THE IRS' NEW 2014 OFFSHORE VOLUNTARY DISCLOSURE PROCEDURES ANALYZED IN THE NEW OFFSHORE ENFORCEMENT ENVIRONMENT

Part I:

The 2014 OVDP

On June 18, 2014, the Internal Revenue Service (the "IRS" or "Service") announced "major changes" to its offshore voluntary compliance programs. They include "four distinct options" for addressing prior offshore non-compliance. See, http://www.irs.gov/Individuals/International-Taxpayers/Options-Available-For-U-S-Taxpayers-with-Undisclosed-Foreign-Financial-Assets.

The Introduction to this article can be found in the July 5, 2014 posting on Rubin On Tax. In the Introduction, the New Procedures are described. They clearly were intended to bring about significant changes in the offshore compliance process. As discussed in the Introduction, the Streamlined Procedures were intended to apply to taxpayers who did not commit "willful" offshore violations. These "non-willful" taxpayers would not submit their disclosures through the OVDP but instead would file returns under the Streamlined Procedures. By removing Streamlined submissions from the OVDP, the administrative burden on the IRS would be lessened. Streamlined submissions, unlike OVDP filings, in theory, did not require consideration by the Criminal Investigation. Further, unlike the OVDP where each submission is reviewed by the IRS, under the Streamlined Procedures the IRS says that it will apply its regular audit selection process, such that it should be able to accommodate the anticipated large number of Streamlined submissions without undue burden. Additionally, taxpayers filing under the Streamlined Procedures are not required to submit the extensive information required under the OVDP, thus lessening their burden. In theory, the IRS' plan works. However, since the definition of "willful" violations was left to speculation under the New Procedures, a gaping hole exists such that the OVDP continues to be the only avenue available under the New Procedures which offers certainty as to criminal and civil penalties.

Part I, regarding the 2014 OVDP follows.

I. 2014 Offshore Voluntary Disclosure Program- the "2014 OVDP".

A. New OVDP– Bifurcated Aspects-Criminal Prosecution and Certain Civil Taxes and Penalties. IRS Commissioner John Koskinen explained that the new OVDP has been "reshaped" to apply to those who "wilfully" failed to report offshore accounts and who therefore don't qualify for the streamlined procedures. See, "Statement of IRS Commissioner John Koskinen," June 18, 2014 at Website, as follow:

> "[The 2104 OVDP] is designed to cover those whose failure to comply with reporting requirements is considered willful in nature, and who therefore don't qualify for the streamlined procedures. These changes will help focus this program on people seeking certainty and relief from criminal prosecution...."
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> "...In addition, we want to send a message to anyone who continues to willfully and aggressively evade our tax laws by hiding money overseas that they will pay a higher price for that noncompliance. Even though we're tightening components of the OVDP, we still believe it's a better deal than the alternative, because if we find you, you will face higher penalties and, as the record shows, could face criminal prosecution and jail time.

B. 2014 OVDP – What Are the Changes From 2012 OVDP? The 2012 OVDP was available to those concerned with criminal prosecution and provided certainty relative to taxes and offshore penalties. However, since the New Streamlined Procedures are now available to U.S. taxpayers residing in the United States, the 2014 OVDP is intended to be used by taxpayers who have serious concerns with criminal violations. As the analysis herein discusses, the lack of certainty resulting from the IRS' failure to clarify whether an offshore violation is willful may impede taxpayers from using the Streamlined Procedures and leaves the 2014 OVDP as being the only one of the four procedures which, under its terms, provides certainty from criminal prosecution and which provides certain taxes and penalties. Persons filing under the Streamlined Procedures, particularly those who failed to report a significant amount of income taxes, are not offered any assurances that submissions under the Streamlined Procedures which the taxpayers consider non-willful will be considered non-willful by the IRS.

1. OVDP-Generally. The IRS website describes the Offshore Voluntary Disclosure Program (OVDP) as:

"a voluntary disclosure program specifically designed for taxpayers with exposure to potential criminal liability and/or substantial civil penalties due to a willful failure to report foreign financial assets and pay all tax due in respect of those assets. OVDP is designed to provide to taxpayers with such exposure (1) protection from criminal liability and (2) terms for resolving their civil tax and penalty obligations." http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary -Disclosure-Program

2. The 2014 OVDP. The 2014 OVDP is not a "new" offshore voluntary disclosure program according the IRS' in its most recent "Frequently Asked Questions" (FAQ), released in conjunction with the newly announced procedures.

