

January 10, 2014

The 2013 GAO Report¹ of the IRS Offshore Voluntary Disclosure Program²

Reveals Key Facts:

- There Were Not Billions of Income Taxes Collected
- Few Offenders (378 Taxpayers) Represented One Half of All Collected Dollars – Reported At that Time
- Taxpayers with Smallest Accounts (10th Percentile) – Apparently Owed (Median) of a Few Hundred Dollars per Year in Income Taxes

By: Patrick W. Martin,³ | 619.515.3230 | patrick.martin@procopio.com and G. Michelle Ferreira,⁴ Esq.

The IRS offshore voluntary disclosure program has repeatedly been pronounced a great success. The IRS itself has announced its strong progress from the program; including “ . . . the collection of more than US\$5.5 billion in back taxes, interest and penalties from approximately 38,000 participants”⁵ As the GAO had explained in prior reports, the Offshore Voluntary Disclosure Programs have a one-sized-fits-all approach designed for the most extreme taxpayers with criminal exposure but which are also applied identically to taxpayers who truly inadvertently violated complicated offshore reporting rules. As the *GAO Report* indicates, taxpayers with little or no criminal or civil fraud exposure were punished proportionately in higher amounts than those who participated and had true criminal tax exposure.

¹ The authors have taken the taxpayer information that has finally been made, at least partially public, via the following GAO report, to identify the amount of actual estimated taxes collected: *Offshore Tax Evasion: IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion (GAO-13-318)*: March 2013, <http://www.gao.gov/assets/660/653369.pdf> (referred to as “GAO Report”). Table 3 provides that the total “offshore penalty” collected was \$2.81 Billion and “total collected” out of a total US\$4.4 Billion collected. Accordingly, the “offshore penalty” represented 64% of all sums collected under the program out of the 10,543 taxpayers analyzed.

From Table 3:

Offshore penalty	<u>\$ 2,810,000,000</u>
Total Collected	<u>\$ 4,400,000,000</u>

² In 2009, the IRS commenced their 2009 offshore voluntary disclosure program (“OVDP” or “program”) designed to located taxpayers who were hiding assets with unreported income overseas. <http://www.irs.gov/uac/2009-Offshore-Voluntary-Disclosure-Program>.

³ Patrick W. Martin is a Past Chair of the International Committee and past Executive Committee member of the State Bar of California, Taxation Section. He is the tax partner in charge of the tax practice at the San Diego based law firm Procopio et al LLP in San Diego, California. He practices exclusively in international tax related matters.

⁴ G. Michelle Ferreira is the Past Chair of the Taxation Section of the California State Bar and a former member of the Executive Committee of the State Bar of California, Taxation Section. She is managing partner of Greenberg Traurig’s San Francisco office in San Francisco, California. Her practice is exclusively federal and state tax controversies and litigation.

⁵ See letter from former Acting Commissioner of the IRS, Steven Miller, dated March 18, 2013 to Mr. James White, Director, Tax Issues of the U.S. Government Accountability Office (“GAO”).

The data in the *GAO Report*, however, provides a more detailed explanation of the actual income taxes collected by the IRS. Apparently, not more than US\$125 million annually in income taxes were collected. There were not billions of dollars of income taxes collected. The details of the actual income tax collected under these programs have largely remained a secret, until the information released by the *GAO Report*⁶ that analyzed the \$4.4 Billion total collected as of the date in that report.⁷

Curiously, the IRS has yet to provide basic income tax statistics and information about the actual amounts of income tax collected under the program.⁸

- **Highlights Culled from *GAO Report***

The following highlighted information is based upon extrapolations of limited data made available to the public. Generally, the IRS provides comprehensive statistical data of taxpayer income.⁹ However, the IRS has refused to provide similar statistical data for the taxpayers participating in the OVD programs. The authors have extrapolated from the tax data in some of the highlights culled from the data provided for the first time by the *GAO Report* are as follows:

- Only a relatively small percentage of the total \$4.4 billion collected represents income taxes due under the law (approximately US\$125 million per year in income taxes).¹⁰
- The vast majority, approximately 64% of all amounts collected, was for the “Offshore penalty”, which is a “penalty” not provided under the law; unlike the negligence penalty, underpayment penalty, civil fraud penalty, and FBAR penalty, etc.¹¹

⁶ See *Reuters, IRS May be Missing Offshore Tax Evasion: Government Watchdog, April 26, 2013, http://articles.chicagotribune.com/2013-04-26/news/sns-rt-us-usa-tax-offshorebre93p12r-20130426_1_offshore-voluntary-disclosure-program-acting-irs-commissioner-the-irs.*

⁷ See pages 15 and 16 of the *GAO Report*: “About half of the revenues collected through the 2009 OVDP, as of March 30, 2012, came from 378 cases where taxpayers received offshore penalties of \$1 million or greater, meaning they had account balances of \$5 million or greater. This group, which we refer to as “large penalty cases”, accounted for about 6 percent of the closed 2009 OVDP cases, but the penalties they received amounted to 49 percent of the total \$1.9 billion in offshore penalties that had been assessed by IRS at that time.”

