

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

Part II: THE STREAMLINED FILING COMPLIANCE PROCEDURES

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.

At Part I of this Article, posted in this blog on July 9, 2014, the 2014 OVDP is analyzed, through a change-by-change review of the various substantive, and other more technical revisions and clarifications to the new 2012 FAQ which now are a part of the 2014 FAQ for the 2014 OVDP.

Part II follows, “The “Streamlined Filing Compliance Procedures”.

II. The Streamlined Filing Compliance Procedures.

A. Why the New Streamlined Procedures?

1. IRS's Statement Describing New Streamlined Procedures. The IRS' Release (IR-2014-73, June 18, 2014) described the new Streamlined Procedures as having been expanded so that those U.S. taxpayers who "aren't willfully evading their tax obligations" and therefore don't need the criminal protection afforded by the OVDP, could qualify for the program at reduced penalties. The Release reads in part:

"The changes announced today make key expansions in the streamlined procedures to accommodate a wider group of U.S. taxpayers who have unreported foreign financial accounts.

The original streamlined procedures announced in 2012 were available only to non-resident, non-filers. Taxpayer submissions were subject to different degrees of review based on the amount of the tax due and the taxpayer's response to a "risk" questionnaire. The expanded streamlined procedures are available to a wider population of U.S. taxpayers living outside the country and, for the first time, to certain U.S. taxpayers residing in the United States. The changes include:

- *Eliminating a requirement that the taxpayer have \$1,500 or less of unpaid tax per year;
- *Eliminating the required risk questionnaire;
- *Requiring the taxpayer to certify that previous failures to comply were due to non-willful conduct.
- *For eligible U.S. taxpayers residing outside the United States, all penalties will be waived.
- *For eligible U.S. taxpayers residing in the United States, the only penalty will be a miscellaneous offshore penalty equal to 5 percent of the foreign financial assets that gave rise to the tax compliance issue."

2. Statement of IRS Commissioner Describing New Streamlined Procedures. The following is a portion of the IRS' Commissioner's statement regarding the New Streamlined Procedures:

..First, we're expanding the streamlined procedures to cover a much broader group of U.S. taxpayers we believe are out there who have failed to disclose their foreign accounts but who aren't willfully evading their tax obligations. To encourage these taxpayers to come forward, we're expanding the eligibility criteria, eliminating a cap on the amount of tax owed to qualify for the program, and doing away with a questionnaire that applicants were required to complete.

...These changes reflect the helpful feedback of tax practitioners and the National Taxpayer Advocate, along with what we learned in our experience operating the OVDP. Over time, we

discovered that there were people, including many here in the U.S., for whom the existing program penalties were too harsh or restrictive. These people had small enough issues that they didn't really need the protection from criminal prosecution offered by the OVDP. But they also didn't fit into the narrow criteria of the streamlined procedures, either.

It's important to keep in mind that the IRS is seeking a balanced approach with this program, particularly in light of our other work on offshore issues. Our aim is to get people to disclose their accounts, pay the tax they owe and get right with the government. At the same time, for important categories of these non-willful people with offshore issues, a compliance regime that is too harsh won't net the desired result."

B. Prior Streamlined Procedures. The prior "streamlined procedures were announced in June, 2012 and went into effect September 1, 2012. As described in the statement of the Commissioner, they were available only to non-resident non-filers who were considered "low compliance risks" and are entirely replaced by the New Streamlined Procedures applicable to U.S. non-residents. The 2012 streamlined procedures and the 2014 changes are summarized at: <http://www.irs.gov/uac/IRS-Announces-Efforts-to-Help-U.-S.-Citizens-Overseas-Including-Dual-Citizens-and-Those-with-Foreign-Retirement-Plans>).

C. Overview of 2014 Streamlined Procedures: Elements Common to U.S. Residents and U.S. Non-Residents – Components of a "Voluntary Disclosure" Must Be Met, Certification as to "Non-Willful" Conduct is Required In All Submissions. There are two distinct new Streamlined Procedures, one, applicable to "U.S. Taxpayers Residing Outside of the United States," and the other to "U.S. Taxpayers Residing in the United States." The Streamlined Procedures apply to individuals and estates, but not to entities.

1. Eligibility/Certification/ Income Taxes Required From Residents and Non-Residents.

A. Taxpayers Under Examination Not Eligible. The Streamlined Procedures are a part of the voluntary disclosure process, and therefore, taxpayers under examination are not eligible to participate. The explanation is as follows:

"If the IRS has initiated a civil examination of a taxpayer's returns for any taxable year, regardless of whether the examination relates to undisclosed foreign financial assets, the taxpayer will not be eligible to use the streamlined procedures. Taxpayers under examination may consult with their agent. Similarly, a taxpayer under criminal investigation by IRS Criminal Investigation is also ineligible to use the streamlined procedures."

