February 11, 2011

IRS Unveils New Offshore Voluntary Disclosure Initiative

On February 8, 2011, the Internal Revenue Service announced a new voluntary disclosure initiative designed to bring noncompliant US taxpayers with unreported offshore income and assets back into the fold. The 2011 Offshore Voluntary Disclosure Initiative (OVDI) follows on the heels of the 2009 Offshore Voluntary Disclosure Program (OVDP), which ran from March 23, 2009, to October 15, 2009, and brought in 15,000 voluntary disclosures. Since that time, more than 3,000 taxpayers have come forward with undisclosed bank accounts. These taxpayers will also be eligible to take advantage of the 2011 OVDI.

Not surprisingly, the 2011 OVDI penalty structure is higher than that of the 2009 OVDP. Individuals are required to pay a penalty of 25 percent of the amount in the foreign bank accounts in the year with the highest aggregate account balance over the past eight years, plus back taxes and interest for the past eight years and accuracy-related and/or delinquency penalties. (The 2009 OVDP required six years of back taxes and a 20 percent penalty of the highest account balance in the foreign bank account.) In return, the IRS will forgo criminal prosecution and will not assert other civil penalties, including the FBAR penalty (which alone could exceed the value of the account).

As under the 2009 OVDP, some taxpayers may be eligible for a reduced 5 percent penalty for inherited accounts that they have never accessed. In addition, the 2011 OVDI creates a new penalty category of 12.5 percent for offshore accounts or assets that did not surpass $75,000 in any calendar year.

Taxpayers who wish to participate must file all original and amended tax returns and pay all taxes, interest and accuracy-related penalties by August 31, 2011, in order to take advantage of the new initiative. The IRS cautions that this is a hard-and-fast deadline that will not be extended. It will be challenging for some taxpayers to obtain all information from offshore banks by this date, so they need to act promptly.

It is always preferable for taxpayers to come forward before the IRS finds them. Discovery by the IRS has become increasingly likely in view of expanded US information reporting obligations for offshore assets, cooperation among countries under tax information exchange treaties, the sale and exchange of stolen lists of clients of offshore banks, and aggressive IRS pursuit of hidden assets offshore.