⁸ Attached as Exhibit A, please find a copy of the IRS rejection letter in response to multiple Freedom of Information Act Requests for basic taxpayer information made by one of the co-authors. The *GAO Report* for the first time, however, does



FOIA Rejection.pdf

provide some key information about income taxes actually collected.

⁹ See <http://www.irs.gov/uac/Tax-Stats-2>

¹⁰ See basic information from Table 3 of the *GAO Report*, which reflects US\$4.4B total collected and “offshore penalty” of \$2.81B, which leaves a relatively small amount for income taxes:

From Table 3:

Number of Total 2009 Taxpayers Analyzed -		10,543
Offshore penalty	64%	<u>\$ 2,810,000,000</u>
Total Collected		<u>\$ 4,400,000,000</u>

¹¹ The maximum civil penalty applicable to a taxpayer for “willfully” failing to file a Foreign Bank Account Report (“FBAR”) is the greater of 50% of the taxpayer’s total accounts or \$100,000 per year. The IRS typically does not generally apply the willful FBAR penalty to taxpayers who inadvertently fail to report accounts, particularly if the taxpayer voluntarily corrects the violations before the IRS contacts them for audit. 31 U.S.C. §5321(a)(5)(C).

- Those taxpayers with accounts that represented the 10% smallest accounts (i.e., “10th percentile”) apparently owed an average of a few hundred dollars per year in income taxes (seventeen dollars and seventeen cents).¹²
- These same taxpayers (the 10th percentile account holders) paid an average “offshore penalty” which was multiple times (upwards of 12,932% twelve thousand, nine hundred and thirty two percent), of the amount of income taxes these individuals owed under the law (i.e., US\$13,320). The Taxpayer Advocate Office identified taxpayers as having paid an Offshore Penalty (“in lieu of penalty”) of “. . . at least 575 percent of the tax, interest and penalties on their unreported income.”¹³
- Half of all the monies collected by the IRS (\$4.4 Billion total collected as of the dates as reflected in the *GAO Report*¹⁴) were attributed to only 378 cases (referred to as “Bad Actors” in this article) out of a total 10,543 taxpayers who have participated in the Program.
- The Bad Actors had accounts of apparently US\$5M or greater, yet paid a fractional percentage of an “Offshore Penalty” compared to the amounts paid by the other taxpayers (10,000+/- taxpayers) who entered the program¹⁵ with much smaller offshore accounts.
- The Bad Actors’ relative small percentage paid as an Offshore Penalty can be compared to other taxpayers who participated in the program as reflected Table 1 and Chart A below (measured in size of accounts; e.g., smallest 10th percentile; 25th percentile, median, 75th percentile and the largest accounts in the 90th percentile): Table 1 reflects the calculations extrapolated by the authors from the limited data provided:

Percentage of “Offshore Penalty” compared to income taxes owed:

10th percentile	25th percentile	Median	75th percentile	90th percentile
12932%	2148%	847%	514%	417%

¹² See Table 2, on page 13 of the GAO Report, showing that of the 10,439 cases closed (i.e., 10th percentile, represents 10% X 10,439 cases closed, i.e., 1,044). The average total income taxes owed by these taxpayers over the 6 year period (i.e., 2003, 2004, 2005, 2006, 2007 and 2008) were only \$103, which is an average of only \$17.17 per year. Similarly, statutory interest for that 6 year period averaged US\$52 for these taxpayers, which represents only \$8.67 per year. The penalties that were assessed, and provided for under the law, averaged US\$84 over that six year period, which represents an average of only US\$14 of statutory penalties per year. In contrast, the “offshore penalty” which is not a penalty under the law, represented 129 times the amount of tax owed (or 12,932% of the income tax owed), and averaged \$13,320 (or \$2,220 per year compared to US\$17 and 17 cents of income tax owing for the same year).