B. Eligibility Does Not Assure Acceptance Of Returns/Examination of Returns May Determine Taxpayers Were Not Eligible. Returns submitted under the Streamlined Procedures are subject to selection for examination. There is no assurance that the IRS will accept a taxpayer's submission. The website cautions both non-U.S. and U.S. taxpayers:

“Returns submitted under either the Streamlined Foreign Offshore Procedures or the Streamlined Domestic Offshore Procedures will not be subject to IRS audit automatically, but they may be selected for audit under the existing audit selection processes applicable to any U.S. tax return and may also be subject to verification procedures in that the accuracy and completeness of submissions may be checked against information received from banks, financial advisors, and other sources. Thus, returns submitted under the streamlined procedures may be subject to IRS examination, additional civil penalties, and even criminal liability, if appropriate. Taxpayers who are concerned that their failure to report income, pay tax, and submit required information returns was due to willful conduct and who therefore seek assurances that they will not be subject to criminal liability and/or substantial monetary penalties should consider participating in the Offshore Voluntary Disclosure Program (OVDP) and should consult with their professional tax or legal advisers.”

C. Certifications As to Non-Willful Omissions Required. Both U.S. residents and non-residents must submit certifications, on forms provided under the Streamlined Procedures. The Certification forms include the following:

1. Taxpayers must certify that they failed to report income from one or more foreign financial assets during the one or more of the three prior years.

2. Taxpayers must certify that their failure to report and pay tax with respect to offshore financial assets was “non-willful.” They will be required to certify the following statement:

“My failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to non-willful conduct. I understand that non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.”

3. The Certification form asks the taxpayer to “provide specific reasons for your failure to report all income, pay all tax, and submit all required information returns, including FBARs. If you relied on a professional advisor, provide the name, address, and telephone number of the advisor and a summary of the advice. If married taxpayers submitting a joint certification have different reasons, provide the individual reasons for each spouse separately in the statement of facts.”

4. Acknowledgment of Potential IRS Exam and Criminal or Civil Penalties. The following acknowledgment must be provided:

“I recognize that if the Internal Revenue Service receives or discovers evidence of willfulness, fraud, or criminal conduct, it may open an examination or investigation that could lead to civil fraud penalties, FBAR penalties information return penalties, or even referral to Criminal Investigation.”

5. FBARs Must Be Filed With Statement of Streamlined Submission. If the taxpayer failed to timely file correct and complete FBARs for any of the last 6 years, the taxpayer certifies that it has now filed those FBARs , and has included a statement explaining that the FBARs are being filed as part of the Streamlined Filing Compliance Procedures.

6. 3 Years income taxes plus interest, no penalties. Both residents and non-residents must pay additional income taxes plus interest attributable to the omitted offshore income for 3 prior years; however, there are no other income tax penalties. As set out below, U.S. residents are subject to the 5% offshore penalty whereas non-residents are not subject to any offshore penalty.

2. Non-Resident Status Certification Requirement. In addition to the above-listed requirements and certifications applicable to both residents and non-residents, non-residents must certify to their non-resident status. See <http://www.irs.gov/Individuals/International-Taxpayers/US-Taxpayers-Residing-Outside-the-United-States>). It provides in part, as follows:

“Individual U.S. citizens or lawful permanent residents, or estates of U.S. citizens or lawful permanent residents, meet the applicable non-residency requirement if, in any one or more of the most recent three years for which the U.S. tax return due date (or properly applied for extended due date) has passed, the individual did not have a U.S. abode and the individual was physically outside the United States for at least 330 full days. Under IRC section 911 and its regulations, which apply for purposes of these procedures, neither temporary presence of the individual in the United States nor maintenance of a dwelling in the United States by an individual necessarily mean that the individual’s abode is in the United States. For more information on the meaning of “abode,” see IRS Publication 54, which may be found at Publication 54.”

3. Residents Must Have Previously Filed Tax Returns Which Were Required. Residents must certify that have previously filed income tax returns for the 3 previous years (if returns were required to be filed).

Based upon this requirement, the message from the IRS is that residents who were not compliant with their reporting obligations to file U.S. tax returns are not considered to be “non-willful” offshore offenders.

4. Penalties and Relief Requirements Under Streamlined Procedures. U.S residents will pay a 5% offshore penalty whereas non-U.S. residents will not pay any offshore penalty under the Streamlined Procedures.

5. Relationship Between Streamlined Procedures and OVDP. The relationship of the procedures to treatment under the OVDP is generally mutually exclusive. However, transitional rules which apply only through July 1, 2014 are available to taxpayers who have submitted an OVDP disclosure letter prior to July 1, 2014 and have not executed and received back

from the IRS executed closing agreements, such that this class of OVDP participants may request to be removed from the OVDP penalty structure and have the non-willful 5% streamlined penalty applied (or no penalty for non-resident U.S. taxpayers”). See, <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures>:

“Coordination with treatment under OVDP: Once a taxpayer makes a submission under either the Streamlined Foreign Offshore Procedures or the Streamlined Domestic Offshore Procedures, the taxpayer may not participate in OVDP. Similarly, a taxpayer who submits an OVDP voluntary disclosure letter pursuant to OVDP FAQ 24 on or after July 1, 2014, is not eligible to participate in the streamlined procedures.