FAQ 1.1 explains the 2014 OVDP as follows:

"This is a continuation of the program introduced in 2012 with modified terms, but for purposes of referring to this modified program, it may be referred to as the 2014 OVDP. The IRS's prior Offshore Voluntary Disclosure Program (2009 OVDP), and Offshore Voluntary Disclosure Initiative (2011 OVDI), and the 2012 OVDP have demonstrated the value of uniform penalty structures for taxpayers who come forward voluntarily and report their previously undisclosed foreign accounts and assets. These initiatives have enabled the IRS to centralize the civil processing of offshore voluntary disclosures and to resolve a very large number of cases without examination. Because the implementation of the Foreign Account Tax Compliance Act (FATCA) and the IRS and Department of Justice offshore enforcement efforts continue to raise the risk of detection of taxpayers with undisclosed foreign accounts and assets for the foreseeable future, it has been determined that 2012 OVDP should be modified and made available to taxpayers who wish to voluntarily disclose their offshore accounts and assets to avoid prosecution and limit their exposure to civil penalties but have not yet done so. Unlike the 2009 OVDP and the 2011 OVDI, the 2014 OVDP has no set deadline for taxpayers to apply. However, the terms of this program could change at any time. For example, the IRS may increase penalties or limit eligibility in the program

for all or some taxpayers or defined classes of taxpayers – or decide to end the program entirely at any time."

3. Changes From 2012 OVDP to 2014 OVDP Listed by IRS in FAQ 1.1. The 2014 FAQ describes the changes contained in the 2014 OVDP, which is effective July, 1, 2014. They are listed here, as set out in FAQ 1.1 and then discussed.

A. Overview of Changes in 2014 FAQ. FAQ 1.1 sets out these changes made to the 2012 OVDP, some of which it states "may be considered significant":

> "A 50% offshore penalty applies if either a foreign financial institution at which the taxpayer has or had an account or a facilitator who helped the taxpayer establish or maintain an offshore arrangement has been publicly identified as being under investigation or as cooperating with a government investigation. See FAQ 7.2.
>
> As described below, FAQ 17 concerning filing delinquent Report of Foreign Bank and Financial Accounts (commonly known as an FBAR) has been replaced and superseded. See "Options Available For U.S. Taxpayers with Undisclosed Foreign Financial Assets.
>
> As described below, FAQ 18 concerning filing certain delinquent international information returns has been replaced and superseded. See "Options Available For U.S. Taxpayers with Undisclosed Foreign Financial Assets".
>
> The reduced penalty structure under former FAQs 52 and 53 has been eliminated due to the expansion of the Streamlined Filing Compliance Procedures. See "Options Available For U.S. Taxpayers with Undisclosed Foreign Financial Assets" for a discussion of the various options for taxpayers with international tax compliance issues.
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> FAQs 31 through 41 pertaining to the asset base to which the offshore penalty applies have been modified to promote

clarity and consistency of application.

FAQ 23 has been modified to require additional information for pre-clearance by Criminal Investigation.

The Offshore Voluntary Disclosures Letter and attachment have been modified.

FAQ 7 has been modified to require that the offshore penalty be paid at the time of the OVDP submission.

FAQ 25 has been modified to require that account statements be provided for all foreign financial accounts regardless of account balance and to provide that voluminous documents not requiring original signatures may be submitted on CD or DVD.

The following FAQs have been deleted as moot: 16, 17, 18, 19, 51.1, 51.2, 52, and 53."

B. Changes Listed in 2014 FAQ 1.1 Discussed.

1. FAQ 7 (and FAQ 25): Submission Requirements of 2014 OVDP-Payment of Offshore Penalty Now Required and Additional Changes. All information required under 2014 FAQ 25, was required under 2012 FAQ 25. However, additional requirements from 2012 are follows (see 2014 FAQ 7 and 25):

A. Payments of Taxes and Penalties. Under the 2012 OVDP and prior OVDPs, the offshore penalty was paid when the closing agreement was signed at the end of the OVDP process. Under the 2014 OVDP the FBAR/offshore penalty is required to be paid when the amended tax returns are filed, As in the 2012 OVDP, all income taxes must be then paid as well.

