Offshore FAQs Offer New Relief For U.S. Citizens Living Abroad

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The IRS on June 26 released a long-awaited update to frequently asked questions for the latest iteration of the offshore voluntary disclosure program (OVDP), tightening eligibility guidelines for interested taxpayers and announcing a plan to help U.S. citizens living abroad meet their filing responsibilities.

Practitioners welcomed the news, but some told Tax Analysts that the FAQs fell short of their expectations, given the long development time. (For the updated FAQs, see *Doc 2012-13612* or *2012 TNT 124-17*. For prior coverage of the third OVDP, see *Tax Notes*, Jan. 16, 2012, p. 276, *Doc 2012-445*, or *2012 TNT 6-1*.)

The IRS said in a news release that more than 33,000 taxpayers came forward under the first two disclosure programs, with the government collecting more than $5 billion. About 1,500 disclosures have been made so far under the third OVDP. (For IR-2012-64, see *Doc 2012-13611* or *2012 TNT 124-8*.)

"We continue to make strong progress in our international compliance efforts that help ensure honest taxpayers are not footing the bill for those hiding assets offshore," IRS Commissioner Douglas Shulman said in the release. "People are finding it tougher and tougher to keep their assets hidden in offshore accounts."

> ***'We continue to make strong progress in our international compliance efforts that help ensure honest taxpayers are not footing the bill for those hiding assets offshore,' said Shulman.***

Practitioners working with offshore issues have had a busy few weeks. On June 22 Treasury announced joint statements with Switzerland and Japan for implementing the Foreign Account Tax Compliance Act. Meanwhile, practitioners were scrambling to finalize and submit for clients Form TD F 90-22.1, "Report of Foreign Bank and Financial Accounts," which was due June 30. (For prior coverage, see *Tax Notes*, June 25, 2012, p. 1553, *Doc 2012-13291*, or *2012 TNT 121-1*.)

Pension and Nonresident Relief

The IRS announced a proposed new procedure intended to help U.S. citizens living abroad and dual citizens with low compliance risks become current on their income tax return filing obligations and to provide assistance for people with foreign retirement account issues.

Affected taxpayers will generally have simple tax returns and owe $1,500 or less in tax for any of the covered years, the IRS said in a release. "Today we are announcing a series of common-sense steps to help U.S. citizens abroad get current with their tax obligations and resolve pension issues," Shulman said. (For IR-2012-65, see *Doc 2012-13618* or *2012 TNT 124-9*.)

The procedure, details of which have yet to be finalized, requires affected taxpayers to file delinquent tax returns with related information returns for the past three years and to file delinquent foreign bank account reports for the past six years. According to the IRS website, "the intensity of the review will vary according to the level of compliance risk presented by the submission." Payment of tax and interest would have to accompany the submission, and 2011 tax returns that have yet to be filed would need to be filed under the procedure. (For an outline of the procedure, see *Doc 2012-13650* or *2012 TNT 124-18*.)

Of particular concern among the North American tax community has been the income tax treatment of Canadian registered retirement savings plans. Income from those plans is not taxable in the United States as long as the taxpayer timely files a tax return and attaches Form 8891, "U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans," to report the account.

In December the IRS issued FS-2011-13, which provided information for U.S. citizens living in Canada and for dual citizens. The fact sheet stated that penalties for noncompliance will not always be applied. It generated some controversy in late 2011 when David Jacobson, the U.S. ambassador to Canada, apparently mistook the fact sheet as guidance that the IRS was waiving late-filing penalties for Americans living in Canada. (For FS-2011-13, see *Doc 2011-25752* or *2011 TNT 237-12*. For prior coverage, see *Tax Notes*, Dec. 19, 2011, p. 1459, *Doc 2011-26415*, or *2011 TNT 242-5*.)

The proposed procedure would offer retroactive relief for failure to timely elect income deferral on specific retirement and education savings plans in

which deferral is permitted by treaty. Taxpayers seeking to defer income on those types of accounts would need to file a request for more time to elect the deferral and provide a statement describing the events that led to the failure to make an election, the events that led to discovery of the failure, and the nature of any professional adviser's engagement and responsibilities if the taxpayer relied on one.

Scott D. Michel of Caplin & Drysdale called the news "laudable" and praised the IRS for loosening restrictions that would let longtime nonresidents with minimal tax liabilities come back to the U.S. tax system. It is "excellent news for practitioners, in terms of advice we can give to clients," and it will likely be welcome news to the thousands of Americans living overseas, Michel said.

Barbara T. Kaplan of Greenberg Traurig LLP said many taxpayers, including retired pensioners who have moved to another country and young people looking for work in foreign countries, inadvertently failed to adequately file returns or report foreign accounts. Many times, those taxpayers used local return preparers who were not versed in U.S. tax law, she said.

Kaplan said the procedure's requirement for affected taxpayers to detail what led to a failure to file, how that failure was discovered, and how the taxpayers interacted with their tax professionals would give the IRS a better idea of what steps taxpayers took to become compliant.

Kendall C. Jones of Sutherland Asbill & Brennan LLP questioned the basis for the $1,500-per-year tax liability cutoff. "Where did they come up with that number?" he asked. He said it's unclear how it reflects the taxpayer's state of mind or the complexity of the return. Even a small deduction can be abusive, Jones said.

Megan L. Brackney of Kostelanetz & Fink LLP said that although she was pleased to see the IRS acknowledge that U.S. taxpayers who have lived abroad often have reasonable cause for their noncompliance, "we were hoping for more certainty as to whether these taxpayers will be subject to penalties, and if so, the level of penalties that will be imposed."