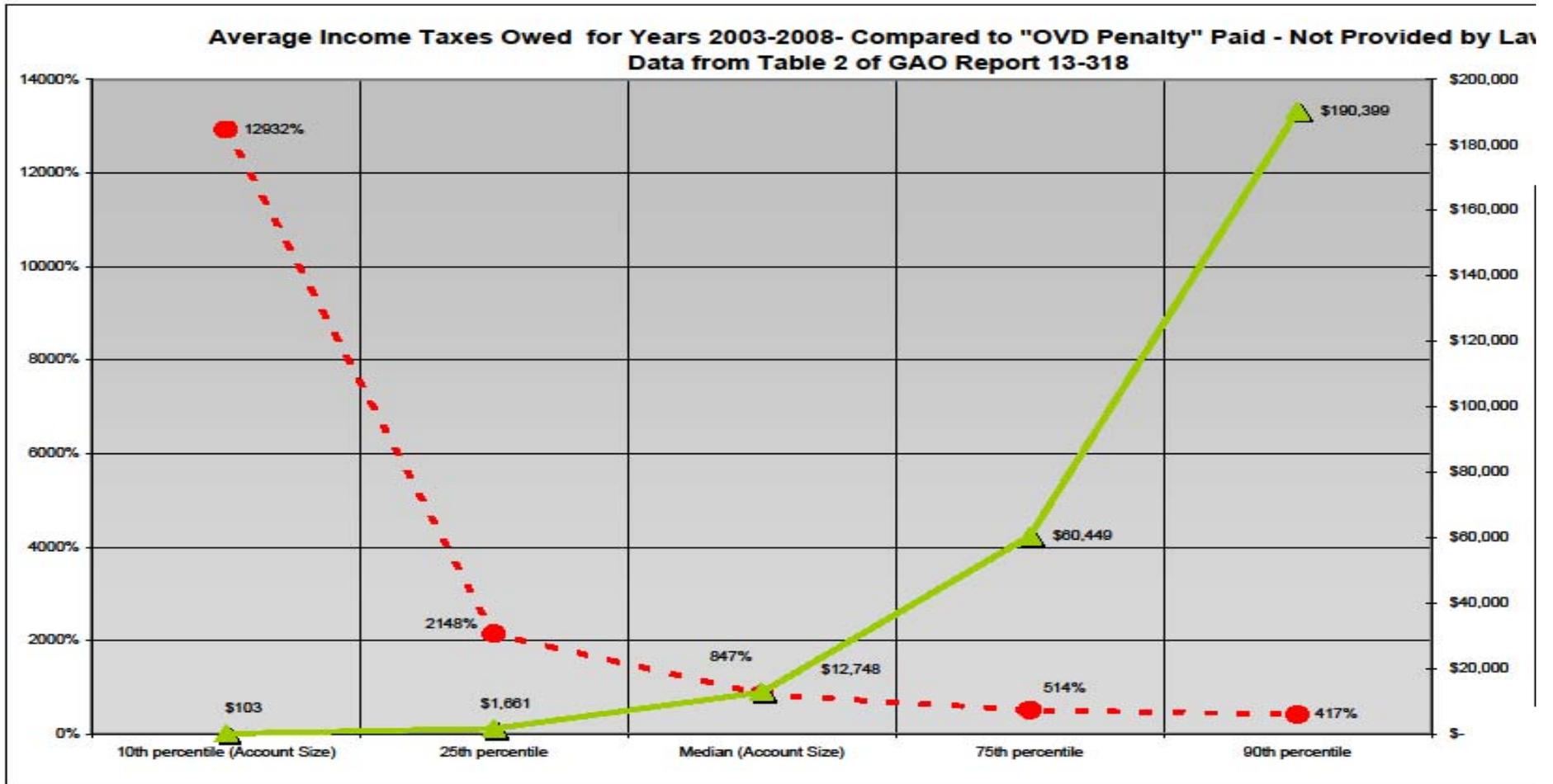
¹³ See, page 36 of 2014 Fiscal Year Objectives Report to Congress by National Taxpayer Advocate - <http://www.taxpayeradvocate.irs.gov/userfiles/file/FullReport/IRS-Offshore-Voluntary-Disclosure-Programs-Continue-to-Burden-Benign-Actors-and-Damage-IRS-Credibility.pdf>

¹⁴ See pages 15 and 16 of the GAO Report; “About half of the revenues collected through the 2009 OVDP, as of March 30, 2012, came from 378 cases where taxpayers received offshore penalties of \$1 million or greater, meaning they had account balances of \$5 million or greater. This group, which we refer to as “large penalty cases”, accounted for about 6 percent of the closed 2009 OVDP cases, but the penalties they received amounted to 49 percent of the total \$1.9 billion in offshore penalties that had been assessed by IRS at that time.”

¹⁵ *Id.*

Chart A

- The above Table 1 data from the report does not provide much detail regarding the 378



OVD Penalty as a Percentage of Taxes Owed

Bad Actor cases identified in the *GAO Report*, which implies that their "Offshore Penalty" was relatively small than those other taxpayers with the largest accounts in the 90th percentile.¹⁶ Further data was not provided in the report.

- These amounts demonstrate how the taxpayers with the smallest amount of foreign assets and income, nevertheless paid a disproportionately larger "Offshore Penalty" amount; with the smallest accounts (10th percentile) compared with the largest accounts (90th percentile).
- The *GAO Report* reveals that on average the IRS apparently collected less than US\$125M¹⁷ annually in income taxes under the offshore voluntary disclosure program for each of six tax years 2003, 2004, 2005, 2006, 2007 and 2008?¹⁸

Curiously, the federal government then paid US\$104M (almost all of the income taxes collected for a single tax year in the entire Offshore Program from 10,540 taxpayers) to one individual rogue UBS banker, who was himself convicted of criminal behavior

¹⁶ Table 1 shows how as the accounts get larger in size, the penalty declines in value. Chart A shows the relative penalty paid compared to the amount of income taxes owed.