B. Increased Cooperation. Agreed cooperation as a condition to participation in the OVDP

now expressly extends to not only "offshore" institutions, but also to U.S. institutions." For example, cooperation expressly extends to providing information regarding bankers and promoters in the U.S. Cooperation now expressly extends to the Justice Department, whereas in 2012 only the IRS was referenced.

C. FBAR Extensions. Although execution of extension of FBAR limitations period was required under the 2012 OVDP and in the 2012 FAQ, the 2014 FAQ now expressly adds that failure to extend the FBAR assessment period "will render your OVDP submission incomplete."

D. Estate and Gift Returns. FAQ 25 now expressly states that gift and estate tax returns must be filed if not previously filed as follows: "Applicants with estate and gift tax issues: If the taxpayer is a decedent's estate, or is an individual who participated in the failure to report an OVDP asset (see FAQ 35) in a required gift or estate tax return, either as executor or advisor, provide complete and accurate amended estate or gift tax returns (original estate or gift tax returns if not previously filed) for tax years included in the voluntary disclosure correcting the under-reporting or omission of OVDP assets (see FAQ 35)."

E. Copies of Financial Accounts Regardless of Balance. The 2012 OVDP required copies of all offshore account statements with an aggregate balance of $500,000 whereas now all such statements are required without regard to their balance.

F. Voluminous Documents May On Flash Drives

etc. Submissions of voluminous documents such as bank statements may be submitted on CDs in PDF form or flash drives/ USB removable storage devices are permitted

2. FAQ 7.2: 50% Penalty if IRS Investigations Are Public. New FAQ 7.2 provides that if there is public disclosure of IRS or Department of Justice (DOJ) investigations relating to the taxpayer, the offshore penalty will be increased to 50%. It is therefore extremely important for taxpayers to be aware of events which impact an offshore institution or an offshore promoter or facilitator with whom they have established an account. They should consider entering the OVDP while the penalty is 27.5% rather than 50%, that is, if they are going to submit in the OVDP sooner or later. FAQ 7.2 reads as follows:

"beginning on August 4, 2014, any taxpayer who has an undisclosed foreign financial account will be subject to a 50-percent miscellaneous offshore penalty if, at the time of submitting the pre-clearance letter to IRS Criminal Investigation an event has already occurred that constitutes a public disclosure that either (a) the foreign financial institution where the account is held, or another facilitator who assisted in establishing or maintaining the taxpayer's offshore arrangement, is or has been under investigation by the IRS or the Department of Justice in connection with accounts that are beneficially owned by a U.S. person; (b) the foreign financial institution or other facilitator is cooperating with the IRS or the Department of Justice in connection with accounts that are beneficially owned by a U.S. person or (c) the foreign financial institution or other facilitator has been identified in a court- approved issuance of a summons seeking information about U.S. taxpayers who may hold financial accounts (a "John Doe summons") at the foreign financial institution or have accounts established or maintained by the facilitator. Examples of a public disclosure include, without limitation: a public filing in a judicial proceeding by any party or judicial officer; or public disclosure by the Department of Justice regarding a Deferred Prosecution Agreement or Non-Prosecution Agreement with a financial institution or other facilitator. A list of foreign financial institutions or facilitators meeting this criteria is available.

3. FAQ 17: "Delinquent FBAR Submission Procedures" Replaces Procedures in FAQ 17. Option 3, the Delinquent FBAR Submission Procedures, replaces the procedures which were formerly a part of the 2012 OVDP FAQs. Under the 2012 procedures in FAQ 17, the filing of the FBAR seemingly ended the process. However, under the new 2014 Procedures, assuming that all income was disclosed but that the "reasonable cause" statement is not satisfactory to an examining agent, is that reason for the agent to impose penalties for late filing under the New Procedures? See discussion below at Part III.

As under 2012 FAQ 17, the IRS states that it will not impose a penalty for the failure to file the delinquent FBARs "if you properly reported on your U.S. tax returns, and paid all tax on, the income from the foreign financial accounts reported on the delinquent FBARs." However, delinquent FBAR filings become subject to the applicable examination procedures (as to the submissions under the Streamlined Procedures and under the Delinquent Informational Return Procedures). The New Procedures state that "FBARs will not be automatically subject to audit but may be selected for audit through the existing audit selection processes that are in place for any tax or information returns." In contrast, an OVDP submission, once closed with a closing agreement, will not be subject to examination under ordinary circumstances (subject to rules in Internal Revenue Code Section 7121(b)"closing agreements/finality"which provides that closing agreements are final except upon a showing of "fraud or malfeasance, or misrepresentation of a material fact."

