CORPORATE TAX CENTRE NEWSLETTER SERIES

AMERI-CAN TAX TALK NEWSLETTER

MAY 2011

NEW US OFFSHORE VOLUNTARY DISCLOSURE

Mark A. Feigenbaum, US Attorney at Law, CPA, CA

The US has announced they are offering a new amnesty type program for international non filers called the “2011 Offshore Voluntary Disclosure Initiative” (IR-2011-14). They feel that they were very successful with the last 2009 voluntary initiative, through which they claim to have received 15,000 disclosures.

As a Canadian practitioner you may be familiar with the CRA’s voluntary disclosure program; it is important to know that this initiative bears no resemblance to that program whereby CRA may eliminate penalties.

All US citizens are subject to US tax laws no matter where in the world they live and regardless of their connection to the US. Those laws include the requirement to file a tax return, reporting ownership and possibly activity in non-US corporations owned by the citizen, and to file a report of any interest including signing authority in any bank, or brokerage, or investment accounts outside of the US which form more than $10,000 in the aggregate in any year (Form TD F 90-22.1, called a “Report of Foreign Bank and Financial Accounts” or FBAR).

It is believed that many US citizens do not file tax returns, and do not report their ownership of accounts. It is suspected that millions of dollars exist in international accounts of which the interest has not been reported to the IRS, and for which there are possible taxes due. For most Canadians this is not a concern because of the Income Tax Treaty and foreign tax credit system. It would be unusual for a Canadian resident to have US tax payable for reasons other than US source income or other highly specialized situations. However, this would not be the case in many countries where the tax rate is lower than the US or where there is no tax treaty allowing US citizens to claim credits for their foreign taxes paid.

Even if a US citizen/Canadian resident taxpayer owes no tax to the US, they are still required to file a tax return and other relevant reports. Severe penalties could arise from not filing, even if no tax is due.

The stated purpose of the US voluntary disclosure program offered by the IRS is to get non-compliant US taxpayers who hold offshore accounts back into the US tax system. The voluntary disclosure program offers a way for US people with offshore accounts to resolve their tax problems without a fear of criminal prosecution. This program is not for people who reported and paid tax on all taxable income but neglected to file FBARs, but rather for people who did not report the income earned in these accounts.

The current program entails a penalty of 25% of the amount in the foreign bank accounts in the year with the highest aggregate account balance from 2003 – 2010, as compared to the 2009 program, which entailed a penalty of 20% on the highest aggregate account balance from 2003 – 2008. The reason for the increase in the penalty rate is to make it clear that there will be no benefit to waiting for subsequent voluntary disclosure programs to make the disclosure.

There is, however, an advantage to the new program in that the IRS will be taking individual circumstances into consideration when levying the new penalties. In the prior program there was no ability to waive or lower the penalty, regardless of the reason for the non-filing.

With the new program some taxpayers will be eligible for reduced penalties as low as 12.5% or even 5% in limited situations. The 12.5% penalty will be applied in cases where the taxpayer’s offshore accounts or assets did not surpass $75,000 in any calendar year covered by the program. Participants in the program also must pay back-taxes and interest for up to 8 years as well as paying accuracy related and/or delinquency penalties. It is crucial to understand that this disclosure program does not come without penalties; the taxpayer will have to pay something to the IRS, even if no taxes are due.

Some of the advantages to entering the program can be considered:

- By coming forward now, taxpayers can avoid the risk of far higher penalties in the future, as well as the possibility of criminal prosecution.

- There is a fixed penalty amount, so the taxpayer can determine ahead of time the approximate penalty that will be levied.

- The potential penalties for people that choose to take their chances and not disclose now could be significantly higher than those that are currently being levied.

- Under the Foreign Account Compliance Act, foreign banks will be required to report directly to the IRS information about the accounts held by US taxpayers, or by foreign entities in which US taxpayers hold a substantial ownership interest beginning in 2013, increasing the likelihood of the IRS discovering any offshore accounts and thus the risk of criminal prosecution.

Before considering the program, however, the following points should also be noted:

- The program is very punitive to US citizens living and earning their income abroad, including those who had no tax owing for the years covered by the program. The voluntary disclosure program's penalties were purportedly put in place for taxpayers who were attempting to hide income offshore to avoid taxation in the US. However, many of the people participating do not fall into this category; for these people, the penalties do not appear appropriate, as they seem to imply willful intent. This is especially true for US people living in Canada (where the tax rates are generally higher than those in the US) most of whom would have had no tax owing.

- Without the voluntary disclosure program (i.e. for taxpayers simply filing late returns), instead of the mandatory penalties the IRS would have to prove willful intent in order to levy the maximum penalties against the taxpayer. Importantly, the Internal Revenue Manual seems to suggest that in most cases where the taxpayer has rectified their FBAR non-compliance, no penalty should be levied, but rather a letter to taxpayer's file could be more appropriate. Further, the Internal Revenue Manual recommends consideration of the purpose of any penalties and whether they would enhance compliance in particular circumstances, and notes that penalties should only be applied in the most egregious of cases.

- In *US v. J. Byran Williams* (106 A.F.T.R.2d 2010-5158), the court held that proving that the taxpayer willfully violated the law may be an uphill battle. In this case, the Taxpayer held accounts outside the US, which he used for the purpose of evading tax. The Taxpayer plead guilty to tax fraud, conspiracy to defraud the United States, and criminal tax evasion, but the court still found that the taxpayer "lacked any motivation to willful conceal the accounts from authorities".

- Although the term "voluntary disclosure" sounds promising for taxpayers and a great way to get US citizens back on track in their filings, careful consideration must be taken before entering into the program.