¹⁷ Table 3 of the *GAO Report* provides that the total "offshore penalty" collected was \$2.81 Billion and "total collected" under the program through the years analyzed was US\$4.4 Billion. This means that there is a difference of these two amounts of approximately \$1.59 Billion. Further, Table 2 has provided the mean amounts for the "2009 offshore penalty"; "additional tax owed, tax years 2003 and 2008"; "interest, tax years 2003-2008"; and "other penalties, interest and taxes". Taking the approximation of the average income tax owed over this six year period, compared to the "2009 offshore penalty" the relative amount of income taxes paid represents 25.99% of the "2009 offshore penalty". Applying this 25.99% to the total amount offshore penalty reflected in Table 3, the total estimated income taxes collected in total for this six year period is estimated to be US\$730 million (US\$730,244,600). If this US\$730 million in income taxes is divided by the number of years (6 years), the average total income taxes collected by the IRS for each year would be approximately US\$121,707,422; which was rounded up to US\$125M to be more conservative. These calculations are reflected below:

From Table 2:

	<i>Mean</i>	
<i>Offshore account(s) balance^a</i>	<i>\$1,923,310</i>	
<i>2009 offshore penalty</i>	<i>375,879</i>	
<i>Additional tax owed, tax years 2003-2008</i>	<i>97,681</i>	<i>25.99%</i>
<i>Interest, tax years 2003-2008</i>	<i>29,645</i>	<i>7.89%</i>
<i>Other penalties^b</i>	<i>24,014</i>	<i>6.39%</i>
<i>Total penalties, interest and taxes</i>	<u><i>\$433,840</i></u>	

From Table 3:

<i>Offshore penalty</i>		<u><i>\$2,810,000,000</i></u>	
<i>Total Collected</i>		<u><i>\$4,400,000,000</i></u>	
		<u><i>Difference</i></u>	<u><i>\$1,590,000,000</i></u>
<i>Estimated Income Tax Liability (8 Year Period)</i>	<i>25.99%</i>	<u><i>\$730,244,600</i></u>	
<i>Estimated 20% Negligence Penalty (x8%)</i>	<i>7.89%</i>	<u><i>\$221,620,388</i></u>	
<i>Estimated Statutory Interest Owed</i>	<i>6.39%</i>	<u><i>\$179,524,102</i></u>	

¹⁸ The *GAO Report* provides numerous summary information for the 10,439 closed cases from the 2009 OVDP. The tax, interest, penalty and "in lieu of penalty" aka "offshore penalty" is provided throughout the report, with specific detailed summarized in Tables 1, 2, 3 6 and 7. <http://www.gao.gov/assets/660/653369.pdf>

but was paid under the IRS's new Whistleblower Program. See, *Whistleblower Gets \$104 Million Now a Felon, Former Banker Told U.S. About Tax-Evasion Tactics by UBS and Its Wealthy Clients*. **The Wall Street Journal**.¹⁹

- **"Offshore Penalty"**

Importantly, the *GAO Report*²⁰ summarizes the "Offshore Penalty" as one that does not exist in the federal tax statutes or other law:

' . . . is not a penalty established by statute that taxpayers with undisclosed foreign accounts are required to pay by law. It is an amount voluntary participants in the offshore programs agree to pay in exchange for the benefits associated with participation in those programs, and its collection is authorized by the IRS's settlement authority conferred in IRC sections 7121 and 7122

The authors applaud all bona fide efforts of the IRS and Justice Department to locate and identify taxpayers who are taking steps to evade U.S. income taxes required under the law. However, the authors are of the view that many of the conclusions drawn by the IRS regarding the success of the Offshore Voluntary Disclosure Program need to be critically examined.

Moreover, the current Offshore Voluntary Disclosure Program, announced in January, 2012, requires all participants to pay a one-time Offshore Penalty ("in lieu of an FBAR penalty") of 27.5 percent of the taxpayer's "offshore assets" during the year where those assets were highest in value during the 8 years covered under the OVDP.²¹ Thus, the Offshore Penalty has been expanded since the original 2009 OVDI program to not only require an Offshore Penalty on the taxpayer's foreign accounts, but to also include all the taxpayer's foreign asset values for purposes of determining the Offshore Penalty. The authors can find no applicable legal authority for the IRS to impose a similar penalty under the law on anyone's offshore assets. Thus, certain Benign Actors should carefully consider where to avail themselves of the new 2012 OVDP before subjecting themselves to an onerous Offshore Penalty on all their offshore assets and accounts.

- **Why Did So Many U.S. Taxpayers Participate in the Offshore Voluntary Disclosure Program – If Many Would Have a More Favorable Liability Under the Law?**

One key question that the GAO Report raises, is why would so many taxpayers enter into the Offshore Voluntary Disclosure Program if they were not at least as liable for income taxes or penalties under the law? The authors think the answer to this question can be simply answered. Neither taxpayers nor many of their tax advisors understand how tax penalties actually apply under the law, particularly because some penalties are not in the Internal Revenue Code. Instead of understanding what the requirements are under the law, taxpayers simply relied upon the Internal Revenue Service to inadequately explain how penalties could apply in and outside of the Program. Based upon only the Frequently Asked Questions (which were published subsequent to the Program's announcement), taxpayers and their advisors had to make swift and uneducated determinations as to whether a taxpayer should participate on the Offshore Program at all and many feared all would be criminally prosecuted, as the IRS continuously led them to believe.

