



## IRS Announces a Second Voluntary Offshore Disclosure Initiative

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The IRS announced a voluntary disclosure initiative for taxpayers with undisclosed foreign financial accounts. It applies to both individuals and entities who make timely, accurate and complete disclosure of their foreign accounts. The IRS announced the initiative, officially called the 2011 Offshore Voluntary Disclosure Initiative, on February 8, 2011. The 2011 initiative covers the 2003 to 2010 time period and follows the IRS's very successful 2009 initiative that saw thousands of taxpayers disclose their foreign accounts to the IRS.

### **Details of the 2011 Offshore Voluntary Disclosure Initiative**

The penalty faced by taxpayers who take advantage of the 2011 voluntary disclosure initiative is steeper at 25% than the 20% penalty that taxpayers faced during the 2009 initiative. The IRS believed that it was important to increase the penalty to avoid rewarding taxpayers who failed to take advantage of the 2009 voluntary disclosure initiative.

The 2011 initiative provides a significantly reduced penalty of 12.5% for small accounts that have not surpassed \$75,000 during the 2003 to 2010 time period. The 12.5% penalty was not available in the 2009 initiative. Taxpayers who participated in the 2009 initiative, but would be eligible for the 12.5% penalty under the 2011 initiative, can apply for a retroactive reduction of their penalty. The 2011 initiative retains a 5% penalty for taxpayers with little connection to the foreign account.

The penalties under the 2011 initiative are applied in addition to the accuracy-related penalties, the failure to file or pay penalties, and the amount of unpaid tax. Taxpayers who take advantage of the 2011 initiative should expect that total tax and penalties will represent a large portion of their account balances. Taxpayers must complete the voluntary disclosure process by August 31, 2011.

### **Benefits of Disclosure**

The 2011 voluntary disclosure initiative offers benefits designed to encourage taxpayers to disclose their

foreign account information to the IRS now rather than risk IRS detection in the future. The IRS takes timely, accurate, and complete voluntary disclosures into account in deciding whether to recommend to the Department of Justice that a taxpayer be criminally prosecuted. The initiative, therefore, enables noncompliant taxpayers to resolve their tax liabilities and minimize their chance of criminal prosecution. When a taxpayer truthfully and timely complies with all provisions of the 2011 initiative, the IRS will not recommend criminal prosecution to the Department of Justice.

Besides risking criminal prosecution, taxpayers who do not disclose their foreign accounts risk larger civil penalties if detected than they do under the 2011 initiative. For example, U.S. citizens and residents with foreign accounts must file an annual form commonly known as an "FBAR" if the value of the accounts exceeds \$10,000. If detected, the civil penalty for willfully failing to file an FBAR can be as high as the greater of \$100,000 or 50% of the total balance of the foreign account per violation.

### **Voluntary Disclosure versus Nondisclosure**

The following IRS example calculates the difference between civil penalties under the 2011 voluntary disclosure initiative and the penalties if detected by the IRS. The example assumes a 35% tax rate.

<b>Year</b>	<b>Amount on Deposit</b>	<b>Interest Income</b>	<b>Account Balance</b>
2003	\$1,000,000	\$50,000	\$1,050,000
2004		\$50,000	\$1,100,000
2005		\$50,000	\$1,150,000
2006		\$50,000	\$1,200,000
2007		\$50,000	\$1,250,000
2008		\$50,000	\$1,300,000

2009	\$50,000	\$1,350,000
2010	\$50,000	\$1,400,000

Under the 2011 initiative, the taxpayer would pay \$518,000 plus interest. This includes:

- Tax of \$140,000 (8 years at \$17,500) plus interest;
- An accuracy-related penalty of \$28,000 (\$140,000 x 20%); and
- An additional penalty, in lieu of the FBAR and other potential penalties that may apply, of \$350,000 (\$1,400,000 x 25%).

If the taxpayer did not disclose voluntarily, and the IRS detected the taxpayer's nondisclosure, the taxpayer could owe up to \$4,543,000 in tax, accuracy-related penalties, and FBAR penalties. The taxpayer could also be liable for interest and possibly additional penalties, and an IRS examination could lead to criminal prosecution. The civil liabilities outside the 2011 voluntary disclosure initiative potentially include:

- The tax, accuracy-related penalties, and, if applicable, the failure to file and failure to pay penalties, plus interest, as described above;
- FBAR penalties totaling up to \$4,375,000 for willful failures to file complete and correct FBARs 2004 - (\$550,000), 2005 - (\$575,000), 2006 - (\$600,000), 2007 - (\$625,000), 2008 - (\$650,000), 2009 - (\$675,000), and 2010 - (\$700,000);
- The potential application of the 75% fraud penalty ; and
- The potential of substantial additional information return penalties if the foreign account or asset is held through a foreign entity such as a trust or corporation and required information returns were not filed.

### **Risks of Nondisclosure are Increasing**

The IRS currently is investigating a number of foreign financial institutions, including those in countries outside Europe and Asia. Taxpayers face an even higher risk of financial penalties and criminal prosecution if the IRS uncovers the foreign accounts before taxpayers voluntarily disclose their existence. As IRS Commissioner Doug Shulman stated in his announcement of the 2011 initiative, *"Tax secrecy continues to erode. We are not letting up on international issues, and more is in the works. For those hiding cash or assets offshore, the time to come in is now. The risk of getting caught will only increase."*

*For more information about this topic, please contact the author or any members of the Williams Mullen Tax Law Team.*

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