

J. IRS Offshore Voluntary Disclosure Programs Continue to Burden “Benign Actors” and Damage IRS Credibility

The IRS offered a series of offshore voluntary disclosure (OVD) programs to settle with taxpayers who had failed to report offshore income and file one or more related information returns (e.g., Form TD F 90–22.1, *Report of Foreign Bank and Financial Accounts* (FBAR)).¹ As described in prior reports, these programs apply a one-size-fits-all approach designed for “bad actors” to “benign actors” who inadvertently violated the rules, requiring them to opt-in and then opt-out, and subjecting them to lengthy examinations and draconian civil and criminal penalties.²



A Government Accountability Office (GAO) analysis shows that the offshore penalty paid by those with the smallest accounts (i.e., those in the 10th percentile with accounts of \$78,315) was disproportionate – at least 575 percent of the tax, interest, and penalties on their unreported income.³ It was also disproportionately greater than the amount paid by those with the largest accounts (i.e., those in the 90th percentile with accounts of more than

- 1 The Bank Secrecy Act (BSA) requires U.S. citizens and residents to file an FBAR so the government can better detect those engaged in tax evasion, terrorism, and money laundering. See generally 31 U.S.C. § 5321(a)(5); 31 C.F.R. § 1010.350; Internal Revenue Manual (IRM) 4.26.16 (July 1, 2008); Joint Committee on Taxation (JCT), JCS-5-05, General Explanation of Tax Legislation Enacted in the 108th Cong. 377-78 (May 2005). The terms of these programs are all promulgated by frequently asked questions (FAQs) posted to various IRS websites, rather than published in the Internal Revenue Bulletin, as the IRS had done with earlier programs. See IRS, Voluntary Disclosure: Questions and Answers, <http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers> (first posted May 6, 2009); IRS, 2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers, <http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers> (first posted Feb. 8, 2011); IRS, Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers, <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers> (first posted June 26, 2012).
- 2 In addition to criminal penalties, the maximum civil penalty for “willfully” failing to report foreign accounts on an FBAR is severe – the greater of 50 percent of the account or \$100,000 per year. 31 U.S.C. § 5321(a)(5)(C). Specific problems with these settlement programs are described in prior reports. See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress 134-153; National Taxpayer Advocate 2011 Annual Report to Congress 191-205 and 206-72; National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 7-8 and 21-29. See also Taxpayer Advocate Directive 2011-1 (Aug. 16, 2011).
- 3 See GAO, GAO-13-318, *IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion* 13 (Mar. 2013) (TAS analysis of data reflected on Table 2).

\$4 million) who paid 86 percent or less.⁴ Moreover, the IRS initially processed applications from benign actors who are expected to opt out much more slowly than others, though it has recently begun to process them more quickly, as shown by the following table.

FIGURE II.4, OVD PROGRAM APPLICATIONS, DISPOSITIONS, AND PROCESSING TIMES (AS OF JUNE 7, 2013)⁵

	2009 OVDP		2011 OVDI		2012 OVDP	
	Number	Average Days to Closure	Number	Average Days to Closure	Number	Average Days to Closure
Total certifications applicants	10,792		12,532		6,435	
Closed after certification	10,735	309.0	3,666	180.5	6	238.9
Open certifications	55		8,849		2,876	
Total opt outs	290		323		0	
Closed after opt out	258	563.2	111	166.0	0	
Open after opt out	30		210		0	
Total removed	110		0		0	
Closed after removal	83	616.8	0		0	
Open after removal	25		0		0	

In 2012, the IRS began allowing certain “low risk,” nonresident nonfilers – those with simple returns and owing less than \$1,500 in tax – to file the returns without triggering penalties (the “Streamlined Nonresident Filing Initiative”).⁶ In January 2013, following the National Taxpayer Advocate’s recommendation to expand the Streamlined Nonresident

4 *Id.* The total tax, interest, and penalties row in the GAO table may include tax, interest, and penalty amounts that are not part of the OVD program assessments. Taxpayers who are in the 10th percentile for offshore account balances are not necessarily the same individuals who are in the 10th percentile for total tax, penalties, and interest. Nor are taxpayers who are in the 90th percentile for offshore account balances necessarily the same individuals who are in 90th percentile for total tax, interest, and penalties.

5 IRS response to TAS information request (June 7, 2013).

6 IRS, *New Filing Compliance Procedures for Non-Resident U.S. Taxpayers* (first posted June 28, 2012), <http://www.irs.gov/Individuals/International-Taxpayers/New-Filing-Compliance-Procedures-for-Non-Resident-U.S.-Taxpayers>.

Filing Initiative to both U.S. residents and those owing more than \$1,500, IRS officials publicly announced the IRS had eliminated the \$1,500 threshold.⁷

Although this is a positive change, the National Taxpayer Advocate remains concerned that the IRS does not have a simple and easy method for allowing benign actors who are U.S. residents to resolve past filing delinquencies. Nor has it provided clear guidance about key terms that it has used in its programs, such as when someone will be considered “high risk,” how they may avoid a penalty (*e.g.*, by demonstrating “reasonable cause”), and when they will be subject to the lower penalty applicable to “nonwillful” conduct. The uncertainty surrounding these terms and the consequences of opting out has likely prompted some benign actors to pay more than they should inside the OVD programs.