The IRS has a set of "frequently asked questions" ("FAQs") and "answers" on its website that address a number of questions.²² FAQs 5 and 6 address the type of penalties that could apply. Instead of explaining how and when these penalties actually can apply under the law and in particular circumstances, the answers provide a comprehensive list of a "parade of horrors" of all penalties that "could" apply in the worst of circumstances. There is little attempt by the IRS to actually explain the law regarding penalties, how the penalties work, and under what circumstances do these penalties actually apply under the law. FAQ 5 focuses on civil penalties as set forth in endnote A.^A Additionally FAQs 51.1, 51.2 and 51.3 in the endnote^B list out a number of factual scenarios of penalty amounts (without attempting to explain the actual application of the law to any particular type of

¹⁹ <http://online.wsj.com/article/SB10000872396390444017504577645412614237708.html>

²⁰ *Id.* at footnote 13 on page 11, <http://www.gao.gov/assets/660/653369.pdf>

²¹ *IRS's 2012 Offshore Voluntary Disclosure Program Frequently Asked Question #8.*

²² See, <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers>

facts), demonstrating yet again how any particular taxpayer ultimately risks losing a large portion of his or her assets to the civil penalty regime.

Finally, FAQ 6 focuses on criminal penalties that could apply under the law, without describing in any way how and when a taxpayer has actually committed a tax crime.^c Additionally, the FAQs are peppered with express language of “criminal” law and consequences throughout them, without providing any serious consideration of when under the law a tax crime could have ever been committed. Of course, if almost any layperson who has assets or other accounts outside the United States, reads these FAQs, they are left with the impressions that they have somehow committed a terrible act; possibly a criminal act which could lead to at least 5 years in prison. The last sentence in the answer to FAQ 6 goes on to provide in its entirety **“Failing to file an FBAR subjects a person to a prison term of up to ten years and criminal penalties of up to \$500,000.”** This sentence is in no way qualified, nor does it explain under what circumstances that would indeed be the result under the law.

If a taxpayer does not understand how the complex law applies to their actual circumstances they can easily be misled into making a poor decision and participating in the OVDP; especially when faced only with the choices that are presented in the IRS materials. Many taxpayers are not getting better advice from various tax professionals, who themselves read the IRS website and pass them along to their clients, sometimes verbatim. These choices, in the author’s view are commonly a false choice of (a) losing a large portion, if not all of, their assets to penalties, or worse, going to prison; compared with (b) paying a certain percentage of their assets to the IRS in order to resolve their case. One can understand how and why almost all taxpayers faced with this choice would choose the one that would lead to a more certain outcome, instead of a choice that would most certainly be filled with anxiety, stress and confusion, especially if the taxpayer continued to go back to and read the IRS FAQs and answers, representing some 28 pages in length with more than 16,000 words of explanation. To be repetitive, in no part of the IRS FAQs, is there any attempt to explain how penalties under the law actually apply to any particular factual circumstances if the taxpayer were to NOT participate in the OVDP. To the ill-informed taxpayer, this necessarily would leave them in a deeply confused state, regarding the application of U.S. tax law.

A layperson who has no real understanding of the complexities of the tax law (particularly in the international area) can be forgiven for their lack of understanding of legal concepts, which for many created the inadvertent mistake in not reporting their foreign accounts. Many U.S. taxpayers are unaware of their Constitutional rights and protections afforded to all U.S. citizen taxpayers in an audit, i.e. if they do not participate in the Offshore Voluntary Disclosure Program. The authors are of the view that many tax lawyers and CPAs do not themselves understand the complexities of the tax law; when penalties can apply under the law, and when a criminal act has actually been committed when evaluating a taxpayer’s options. The result is that many of these advisors may simply have neglected to truly advise their clients of the law and its application and the options available to each and every Benign and Bad Actor separately.

- **Few Options Remain for Benign Actors to Correct Offshore Violations**

The GAO Report questions whether the Offshore Program encourages or discourages self-correction. For Benign Actors, those who inadvertently failed to file FBARs and report their foreign income and entities, the IRS still “strongly encouraged” everyone with these violations to participate in the OVD programs and initially discouraged them from opting out of the program.

The FAQ’s stress the following:

- Those taxpayers making “quiet” disclosures should be aware of the risk of audit and that they will be considered for criminal prosecution for all applicable years.²³
- Those taxpayers who do not submit a voluntary disclosure run the risk of detection by the IRS and the imposition of “substantial” penalties, including the fraud penalty, FBAR penalty and the “increased risk” of criminal prosecution.²⁴

²³ 2009 Offshore Voluntary Disclosure Program Frequently Asked Questions #10, 2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions #15 and 2012 Offshore Voluntary Disclosure Program Frequently Asked Questions #15.

- Filing a false FBAR subjects a person to a prison term of up to 10 years and criminal penalties of up to \$500,000.²⁵
- And, for those who choose to opt out of the Offshore Program, all relevant years and all issues on the tax return will be subject to a complete examination. At the conclusion of the examination, all applicable penalties, including FBAR penalties will be imposed. Those penalties could be substantially greater than the penalty which would be paid “in lieu” of an FBAR penalty in the Program.²⁶

Because of these threats in the Offshore Programs’ Frequently Asked Questions, and the uncertainties that still remain for the fate of Benign Actors who have either opted out of prior programs or those who filed quiet voluntary disclosures, many taxpayers were and are scared into participating in the IRS’s Offshore Programs. The one-sized-fits-all approach to penalties inside the program unfairly punishes the Benign Actors who fear severe penalties, drawn out IRS examinations, or worse, criminal prosecution, if they do not participate. Very few options remain outside of the OVDP today for taxpayers to self-correct their inadvertent failures with respect to their foreign reporting

- **Critical Questions Remain**

Critical questions remain unanswered about the IRS offshore voluntary disclosure program and its effectiveness.