4. FAQ 18: Delinquent International Information Return Submission Procedures" Replaces Procedures in FAQ 18. Similar to the above deletion of FAQ 17 relative to unfiled FBARs, in cases where all income was reported by the reporting entity, FAQ 18 has been deleted and replaced by a separate procedure for the "Delinquent International Informational Returns" (such Forms 5471 or Forms 3520). See discussion below at Part IV. The New Procedures--unlike 2012 FAQ 18 and unlike the delinquent FBAR procedures under 2012 FAQ 17 and the New Procedures--fail to state that no late penalties will be applied.

As with late filed FBARs, and the other offshore disclosures other than the OVDP, under the New Procedures, examination of delinquent international information returns may result under applicable audit selection procedures.

The New Procedures require "..a statement of all facts establishing reasonable cause for the failure to file.

A new requirement is that as part of the reasonable cause statement, taxpayers must also certify that "any entity for which the information returns are being filed was not engaged in tax evasion." An example of use of an entity for tax evasion might be the creation of a foreign corporation or trust to which dividends or capital gains from the U.S. are paid. See, "Tax Havens: International Tax Avoidance and Evasion," Jane G. Gravelle, Senior Specialist in Economic Policy, Jan. 23, 2013: "A typical way that U.S. individuals can easily evade tax on domestic income through a Cayman Islands operation with little expense using current technology. The individual, using the Internet, can open a bank account in the name of a Cayman corporation that can be set up for a minimal fee. Money can be electronically transferred without any reporting to tax authorities, and investments can be made in the United States or abroad. Investments by non-residents in interest bearing assets and most capital gains are not subject to a withholding tax in the United States." In the foregoing example, arguably, any omitted income would be the income of the individual and the entity created would not have income but would have been used solely for tax evasion.

The New Procedures state that failure to attach a reasonable cause statement to each delinquent information return filed will result in penalties being assessed in accordance with existing procedures." A "reasonable cause" statement was also required under the 2012 but the failure to attach it didn't carry the potential consequence now stated.

5. FAQ 23: Changes To Pre-clearance Letter-More Information Required. FAQ 23**,** regarding pre-clearance submissions to be sent to the IRS' Criminal Investigation Center for the OVDP, revises the 2012 FAQ 23. Information now required includes phone numbers of inquiring taxpayers, and identification of the financial institutions. The increased information provided is significant. In today's offshore

environment, a "complete disclosure" under the voluntary disclosures of IRM 9.5.11 may well require disclosure of information as to "facilitators" and banks. Further, as discussed herein, failure to obtain a pre-clearance letter outside of the OVDP may result in a submission of information regarding a person ineligible to make a voluntary disclosure if unbeknownst to the submitting taxpayer there is a disqualifying ongoing civil or criminal investigation (such that the disclosure would fail to the meet the "timely" requirement under IRM 9.5.11).

The additional information now required is underlined below (the remaining information continues the requirements of the 2012 OVDP):

"Taxpayers or representatives send a facsimile to the IRS – Criminal Investigation Lead Development Center (LDC) with:

> (a) Applicant identifying information including complete names, dates of birth (if applicable), tax identification numbers, addresses, and telephone numbers.
>
> (b) Identifying information of all financial institutions at which undisclosed OVDP assets (see FAQ 35) were held. Identifying information for financial institutions includes complete names (including all DBAs and pseudonyms), addresses, and telephone numbers.
>
> (c) Identifying information of all foreign and domestic entities (e.g., corporations, partnerships, limited liability companies, trusts, foundations) through which the undisclosed OVDP assets (see FAQ 35) were held by the taxpayer seeking to participate in the OVDP; this does not include any entities traded on a public stock exchange. Information must be provided for both current and dissolved entities. Identifying information for entities includes complete names (including all DBAs and pseudonyms), employer identification numbers (if applicable), addresses, and the jurisdiction in which the entities were organized.
>
> (d) Executed power of attorney forms (if represented).

