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Client Alert

Undisclosed Offshore Accounts: IRS Offers Limited Tax Amnesty But The Window Of Opportunity Is Short

On March 23, 2009 the Internal Revenue Services, announced a new initiative for voluntary disclosure of offshore accounts (the “Program”) under which the IRS would be lenient and consistent in assessing penalties.

The Internal Revenue Code requires every U.S. citizen or resident to report on his income tax return, all sources of income, whether foreign or domestic. In addition to reporting such income, U.S. persons are required to provide details of all non-U.S. accounts which together hold assets in excess of \$10,000. This annual information reporting is made on Form TD F 90-22.1, (Report of Foreign Bank and Financial Accounts or “FBAR”).¹ As described below, severe penalties apply for failure to report the income or existence of any offshore accounts and these penalties may be increased under the President’s new budget proposals.

In order to encourage non-compliant U.S. taxpayers to come forward, the IRS is offering, for a limited time,² substantially reduced penalties and, in most cases, exemption from criminal prosecution, for taxpayers with undisclosed foreign accounts. In order to take advantage of the Program a taxpayer must make a full and detailed written disclosure to the IRS of his offshore accounts and pay taxes on the income earned, together with interest and certain enumerated penalties, described below. After a preliminary determination by the IRS that the taxpayer’s actions do not warrant criminal prosecution, and provided the taxpayer has fully cooperated, the IRS will:

- assess all taxes and interest going back six years, or such shorter period that the account has been in existence;
- require taxpayers to file amended returns for the applicable period, including FBARs;

¹ The FBAR must be filed by June 30 each year and no extensions are available. The general purpose of the FBAR is to provide disclosure of financial or other interests, such as signatory authority, for financial accounts located in foreign jurisdictions. Even individuals and businesses which use foreign accounts for wholly legitimate reasons should take note of increasingly stringent disclosure requirements in the U.S. for such accounts and should be mindful that the civil and criminal penalties associated with noncompliance may increase.

² The Program runs for 6 months, from March 23, 2009 to September 22, 2009.

- assess either an accuracy penalty (20% of the amount of tax due on the under-reported income) or a delinquency penalty (25% of the tax due, in a situation where no tax return was filed), on taxes required to have been reported within the six year look back period;
- in lieu of all other penalties that could apply, including FBAR and information return penalties, assess a penalty equal to 20% of the highest balance in the foreign bank account (presumably during the six-year look-back period). This 20% penalty will be reduced to 5% only if the following conditions exist:
 - the taxpayer did not open or cause the account to be opened (e.g., the account was inherited);
 - there has been no activity in the account (such as deposits or withdrawals during the period the account was controlled by the taxpayer);
 - all applicable U.S. taxes have been paid on the funds deposited in the account, except for taxes on the income or earnings of the account.

It is anticipated that criminal prosecution will be reserved for only the most egregious cases; for example, where the proceeds in the account were derived from illegal activities. However, since the IRS will not guarantee that participants in the Program will not be criminally prosecuted, taxpayers are strongly advised to retain counsel to assist them in making any voluntary disclosure.

On May 6, 2009, the IRS issued further guidance on how it will operate the Program in the form of Frequently Asked Questions (“FAQs”).³ These FAQs provide the following additional guidance:

- Taxpayers who have made so-called "quiet disclosures" (by filing amended returns reporting previously unreported income) may participate in the Program. Taxpayers making quiet disclosures who do not participate in the Program are at risk of being subject to the more severe civil penalties under current law (described below) or even potentially criminal prosecution.
- Corporations, partnerships and trusts are eligible to participate in the Program.
- Taxpayers who do not have the immediate ability to pay all back taxes, penalties and interest due may still participate in the Program by submitting a payment plan that is acceptable to the IRS.

³ We understand that additional FAQ's may be issued from time to time in the future to address additional questions raised by taxpayers and their representatives, including the application of the Program to inherited accounts or multiple successor accounts.

- Taxpayers who are already under examination, regardless of whether it relates to undisclosed foreign accounts or undisclosed foreign entities, are not eligible to participate in the Program.

A non-compliant taxpayer who does not make a voluntary disclosure prior to being contacted by the IRS will face a considerably harsher penalty regime which includes potential criminal prosecution and significantly greater monetary penalties. The IRS can, under current law, confiscate the greater of \$100,000 or 50% of the value of an offshore account when the holder deliberately fails to disclose the account to the Treasury. The penalty can apply separately for each year that the FBAR is not filed, so after 3 years of non-compliance, the account holder can owe 150% of the account's value. There are proposals to double these penalties. In addition, there are a myriad of other returns that the taxpayer may have been required to file if trusts or foreign entities are involved, and each such return carries potential additional penalties for failure to file.

Taxpayers should also be aware that any adjustment of their federal income taxes, whether as a result of a voluntary disclosure or otherwise, may also have state tax implications. It is common practice for the IRS to pass information on to the appropriate state tax authorities once the federal tax liabilities have been adjusted. To encourage taxpayers to come forward and comply with their full state tax obligations, some states are offering a tax amnesty program of their own. These states include New Jersey and Connecticut. However, New Jersey's amnesty program is currently scheduled to end on June 15, 2009 and Connecticut's is currently scheduled to end on June 25, 2009.

We encourage all clients who have undisclosed offshore accounts to consider participating in the federal Program and any applicable state amnesty program. Persons wishing to participate in the Program are strongly advised to discuss the particular circumstances of their case with a qualified tax advisor before contacting the IRS or any other taxing authority.

If you would like more information about the new IRS initiative or to discuss a particular set of facts please contact:

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