- Did most of the 10,000+ participants surveyed in the *GAO Report* not have any type of criminal liability under the law?
- Did the IRS know that most of the 10,000+ participants who filed through the offshore voluntary disclosure program were ***not*** subject to large civil penalties under the law as set forth in IRS FAQ 5?
- Why have only 5,000+ taxpayers participated in the 2012 OVD program that has been open for nearly twice as long as the 2009 and 2011 OVD programs which apparently attracted approximately 33,000 participants?
- Is the offshore voluntary disclosure program being administered fairly, when those with the largest foreign assets and highest taxable incomes, pay much lower relative amounts in penalties compared to those with the smallest foreign assets and lowest amounts of taxable income?
- What options remain for Benign Actors to self-correct inadvertent failures so that they are not punished with the onerous 27.5% Offshore Penalty which now applies on all foreign assets and foreign accounts?
- Should most of the taxpayers with their cases pending before the IRS under the 2011 or 2012 OVD programs opt out?

The answers to most of these questions will likely remain unanswered, at least as long as the IRS does not provide statistical information about the effectiveness of its program.

²⁴ 2009 Offshore Voluntary Disclosure Program Frequently Asked Questions #3, 2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions #4 and 2012 Offshore Voluntary Disclosure Program Frequently Asked Questions #4.

²⁵ 2009 Offshore Voluntary Disclosure Program Frequently Asked Questions #14, 2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions #6 and 2012 Offshore Voluntary Disclosure Program Frequently Asked Questions #6.

²⁶ 2009 Offshore Voluntary Disclosure Program Frequently Asked Questions #34.

EXHIBIT



PRIVACY, GOVERNMENTAL
LIAISON AND DISCLOSURE

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

December 3, 2012

Patrick W. Martin
Procopio, Cory, Hargreaves & Savitch LLP
525 B Street, Suite 2200
San Diego, CA 92101

Dear Mr. Katzberg:

I am responding to your Freedom of Information Act (FOIA) request dated November 2, 2012, that we received on November 5, 2012.

You indicated this is the third request as the first request was rejected by the government and the second request was never answered by the government. I apologize for any inconvenience you may have been caused in the past.

Your request is seeking any and all documents, reports, including electronic files or other data (e.g., e-mails, spreadsheets, memoranda, internal and external reports, etc.) in the possession of the IRS. Specifically, you are seeking the following:

1. How many total taxpayers participated in the 2009 Offshore Voluntary Disclosure Program
2. How many total taxpayers participated in the 2011 Offshore Voluntary Disclosure Initiative
3. How many total taxpayers up to the present date participated in the 2012 Offshore Voluntary Disclosure Initiative
4. All documents that include how much in total revenue was collected by the 2009 OVDP from the taxpayers identified in Item 1 above
 - a. How much of the total revenue collected was attributable to unpaid federal income taxes
 - b. How much of the total revenue collected was attributable to the "20% additional penalty, in lieu of the FBAR and other potential penalties" representing the highest aggregate balance in 2003-2008 of unreported foreign account amounts
 - c. How much of the total revenue collected was attributable to statutory interest for underpayment of tax
5. All documents that include how much in total revenue was collected by the 2011 OVDI from the taxpayers identified in Item 2 above
 - a. How much of the total revenue collected was attributable to unpaid federal income taxes

- b. How much of the total revenue collected was attributable to the 20% accuracy-related penalty
 - c. How much of the total revenue collected was attributable to the "25% additional penalty, in lieu of the FBAR and other potential penalties" representing the highest aggregate balance in 2003-2010 of unreported foreign account amounts
6. All documents that include how much in total revenue was collected up to the present date, by the 2012 OVDI from the taxpayers identified in Item 3 above
 - a. How much of the total revenue collected was attributable to unpaid federal income taxes
 - b. How much of the total revenue collected was attributable to the 20% accuracy-related penalty
 - c. How much of the total revenue collected was attributable to the "27.5% additional penalty, in lieu of the FBAR and other potential penalties" representing the highest aggregate balance in 2003-2010 of unreported foreign account amounts
 - d. How much of the total revenue collected was attributable to statutory interest for underpayment of tax
 7. All documents that include how any other types of revenue or amounts collected as part of the 2009 OVDP, 2011 OVDI and 2012 OVDI for other items that are not reflected in questions 4.a. through 4.d., 5.a. through 5.d. and 6.a. through 6.d. above
 8. All documents that include how many individuals reflected in Item 1 above opted out of the 2009 OVDP after initially starting into the program
 9. All documents that include how many individuals reflected in Item 2 above opted out of the 2011 OVDI after initially starting into the program
 10. All documents that include how many individuals reflected in Item 3 above opted out of the 2012 OVDI after initially starting into the program
 11. All documents that include the median and average amounts for taxpayers for (including exact or approximate amounts as reflected in any such documents or electronic data maintained by the IRS) for each of the amounts reflected in Items 4, 5 and 6 above

The information responsive to Items #1-3 has been released to the public and can be located on the IRS website at www.irs.gov under Voluntary Disclosure. For your convenience, I have enclosed copies of IRS News Releases IR-2012-5, IR-2012-64 and IR-2012-65.