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Jones expressed concern over the lack of a guarantee against criminal prosecution for those taxpayers who follow the procedures and submit the information. Although the likelihood of prosecution is low for benign taxpayers or those who are not bad actors, the lack of a guarantee against prosecution seems to go against the spirit of offering an alternative to the OVDP for those taxpayers, he said. Many of those dual citizens or U.S. citizens living abroad — with minimal tax liability — felt pressured to enter into the offshore disclosure programs, he said. That issue has previously spurred considerable criticism from practitioners.

G. Michelle Ferreira of Greenberg Traurig said the new procedures for U.S. taxpayers living abroad will be a "hard sell unless the IRS puts more guidance out on who is a compliance risk and who is not." Taxpayers willing to come forward under the procedures will want more guidance, perhaps in the form of FAQs, before agreeing to pay all tax, interest, and penalties, if appropriate, she said.

> ***'Once the government has the relevant information, a voluntary compliance disclosure with a purely civil resolution is no longer a realistic possibility,' Rettig said.***

Ferreira said that overall, practitioners are having difficulty selling the latest OVDP to clients, a problem she attributed to the IRS's reluctance to give leeway on penalties. Given the lack of a statutory method for applying the penalty on foreign assets, "I find it hard to sell a 27.5 percent penalty on everything the taxpayers have abroad, including their assets," she said. "Most are better off coming forward and facing FBAR penalties on the foreign account, rather than the 27.5 percent 'offshore penalty' on their accounts and their assets."

Tightened Eligibility for OVDP

Under section 3506, U.S. taxpayers challenging a foreign government's disclosure of tax information, in that country's judicial system, must notify the Justice Department. There are no sanctions for failure to notify.

According to the IRS and FAQ 21, taxpayers failing to notify the DOJ will no longer be eligible for the OVDP. Eligibility can also be terminated once the United States has taken action in connection with a taxpayer's specific financial institution, the IRS said.

Michel said the FAQ is an important clarification and will likely "smoke out" those noncompliant taxpayers. "You could ask, how [is the government] going to find out? The answer is, if you go into the program, you are required to cooperate and provide truthful information. All they have to do is ask," with the taxpayer answering under penalties of perjury, Michel said.

Michel agreed with the IRS's position that some taxpayers' eligibility in the OVDP could be terminated based on their accounts at a specific financial institution. That eligibility rule was announced June 15 in New York by an IRS official. (For prior coverage, see *Tax Notes*, June 25, 2012, p. 1567, *Doc 2012-13020*, or *2012 TNT 118-1*.)

FAQ 21 states that ''announcements will provide notice of the prospective date upon which eligibility for the specific taxpayer group ends and will be posted to the Web.'' In recent months, the government has pursued various foreign banks, including Credit Suisse and at least two Israeli banks, seeking the account information of U.S. account holders. (For a DOJ release, see *Doc 2012-12956* or *2012 TNT 117-85*.)

Michel said the tightened eligibility requirements raise questions of fairness. Taxpayers with accounts at some banks under investigation were coming into the OVDP ''late in the game,'' he said. The change in eligibility would provide a fixed date for the taxpayers to come in before being locked out of the OVDP, he said.

Charles P. Rettig of Hochman, Salkin, Rettig, Toscher & Perez PC said that ''a wealth of information has been and continues to be provided to the government from institutions and individuals throughout the world, [including from] whistleblowers and taxpayers who have already participated in the offshore voluntary disclosure programs.'' He said his firm has received many calls from individuals hoping to come into compliance, but that waiting to do so ''is simply not a viable option.''

''Once the government has the relevant information, a voluntary compliance disclosure with a purely civil resolution is no longer a realistic possibility,'' Rettig said.

Marina Hernandez, an enrolled agent specializing in cross-border taxation, said she'd like to see the proposed nonresident relief expanded to apply to recently repatriated U.S. citizens. ''It is not unusual for returning expats, even for those who have filed returns, to first become aware of their FBAR noncompliance upon repatriation from a foreign work assignment or after obtaining a foreign college degree,'' she said.

Not Much Substance

Most of the practitioners with whom Tax Analysts spoke welcomed FAQ 21's eligibility discussion, but some expressed disappointment in the IRS's final product.

''Most of it is the same as what the old rules were, with some clearly noteworthy changes, but the changes are small compared to what existed before,'' Kaplan said. Jones said his initial reaction was that the IRS announced the new OVDP back in January, ''and five months later, this is it?''

Kaplan and Michel said the IRS's decision to give a 90-day deadline for submitting the completed voluntary disclosure was important. Both the first and second offshore disclosure programs had deadlines, but the latest OVDP did not, Michel said. Once the optional intake letter has been submitted, the IRS Criminal Investigation division will review it within 45 days and send the taxpayer a preliminary acceptance letter, Michel said.

FAQ 25 says that the taxpayer then has 90 days to submit the entire voluntary disclosure submission. Under FAQ 25.1, a taxpayer can apply for a 90-day extension. Nonetheless, ''it leaves open the question of what happens to people who are already in the program,'' Michel said. Kaplan said 90 days can be a tight time frame and that the availability of a 90-day extension will help practitioners.

Jones said he's aware of several taxpayer applications to the offshore programs that have lingered without a response from the IRS, which suggests to him that the IRS may lack the staff to meet the programs' demand. ''We made [offshore voluntary disclosure initiative] submissions last August and September, and we never heard anything again,'' he said. ''There's at least some suggestion, given the time it's taken to hear back from the IRS, that they have resource issues. Are they going to have the resources to deal with this on a going-forward basis?'' ■

Matthew Dalton contributed to this article.