IRS Reminder: Foreign Account and Asset Reporting Deadlines are Fast Approaching

by Christopher A. Karachale

On April 10, 2015, the IRS sent out an important reminder for US taxpayers, especially those living abroad, that it may impose substantial penalties and interest for failing to report ownership of foreign accounts and assets. U.S. citizens residing overseas ordinarily must file informational returns, such as Forms 8938, 5471, and 3520, by June 15, 2015 to meet the reporting requirements. In addition to other informational returns, a Report of Foreign Bank and Financial Accounts ("FBAR") may also need to be separately filed by June 30, 2015.

These obligations start as soon as any ownership interest reaches statutorily defined thresholds and continue for as long as the thresholds are met. In addition, taxpayers must disclose the ownership interests regardless of whether a foreign income exclusion or foreign tax credits may be claimed.

Failing to meet the reporting requirements can have significant civil and criminal consequences. The U.S. government imposes substantial civil penalties on taxpayers for such failures, including up to a 50% penalty on the value of undisclosed foreign accounts or assets as well as interest and penalties on any unpaid tax. Further, a taxpayer may be subject to criminal penalties, which the IRS has indicated it will increasingly pursue. As highlighted in its 2014 Criminal Investigation yearly report, the IRS has been devoting more resources to track taxpayers attempting to hide foreign accounts or assets willfully.

Disclosure Programs

Fortunately for taxpayers, the IRS offers several options to correct past reporting failures and avoid the severe penalties that could arise under audit. Since 2009, the IRS has offered the Offshore Voluntary Disclosure Program (OVDP) to provide protection from criminal prosecution and offer fixed terms for resolving civil liabilities. The OVDP generally allows taxpayers to pay a flat penalty on the highest aggregate balance of undisclosed accounts and pay tax and interest on any undisclosed income for the past 8 years.

If a taxpayer believes that the OVDP penalties are too severe given the extent of the reporting failures, the taxpayer may opt out of the OVDP and request a supplemental review of the case.

The OVDP opt out program affords taxpayers the chance to argue why their individual facts justify lower or no penalties to be imposed. The individualized assessment can be an important opportunity to reduce liability, but may require complex legal and factual arguments to be successful.

On July 1, 2014, the IRS opened the Streamlined Disclosure Program as an alternative method for taxpayers to correct limited reporting delinquencies. The Streamlined Disclosure Program provides a reduced penalty structure and corrective reporting obligations. If accepted, U.S. residents pay a penalty of 5% of the highest balance of their offshore accounts, while citizens residing outside the United States are not subject to any penalty.

Recent Developments in Offshore Reporting Compliance

In the Streamlined Disclosure and OVDP opt out programs, the IRS may examine whether a taxpayer engaged in willful activities to circumvent the reporting requirements. If a taxpayer is deemed willful, the IRS may apply full statutory penalties, resulting in liability that could amount to multiple times the value of any undisclosed accounts or assets.

Unfortunately, the IRS thus far has failed to give significant guidance on what may constitute willfulness in avoiding reporting obligations. The IRS has however continued to argue that by merely signing a return, a taxpayer can demonstrate willful behavior. In *United States v. Williams*, No. 10-2230 (4th Cir. 2012), the IRS successfully asserted that signing a return demonstrated willful actions to not further investigate reporting obligations. The *Williams* court agreed with this position and imposed substantial penalties even though the taxpayer's return was prepared by a third party accountant.

Using this position, the IRS appears to be vigorously enforcing even nonwillful penalties associated with reporting noncompliance. Recently, in *Moore v. United States,* No. 2:13-cv-02063 (W.D. Wash. 2015), a court ruled that ignoring questions relating to foreign assets on a tax return was sufficient to prevent claims of reasonable cause for a nonwillful omission. Further, the IRS was able to prevent any reduction of the penalty by requiring the taxpayer to prove the amount imposed was arbitrary, capricious, and an abuse of discretion. This new standard can be a high burden to meet and may prevent many taxpayers from reducing statutory penalties once imposed by the IRS.

Given the complexity of the offshore disclosure programs and the increased focus of the IRS on international tax issues, taxpayers with undisclosed foreign financial accounts and assets should contact tax counsel to assess their options and construct a viable solution for compliance.

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