In response to Item #11, our records indicate there were 15,000 applicants in 2009, 18,000 in 2011 and 1,500 as of June 2012 for a total of 34,500 applicants. Together, 2009 OVDP and 2011 OVDI have resulted in approximately 33,000 voluntary disclosures. As of 7/2/2012, 98.9% of the 2009 OVDP cases have been closed and 7,000 certifications have been started for 2011 OVDI. The IRS has received another

1,500 disclosures under the new OVDP. Most notably, 2009 OVDP and 2011 OVDI have resulted in the assessment of \$5 billion of back taxes, interest and penalties.

I am denying your request for Items # 4 – 10 for the following reasons:

FOIA exemption (b)(7)(A) exempts from disclosure records or information compiled for law enforcement purposes, but only to the extent that production of such records could interfere with enforcement proceedings.

Disclosure of this information is also exempt under FOIA subsection (b)(3) supported by Internal Revenue Code section IRC Section 6103(e)(7), because release would impair federal tax administration.

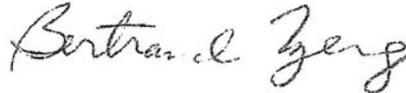
FOIA exemption (b)(7)(E) exempts from disclosure records or information compiled for law enforcement purposes to the extent their production would reveal:

- Techniques and procedures for law enforcement investigations or prosecutions
- Guidelines for law enforcement investigations or prosecutions, if release could reasonably be expected to risk circumvention of the law.

This constitutes a partial denial of your request. I have enclosed Notice 393 explaining your appeal rights.

If you have any questions please call Tax Law Specialist Janice P. Rudolph, ID # 0218169, at (202) 283-7388 or write to: Internal Revenue Service, Headquarters (HQ) FOIA, Mail Stop C2-235, 5000 Ellin Road, Lanham, MD 20906. Please refer to case number F13311-0100.

Sincerely,



Bertrand Tzeng
Disclosure Manager (Acting)
HQ Disclosure Program Operations and FOIA

Enclosures (4)
IRS News Releases
Notice 393

**Information on an IRS Determination to Withhold Records Exempt From
The Freedom of Information Act – 5 U.S.C. 552**

Appeal Rights

You may file an appeal with the Internal Revenue Service (IRS) within 35 days after we (1) deny you access to a record in whole or in part; (2) have made an adverse determination as to your category as a requester; (3) deny your request for a fee waiver or reduction; or (4) have advised you that no records responsive to your request exist. You may file an appeal within 10 days when a request for expedited processing has been denied.

Your appeal **must** be in writing, must be signed by you, and must contain:

Your name and address,
Description of the requested records,
Date of the request (and a copy, if possible),
Identity of the office and contact on the response letter, and
Date of the letter denying the request (and a copy, if possible)

Mail your appeal to: **IRS Appeals**
Attention: FOIA Appeals
M/Stop 55202
5045 E. Butler Ave.
Fresno, California 93727-5136

Judicial Review

If we deny your appeal, or do not address an issue raised in your appeal within 20 days (excluding Saturdays, Sundays, or legal public holidays) after the date we receive your appeal, you may file a complaint in United States District Court in the district in which (1) you reside; (2) your principal place of business is located; (3) the records are located; or (4) the District of Columbia. A complaint may be filed within 10 days (excluding Saturdays, Sundays, or legal public holidays) after the date we receive your appeal if your appeal is from an adverse determination of a request for expedited processing. If you choose to file suit before receipt of a final determination by the Appeals office, the administrative appeals process may cease.

The rule for effecting service of judicial process upon the Internal Revenue Service is set forth in Federal Rule of Civil Procedure 4(i). In addition to service upon the United States, as set forth in Rule 4(i)(1), service must be made upon the Internal Revenue Service by registered or certified mail as set forth in Rule 4(i)(2)(A).

The address of the Internal Revenue Service is: Internal Revenue Service, Attention CC:PA, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

Exemptions

The Freedom of Information Act, 5 U.S.C. 552, does not apply to matters that are:

- (b)(1) • specifically authorized under criteria established by an Executive order to be kept secret in the interest of national defense or foreign policy and are in fact properly classified under such executive order,
- (b)(2) • related solely to the internal personnel rules and practices of an agency,
- (b)(3) • specifically exempted from disclosure by statute (other than section 552b of this title), provided that the statute:
 - (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or
 - (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld.

Note: Internal Revenue Code sections 6103 and 6105 are statutes which qualify for exemption 3 treatment. Section 6103 protects the confidentiality of tax returns and information pertaining to a taxpayer collected by the IRS. Section 6105 protects information obtained from a foreign country under a tax treaty.

IRS News Release

Media Relations Office**Washington, D.C.****Media Contact: 202.622.4000**www.irs.gov/newsroomPublic Contact: 800.829.1040

IRS Offshore Programs Produce \$4.4 Billion to Date for Nation's Taxpayers; Offshore Voluntary Disclosure Program Reopens

IR-2012-5, Jan. 9, 2012

WASHINGTON — The Internal Revenue Service today reopened the offshore voluntary disclosure program to help people hiding offshore accounts get current with their taxes and announced the collection of more than \$4.4 billion so far from the two previous international programs.