6. FAQ 24 Submission Increases Information Requested on Offshore Voluntary Disclosure Letter and Attachment. The Offshore Disclosure Letter under the 2014 OVDP requests additional information, including the following additional information:

   A. Both Spouses as Well as Related Entities Must Actively Participate in the Disclosure. The Disclosure Letter reads as follows: "If you filed jointly at any point during the past eight years, your spouse should also apply for the OVDP by answering the questions below**."** Both spouses are required to respond to most questions regarding the offshore account, such that there are separate boxes for each spouse, rather than a single box with both spouses signing as under the 2012 FAQ. In addition, related entities must directly respond. The following is an example from item 8 of the Disclosure Letter:

"7. Has the IRS notified you, your spouse, or any related entities that it intends to commence an examination or investigation?

Taxpayer	__ Yes	__ No
Spouse	__ Yes	__ No
Related Entities	__ Yes	__ No"

   B. Information Regarding Accounts and Movement of Funds. The question requests additional and more extensive information regarding both the offshore account and any accounts into which funds are moved, as well as information regarding any "methods or schemes" by which funds were moved back to the U.S. This additional information is consistent with the addition of the required cooperation with respect to not only offshore banks but also U.S. banks and U.S. "facilitators."

7. FAQs 31-41 modified. FAQ 2014 FAQs 31-41 have been

"modified to promote clarity and consistency of application." The following are the primary "clarifications" and "modifications":

A. **FAQ 31.** The term "OVDP asset" is introduced, and is used in place of the term "foreign account," such that assets not owned in "accounts" are included in the offshore penalty considerations.

B. **FAQ 32.** The term "offshore penalty" is substituted for the term "27.5% penalty;" either a 27.5% penalty or the 50% offshore penalty could apply under the 2014 OVDP.

C. **FAQ 33.** This FAQ reiterates the following from 2012 FAQ 33 "No amount of unreported gross income is considered *de minimis* for purposes of determining whether there has been tax noncompliance" as to OVDP assets. In addition, it adds the following sentence: "Even one dollar of unreported gross income from an OVDP asset will bring it into the offshore penalty base."

   This language emphasizes that the procedures for filing delinquent FBARs or for filing delinquent information returns do not apply if any income is omitted, even in the amount of $1.00! Instead, submissions under the OVDP would be required under the New Procedures.

D. **FAQ 34.** This FAQ, regarding the "look back period" of 8 years is a continuation of the prior FAQ; however, additional language is included explaining that the offshore penalties are imposed in consideration for the IRS not requiring the reporting of income outside of OVDP period to be taxed.

E. **FAQ 35.** The term "OVDP assets" is defined as meaning: "all of the taxpayer's offshore holdings that are related in any way to tax non-compliance,

regardless of the form of the taxpayer's ownership or the character of the asset."

F. **FAQ 35.1.** This FAQ clarifies that no valuation discounts apply in determining the valuation of OVDP assets which are subject to the offshore penalty. The discounts which won't apply expressly include: discounts for lack of marketability, minority, or tenants in common. Thus, this FAQ has eliminated valuation discounts--something Congresses and some Presidents have failed to do after making "threats" to do so for many years. Treasury's powers are significant indeed when its authority is exercised by FAQ!

G. **FAQ 36.** This FAQ clarifies that all assets which produced "gross income" are included in the penalty base. The prior FAQ merely stated that "assets which produced income" were so included. Therefore, it is clear that, for example, the value of offshore rental real estate operating at a net loss but having unreported gross rental income, is included in offshore penalty base.

H. **FAQ 37.** This modification substitutes term "offshore penalty" for "27.5% penalty".

I. **FAQs 38 and 39.** These FAQs relate to accounts over which a taxpayer has failed to file an FBAR but has only a signatory interests without a beneficial interest, and now include a reference to the new "Delinquent FBAR Submission Procedures."

J. FAQs 40 and 41. Consistent with the foregoing, these FAQs use terms "OVDP asset" and "offshore penalty" in place of "offshore accounts" and "27.5% penalty."

8. 2012 FAQs Deleted As Moot- 16, 51.1, 51.2, 52 and 53. The

following 2012 FAQs were deleted as "moot" for the reasons explained below.

A. 2012 FAQ 16. 2012 FAQs 15 and 16 addressed "quiet disclosures" by the filing of amended returns, and have been consolidated into 2014 FAQ 15. As discussed at Part V herein regarding the continued viability of voluntary disclosures pursuant to IRM 9.5.11.9, a close reading of the 2012 and 2014 FAQs results in the following conclusions:

1. The IRS and FAQs define a "quiet disclosure" to mean "filing amended returns, filing delinquent FBARs, and paying any related tax and interest for previously unreported income from OVDP assets (see FAQ 35) without otherwise notifying the IRS." (emphasis supplied).