In addition, the IRS has reportedly revoked pre-clearance letters authorizing taxpayers to participate in the OVDP, even though some had already made disclosures, filed returns, and paid taxes and penalties in reliance on the IRS’s letters.⁸ These reversals further erode the IRS’s credibility, and are more likely to reduce than to increase voluntary compliance.⁹

Moreover, the IRS has not adopted the National Taxpayer Advocate’s recommendation that IRS send notices to educate those with foreign accounts about the requirements. Nor has it addressed the unnecessarily burdensome requirement to report certain accounts on both Form 8938 and the FBAR.

Finally, in FY 2012 and FY 2013 YTD, TAS assisted 474 taxpayers with OVD-related problems and issued four taxpayer assistance orders (TAOs).¹⁰ In the three cases in which the

7 Compare IRS, Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer Taxpayers Questionnaire (Aug. 2012) (“Eligibility ... 3. Do you owe more than \$1,500 in U.S. tax on any of the tax returns you are submitting through this program? [Y/N] ... If you answered yes to questions ... 3, or 4, any returns submitted through this program will not be eligible for the streamlined processing procedures...”) with Lee Sheppard, *IRS Officials Discuss Streamlined Voluntary Compliance* (Jan. 14, 2013) (“[E]ven if the taxpayer’s income tax owed exceeds the low threshold of \$ 1,500 per return, he or she can still participate if the situation is simple, such as single-source income, according to Frank Bucci of LB&L.”) and IRS, *Frequently Asked Questions Regarding the Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer Taxpayers* (Feb. 27, 2013), <http://www.irs.gov/Individuals/International-Taxpayers/FAQReStreamlinedFilingComplianceProceduresNRNFTPs> (“The \$1,500 per year tax limit will not disqualify you from admission to the Streamlined Procedures, but exceeding that limit may result in your submission being treated as higher risk”). The IRS provided TAS with a copy of these frequently asked questions (FAQs) on February 28, after they had been posted. The National Taxpayer Advocate previously recommended the IRS establish a process for clearing FAQs to ensure taxpayer rights are protected. See National Taxpayer Advocate 2011 Annual Report to Congress 403.

8 Patrick Temple-West, *U.S. IRS Boots Israeli Bank Clients From Amnesty Program*, Reuters (Mar. 7, 2013), <http://www.reuters.com/assets/print?aid=USL1NOBZDP220130307>; Janet Novack, *Taxpayers Who Lost Offshore Account Amnesty Promised Fair Treatment*, Forbes (Apr. 11, 2013), <http://www.forbes.com/sites/janetnovack/2013/04/11/taxpayers-who-lost-offshore-account-amnesty-promised-fair-treatment/>.

9 According to the New York City Bar Committee on Income Taxation: “To resolve the situation and restore the integrity of the OVDP, we urge the IRS (a) to readmit the disqualified taxpayers into the program, subject to the conditions set forth in the guidelines published on the IRS’s website; and (b) to institute new safeguards to avoid such a situation from occurring again. Finally, we would appreciate the inclusion of a description of the proposed safeguards on the IRS’s website and submit that providing such information will enable tax practitioners to appropriately advise clients seeking to rectify past non-compliance regarding the benefits of making a voluntary disclosure and to reassure those clients regarding the minimal risk of being disqualified from the program after admission. These steps are critical so that the OVDP continues to have vitality.” Letter from Chair, The Personal Income Taxation Committee, New York City Bar to Acting Commissioner, IRS, (May 8, 2013), *reprinted as, NYC Bar Committee Urges IRS to Restore Integrity to Offshore Voluntary Disclosure Program*, 2013 TNT 98-18 (May 21, 2013).

10 TAMIS query (May 21, 2013).

IRS did not comply with the TAOs, the National Taxpayer Advocate elevated (or plans to elevate) them to the Operating Division Commissioner level or above.¹¹

In FY 2014, TAS will continue to advocate for taxpayers experiencing problems with the IRS's OVD programs. In addition, TAS will advocate for the IRS to stop unnecessarily burdening taxpayers who inadvertently failed to report foreign accounts on information returns, and to adopt more reasonable policies that will restore its credibility and be more consistent with its mission to promote voluntary compliance. For example, TAS will continue to advocate for the IRS to expand its Streamlined Program to U.S. residents, to clarify and formalize the terms of its OVD programs by requesting public comments and then publishing guidance in the federal register (rather than a website posting), and revise Forms 8938 and/or TD F 90-22.1 to reduce taxpayer burden and the duplicative reporting. TAS will report its progress in the National Taxpayer Advocate 2013 Annual Report to Congress.

11 For a discussion about the IRS's confusion regarding the National Taxpayer Advocate's authority in this area, see National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 7-9 and 26-27.