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Tax Evasion

IRS Guidance on Offshore Asset Disclosure Program Perceived Beneficial to Taxpayers

The Internal Revenue Service's recent guidance on its offshore voluntary disclosure initiative is beneficial to taxpayers and likely will encourage more people to come into the program, practitioners said in recent interviews.

''I think there are a lot of positive things that are coming out of this update,'' Jeffrey Schechter, an attorney at Cole, Schotz, Meisel, Forman & Leonard, P.A., Hackensack, N.J., told BNA June 3. ''There was a tremendous concern about taxpayers' ability to come forward at this stage of the game.''

The new set of frequently asked questions and answers is the agency's first guidance on the Offshore Voluntary Disclosure Initiative (OVDI) that IRS unveiled in February (27 DTR GG-1, 2/9/11).

It allows taxpayers to ask for a 90-day extension of the Aug. 31 application deadline, provides more flexibility around the question of ''opting out'' of the program, and lets more taxpayers living abroad qualify for a reduced 5 percent tax rate (107 DTR G-4, 6/3/11).

Interviews Precede Swiss Developments. The interviews came days before news that Switzerland is seeking to resolve what was described as ''past fiscal problems'' with the United States in its discussions with Washington on implementation of the new Foreign Account Tax Compliance Act (FATCA)—a process that could send hundreds more taxpayers into the OVDI as IRS obtains more information about accounts in foreign banks (see related report in this issue).)

Specifically addressing the new guidance on the OVDI, Schechter called the deadline extension ''a helpful and positive step in the right direction.''

Mark Matthews, a former chief of IRS criminal investigations now with Morgan, Lewis & Bockius LLP, Washington, D.C., also praised the IRS's flexibility on the Aug. 31 deadline.

''The possibility of an extension comes as a great relief to practitioners who want to help the clients come into compliance, but were fearful that delays in obtaining bank records, for example, might cause them to miss the deadline and then get into an unnecessary dispute about penalties,'' Matthews said in a June 6 interview. ''It is rarely the taxpayer's fault that the bank records take a while to obtain.''

Opt-Out Process Discussed. Both practitioners praised the fact that IRS addressed what Schechter called ''a great deal of uncertainty about the opt-out process.''

In that document, IRS clarified that it is possible that taxpayers who opt out of the program could get a better deal on civil penalties—rather than the set 25 percent rate under the OVDI structure—if they have acted in good faith. Schechter said the agency's previous approach ''cast the same net on everybody,'' regardless of whether a taxpayer was willfully evading taxes or was trying to comply and made a mistake.

IRS's new opt-out approach is ''a good option for a pretty limited number of people, but it's a good option,'' he told BNA.

According to Matthews, in the opt-out area, ''Probably more than anything, the tone of the guidance was helpful, because it did not carry the threat that an opt-out was a sure way to a retaliatory audit.''

He stressed, ''It remains a very difficult area in advising clients, however, because there is simply no track record, and the potential penalties are extremely high.″

Flexibility on 5 Percent Rate Seen Positive. Schechter and Matthews also praised a provision in the FAQ that will let certain taxpayers living abroad qualify for a 5 percent rate—a sharp reduction from the general 25 percent mandated by the program—if they earned less than $10,000 annually in U.S. source income and complied with the tax reporting and payment rules in their country of residence.

''It's helpful to have clarification that people in that scenario are not going to get clobbered by a very, very expensive penalty,'' Schechter said.

He added, ''IRS is doing something positive here. They're sending a message that there are situations where mitigation is appropriate, that there are circumstances that don't warrant a 25 percent penalty.''

Although the 5 percent rate was available in the program when it was initially unveiled, Schechter said, very few people were eligible for it. ''It was like trying to fit a square peg in a round hole,'' he said. ''It just never seemed to work.''

Matthews said in his opinion, ''This was probably the most urgently needed fix. Neither long-term non-U.S. residents nor their global tax advisers could conceive of a penalty of 25 percent of their net worth when many clients had no U.S. tax liability.''

''It was causing many of them to remain out of the system, further eroding compliance, rather than improving it,'' Matthews said. ''And the IRS image abroad was being tarnished as overly aggressive given the circumstances of these clients.″

By Alison Bennett

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