2. New FAQ 15 does not mention IRM 9.5.11.9. However, 2012 FAQ 16, consistent with the comments at 1 and 2, above, indicates that a voluntary disclosure under the OVDP must meet the requirements of IRM 9.5.11.9, as it is those requirements which result in the protection from criminal prosecution under the OVDP (the same as is the case with disclosures outside of the OVDP and pursuant to IRM 9.5.11). 2012 FAQ 16 reads in part as follows:

"When criminal behavior is evident and the disclosure does not meet the requirements of a voluntary disclosure under IRM 9.5.11.9, the IRS may recommend criminal prosecution to the Department of Justice."

B. FAQs 51.1 and 51.2 Re: Opt-Outs. The "opt-out" is still an option under 2014 FAQ 51. However, opting out would very rarely, if ever, seem to be appropriate for a taxpayer who, after the submission of all documents, desires to assert that the 27.5% or 50% penalty is not appropriate. After all, the taxpayer filed in the OVDP because his non-compliance was willful, and the taxpayer would sem

to be hard-pressed to maintain that the willful FBAR penalties would not apply under any opt-out exam.. Nonetheless, opt-outs may be appropriate in events where the taxpayer disputes the value of offshore assets used by the IRS in computing the offshore penalties, such that the taxpayer had paid in all penalties the taxpayer found due but the IRS disagrees and proposes an additional offshore penalty which the taxpayer had not paid in. Although the 2012 examples of reduced penalties making opt-outs potentially advantageous in FAQ 51.1 are "moot," because non-willful omissions are addressed by the New Streamlined Procedures, they may be relevant to the New Procedures because they provide some of the few examples of what the IRS will likely agree are non-willful omissions, such that the filing under 2014 Streamlined Procedures is appropriate. On the other hand, the examples from 2012 FAQ 51.2 provide examples of scenarios which the IRS views as willful omissions, such that it would follow that a Streamlined submission by a taxpayer with a similar factual history may well be inappropriate. Again, these examples are not included in the 2014 FAQ nor under the Streamlined Procedures. Therefore, they may be only some, and not the only examples of situations where Streamlined Procedures apply. Some of the examples in the deleted FAQ examples are:

1. 2012 FAQ 51.1-Opt Out Considered Appropriate/Streamlined Procedures Likely Appropriate.

A. U.S. citizen working abroad with unreported income but no tax deficiency; foreign tax was paid and foreign tax credits resulted in no tax deficiency. Because income was omitted, taxpayer was ineligible for a 2012 FAQ 17 filing. While this taxpayer would not be eligible to file under the 2014 "Delinquent FBAR" or "Delinquent Information" procedures for same reason, i.e, "income" was not reported, the FAQ implies that non-willful conduct or perhaps reasonable cause could be determined on examination. See 2012 FAQ 51.1 Ex. 1.

B. U.S. taxpayer living abroad unaware of FBAR requirement until having return professionally prepared and omitting only $2,000 of interest income in first year of account, and reporting correctly in next two years. The FAQ implies that non-willful conduct or perhaps reasonable cause could be determined on examination. See 2012 FAQ 51.1 Ex. 2.

C. Taxpayer not filing Form 5471 to report interest in a controlled foreign corporation, reported all income incorrectly on a Sch. C as a disregarded entity but omitted $5,000 interest income and $1,700 in tax on foreign bank account of the foreign corporation. The taxpayer had signature authority for the foreign corporate bank account with a balance of $1.0 million. The value of the corporation was $100 million. The example implies that non-willful penalties are appropriate. The extremely large FBAR penalty under the OVDP is contrasted with the statutory non-willful FBAR penalty and the minimal income omission. See 2012 FAQ 51.1 Ex. 3.

D. A dual citizen of U.S. and another country with no U.S. income, reported all income in other country and paid taxes there; did not reside in U.S. and filed in U.S. after learning he was not compliant, paying approximately $400 of U.S. tax each year. Taxpayer did not qualify for 2012FAQ 17 and would not qualify for current Delinquent Filing Procedures due to income omissions. The taxpayer qualified for the reduced penalties under 2012 FAQ 52, which is no longer applicable as it is replaced by the New Streamlined Procedures for U.S. non-residents. Those procedures would be appropriate under these facts. See 2012 FAQ 51.1 Ex. 4.

