBAR form, he or she would be exposed to civil penalties in excess of the value of his or her bank account (*i.e.*, 50% of $300,000 every year for 3 years = $450,000) in addition to criminal penalties. The only way for a taxpayer to avoid any penalty is to prove that the failure to file the FBAR form was due to reasonable cause.

The current IRS amnesty program is not the first offshore amnesty program by IRS. The first offshore amnesty program in 2009 was the direct result of IRS's success in getting Switzerland's largest bank, UBS, to admit to violating U.S. criminal laws in its cross-border business and to pay IRS $780 million in fines, interest and disgorging of profits, in addition to providing IRS with the names and account information of certain U.S. customers in Switzerland (despite Swiss bank secrecy laws). The success of the first IRS offshore amnesty program led to the second program in 2011. However, the current program in 2012 will probably be the last chance for U.S. taxpayers to correct previous violations.

In 2010 Congress enacted the Foreign Account Tax Compliance Act ("FATCA") to combat tax evasion through investments in foreign accounts. Starting in 2011, FATCA requires U. S. taxpayers to report offshore financial assets by completing a new tax form (Form 8938) to be included in their tax returns. In addition, FATCA effectively forces foreign financial institutions (under threat of a new 30% U.S. withholding tax on foreign financial institutions) to report directly to the IRS certain information about foreign financial accounts held, directly or indirectly, by U. S. taxpayers. The commencement date for reporting by foreign financial institutions was extended from 2013 to 2015 to allow foreign financial institutions enough time to upgrade their intake process and computer systems to track U.S. accountholders. The implementation of FATCA will make it much more difficult for U.S. taxpayers to maintain anonymity for any foreign financial account.

So what does the IRS offshore amnesty program (known as the 2012 Offshore Voluntary Disclosure Program or "2012 OVDP") do for the U.S. taxpayer? Basically, it provides the U.S. taxpayer with more certainty about the consequences of coming forward to voluntarily disclose unreported foreign bank accounts. To remedy previous violations, a U.S. taxpayer would have to risk incurring serious penalties when filing the delinquent FBAR forms and amended tax returns to declare all undisclosed foreign income from prior years. Under the 2012 OVDP, the U.S. taxpayer would still have to pay additional taxes, penalty and interest on any undeclared foreign income, but the 2012 OVDP would provide amnesty for criminal violation and more certainty about the FBAR penalty to be incurred.

Under 2012 OVDP, if the U.S. taxpayer agreed to voluntarily cooperate with IRS to provide all relevant information regarding the foreign financial accounts, the IRS would agree to eliminate any criminal penalty and limit the FBAR civil penalties. In exchange for (i) a one-time charge of 27.5% (sometimes less) of the highest value of all foreign financial accounts and foreign assets over the last eight years and (ii) a 20% accuracy penalty on offshore related income tax underpayment, the U.S. taxpayer could remedy previous violations without risk of facing criminal prosecution or the draconian annual FBAR penalties. However, the taxpayer would have to pay this one-time penalty regardless of whether there was reasonable cause for some or all of the previous violations.

For anyone with a foreign account who has failed to file the FBAR form for any reason, it is important to remedy the situation before foreign financial institutions begin reporting their U.S. accountholders to the IRS under FATCA. Once the IRS receives information about a U.S. taxpayer's foreign account, it may be too late to get the benefits of 2012 OVDP because the IRS would probably not allow such taxpayer into the program to preserve a potential criminal case against the taxpayer.[2]

Whether or not to participate in the

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2012 OVDP will depend on whether the taxpayer had "reasonable cause" for the previous violations. A U.S. taxpayer should not just automatically join 2012 OVDP because of the fear of potential criminal penalties and draconian civil penalties. The IRS National Taxpayer Advocate has filed a report with Congress criticizing OVDP as inadequate because it does not take into account "benign actors" (*i.e.*, those with "reasonable cause" for their failure to file the FBAR form) and treats all taxpayers as "bad actors."[3] Therefore, an attorney should gather the pertinent facts (*e.g.*, review records and interview client and tax preparers) and assess the U.S. taxpayer's "reasonable cause" defense to arrive at the very critical judgment and decision about whether to get the U.S. taxpayer into full compliance inside or outside 2012 OVDP.

Anyone with an unreported foreign financial account today has the opportunity to remedy previous violations before the IRS learns about the foreign account. This opportunity should be seriously explored before it is too late.

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1 Prior to July 1, 2013, the FBAR form TD F 90-22.1 was required to be mailed separately to the Department of the Treasury in Detroit. However, starting in October of 2013, a new FBAR form, known as FinCEN Form 114, replaced the paper form TD F 90-22.1, and this new FBAR form must be filed electronically through the BSA E-Filing System at *http://bsaefiling.fincen.treas.gov/main.html*

2 Q&A No. 21 in the IRS Q & A description of OVDP in the IRS website states that once the IRS or the Department of Justice obtains information that provides evidence of a specific taxpayer's noncompliance with the tax laws or the Bank Secrecy Act, that particular taxpayer will become ineligible for OVDP.

3 See *http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Most-Serious-Problems-IRS-Offshore-Voluntary-Disclosure-Programs.pdf* .

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