A taxpayer eligible for treatment under the streamlined procedures who submits, or has submitted, a voluntary disclosure letter under the OVDP (or any predecessor offshore voluntary disclosure program) prior to July 1, 2014, but who does not yet have a fully executed OVDP closing agreement, may request treatment under the applicable penalty terms available under the streamlined procedures. A taxpayer seeking such treatment does not need to opt out of OVDP, but will be required to certify, in accordance with the instructions set forth below, that the failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to non-willful conduct. As part of the OVDP process, the IRS will consider this request in light of all the facts and circumstances of the taxpayer’s case and will determine whether or not to incorporate the streamlined penalty terms in the OVDP closing agreement.”

The above “transitional rules” are further discussed in a special “Transitional Rules: Frequently Asked Questions (FAQ)” (<http://www.irs.gov/Individuals/International-Taxpayers/Transition-Rules-Frequently-Asked-Questions-FAQs>), and are not considered further here.

D. Conclusions as to Streamlined Procedures. In the Certification required under the Streamlined Procedures, taxpayers state that their offshore omissions were the result of: “negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.”

Worded as above, the Certification seemingly permits many taxpayers-- even those with significant offshore accounts and omitted income--to meet the “non-willful” requirement of the Streamlined Procedures. However, the Acknowledgment required under the Streamlined Procedures contains what for all practical purposes is a “disclaimer” or “warning” that the IRS may not accept the Certification of Non-Willfulness and may even criminally prosecute.

The Certification and the Acknowledgment are shown together below to highlight the conundrum taxpayers face in considering whether to file under the Streamlined Procedures:

Certification:

“My failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to non-willful conduct. I understand that non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.”

Acknowledgment:

“I recognize that if the Internal Revenue Service receives or discovers evidence of willfulness, fraud, or criminal conduct, it may open an examination or investigation that could lead to civil fraud penalties, FBAR penalties information return penalties, or even referral to Criminal Investigation.

As is discussed throughout this Article, it is inexcusable that the IRS has put these new procedures into place yet has wholly failed to provide examples of “non-willful conduct” or examples of conduct which illustrates “negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.”

The IRS has left the single most significant element of qualification for the Streamlined Procedures open for anyone’s guess. This will be the most troublesome in situations where the IRS selects a good faith Streamlined submission for examination and concludes that the conduct was “willful,” contrary to the Certification of non-willfulness.

The meanings of “willful” and “non-willful” under applicable law are further discussed herein at Part VI (“Willful or Non-Willful Offshore Omissions?”). Part VI includes a closer look at the Streamlined Certification as it relates to its request that taxpayers certify that their offshore non-compliance was the result of “non-willful conduct,” and provide “specific reasons” for their failure to comply.

As a consequence of the risks that the Streamlined Certification might be examined and rejected, taxpayers who might be eligible for the Streamlined Procedures will have to decide whether to:

- (1) Proceed to file under the Streamlined Procedures and risk civil penalties in excess of the OVDP penalties as well as possible criminal prosecution (for example, criminal prosecution for willful failure to file offshore returns, willful non-payment and non-filing of tax returns, or for fraudulent filings or tax evasion);
- (2) Enter the OVDP and accept the 27.5% civil penalty while being assured of no criminal prosecution as long as the submission is truthful; or

(3) Proceed as proposed in Part V herein, i.e, by filing of a voluntary disclosure outside of the OVDP and outside of the Streamlined Procedures, but meeting the requirements under IRM 9.5.11, so as to receive protection from criminal prosecution as would be received under the OVDP.

If the IRS examines the filed returns submitted under the Streamlined Procedures or under IRM 9.5.11 and included the same information as would be included under the Streamlined and OVDP procedures, consistent with the attached Certification of Non-Willful Conduct, the taxpayer would assert that non-willful penalties apply, or, that no penalties apply if there was reasonable cause for the late or non-filed FBARs or international income tax returns. If the returns are not selected for audit, then the taxpayer will have paid only those penalties (if any) which were paid with the returns as filed through the voluntary disclosure submission. The penalty for non-willful FBAR violations is \$10,000 per account per year for 6 years, or \$0 in cases of non-willful violations with “reasonable cause,” such that in the case of a \$1.0 million average balance and only one offshore account, six years of FBAR penalties would be \$60,000. The 5% streamlined penalty on the same account would be \$50,000.

The Procedures for filing Delinquent FBARs and for filing Delinquent International Information Returns are considered at Parts III and IV, herein below.