2. <u>2012 FAQ 51.2-Opt Out Considered Inappropriate/Streamlined Procedures Not Appropriate</u>.

A. U.S. taxpayer not reporting $6 million of offshore gain on sale of building owned in a foreign trust; no tax was paid in foreign country or in U.S.; there was $10 million in foreign bank account, and no FBAR filed. The IRS indicated that civil fraud could be asserted by an examining agent. See 2012 FAQ 51.2 Ex. 6.

B. Taxpayer is one which the example states is one as to whom a "civil fraud penalty was warranted." The example is useful in illustrating that the IRS views the use of

entities such as foreign trusts and schemes such as repatriating proceeds through a disguised loan repayment, are strong indicia of willful omissions and fraud. Further, the example is one of multiple year FBAR penalties being imposed, as in the recent victory for the IRS in U.S. v. Zwerner, discussed herein.

C. FAQ 52- Former 5% Reduced Penalty Eliminated-Non-OVDP Options Expressly Applicable 2014 FAQ 52 states: "If you have circumstances covered by former FAQ 52, you should not use OVDP and should see section 2 of the "Options Available For U.S. Taxpayers with Undisclosed Foreign Financial Assets" (the "Streamlined Procedures").

1. Streamlined Procedures Clearly Apply to The Limited Instances Where Former 5% Penalty Applied. Since the 2012 FAQ 52 examples now are circumstances in the IRS states the non-OVDP Streamlined Options apply, they are considered here at 2 and 3 below.

2. Circumstances for former 5% Penalty. The 2012 OVDP had three limited categories of taxpayers who might qualify for a 5% offshore penalty, generally as follows: (1) persons who did not open offshore account and withdrew less than $1,000 in any year; (2) U.S. citizens unaware that they were U.S. citizens; and (3) U.S. citizens with less than $10,000 of U.S. source income in any year, who had paid all taxes due on their income in the foreign country).

3. Broader Application of Fact Patterns and Difference Between 5% OVDP and Streamlined Procedures. Based upon the examples in part 1 of 2012 FAQ 52: The IRS views a taxpayer residing in the U.S. and having very little omitted U.S. income taxes attributable to offshore income as evidence that a taxpayer is non-willfulillful." Therefore, taxpayers having very little omitted offshore taxable income should consider using the Streamlined Procedures for U.S. Taxpayers Residing in the United States.

Based upon the examples in part 3 of 2012 FAQ 52, where U.S. taxpayers working in a foreign countries had significant income subject to U.S. taxes but had paid all applicable foreign taxes and would have been eligible for 5% streamlined procedure, taxpayers not residing in the U.S. who have paid all foreign taxes should consider using the Streamlined Procedures for U.S. Taxpayers Residing Outsider of the United States even where the omitted U.S. gross income was significant in amount.

D. 2012 FAQ 53 Former 12.5% Reduced Penalty Eliminated/Non-OVDP Options Expressly Applicable 2014 FAQ 53 states. If you have circumstances covered by former FAQ 53, you should not use OVDP" and should see "Options Available for U.S. Taxpayers with Undisclosed Foreign Assets." Thus, the "Streamlined Procedures" are indicated as being applicable to "...taxpayers whose highest aggregate account balance (including the fair market value of assets in undisclosed offshore entities and the fair market value of any foreign assets that were either acquired with improperly untaxed funds or produced improperly untaxed income) in each of the years covered by the OVDP is less than $75,000 will qualify for a 12.5 percent offshore penalty."

C. Conclusions as to 2014 OVDP. The 2014 OVDP likely won't promote "major" changes if the "Streamlined Procedures" do not attract significant submissions which otherwise would have been submitted under the OVDP. The changes to the OVDP, other than those which are intended to eliminate submissions which are non-willful, are reflective of the IRS' intent to more severely penalize willful offenders and reflect the IRS' attempts to gather more information. The changes reflect an increased burden on taxpayers opting for the OVDP, fewer options once it is selected, and a threat of increased penalties up to 50% regardless of fault of the taxpayer, if the IRS makes public an investigation of a bank or facilitator prior to submission of a pre-clearance letter by the taxpayers having offshore assets at that bank or with the facilitator. The changes to FAQs 17 and 18, are such that FBARs and information returns are filed under distinct procedures

outside of the OVDP, and seemingly outside of any assurances that criminal and civil penalties may not be applied if an examination results.

Part II which follows, discusses the New Streamlined Procedures.

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