The IRS reopened the Offshore Voluntary Disclosure Program (OVDP) following continued strong interest from taxpayers and tax practitioners after the closure of the 2011 and 2009 programs. The third offshore program comes as the IRS continues working on a wide range of international tax issues and follows ongoing efforts with the Justice Department to pursue criminal prosecution of international tax evasion. This program will be open for an indefinite period until otherwise announced.

"Our focus on offshore tax evasion continues to produce strong, substantial results for the nation's taxpayers," said IRS Commissioner Doug Shulman. "We have billions of dollars in hand from our previous efforts, and we have more people wanting to come in and get right with the government. This new program makes good sense for taxpayers still hiding assets overseas and for the nation's tax system."

The program is similar to the 2011 program in many ways, but with a few key differences. Unlike last year, there is no set deadline for people to apply. However, the terms of the program could change at any time going forward. For example, the IRS may increase penalties in the program for all or some taxpayers or defined classes of taxpayers – or decide to end the program entirely at any point.

"As we've said all along, people need to come in and get right with us before we find you," Shulman said. "We are following more leads and the risk for people who do not come in continues to increase."

The third offshore effort comes as Shulman also announced today the IRS has collected \$3.4 billion so far from people who participated in the 2009 offshore program, reflecting closures of about 95 percent of the cases from the 2009 program. On top of that, the IRS has collected an additional \$1 billion from up front payments required under the 2011 program. That number will grow as the IRS processes the 2011 cases.

In all, the IRS has seen 33,000 voluntary disclosures from the 2009 and 2011 offshore initiatives. Since the 2011 program closed last September, hundreds of taxpayers have come forward to make voluntary disclosures. Those who have come in since the 2011 program closed last year will be able to be treated under the provisions of the new OVDP program.

The overall penalty structure for the new program is the same for 2011, except for taxpayers in the highest penalty category.

For the new program, the penalty framework requires individuals to pay a penalty of 27.5 percent of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the eight full tax years prior to the disclosure. That is up from 25 percent in the 2011 program. Some taxpayers will be eligible for 5 or 12.5 percent penalties; these remain the same in the new program as in 2011.

Participants must file all original and amended tax returns and include payment for back-taxes and interest for up to eight years as well as paying accuracy-related and/or delinquency penalties.

Participants face a 27.5 percent penalty, but taxpayers in limited situations can qualify for a 5 percent penalty. Smaller offshore accounts will face a 12.5 percent penalty. People whose offshore accounts or assets did not surpass \$75,000 in any calendar year covered by the new OVDP will qualify for this lower rate. As under the prior programs, taxpayers who feel that the penalty is disproportionate may opt instead to be examined.

The IRS recognizes that its success in offshore enforcement and in the disclosure programs has raised awareness related to tax filing obligations. This includes awareness by dual citizens and others who may be delinquent in filing, but owe no U.S. tax. The IRS is currently developing procedures by which these taxpayers may come into compliance with U.S. tax law. The IRS is also committed to educating all taxpayers so that they understand their U.S. tax responsibilities.

More details will be available within the next month on IRS.gov. In addition, the IRS will be updating key Frequently Asked Questions and providing additional specifics on the offshore program.

IRS News Release

Media Relations Office

Washington, D.C.

Media Contact: 202.622.4000

www.irs.gov/newsroom

Public Contact: 800.829.1040

IRS Says Offshore Effort Tops \$5 Billion, Announces New Details on the Voluntary Disclosure Program and Closing of Offshore Loophole

IR-2012-64, June 26, 2012

WASHINGTON — The Internal Revenue Service today announced that its offshore voluntary disclosure programs have exceeded the \$5 billion mark and released new details regarding the voluntary disclosure program announced in January, including tightening the eligibility requirements.

"We continue to make strong progress in our international compliance efforts that help ensure honest taxpayers are not footing the bill for those hiding assets offshore," said IRS Commissioner Doug Shulman. "People are finding it tougher and tougher to keep their assets hidden in offshore accounts."

Shulman said the IRS offshore voluntary disclosure programs have so far resulted in the collection of more than \$5 billion in back taxes, interest and penalties from 33,000 voluntary disclosures made under the first two programs. In addition, another 1,500 disclosures have been made under the new program announced in January.

The voluntary disclosure programs are part of a wider effort by the IRS to stop offshore tax evasion and ensure tax compliance. This includes beefed up enforcement, criminal prosecution and implementation of third-party reporting through the Foreign Account Tax Compliance Act ([FATCA](#)).

The IRS also closed a loophole that's been used by some taxpayers with offshore accounts. Under existing law, if a taxpayer challenges in a foreign court the disclosure of tax information by that government, the taxpayer is required to notify the U.S. Justice Department of the appeal.

The IRS said that if the taxpayer fails to comply with this law and does not notify the U.S. Justice Department of the foreign appeal, the taxpayer will no longer be eligible for the Offshore Voluntary Disclosure Program (OVDP). The IRS also put taxpayers on notice that their eligibility for OVDP could be terminated once the U.S. government has taken action in connection with their specific financial institution.

Additional details of these eligibility issues are available in a new set of questions and answers released today on the current OVDP, which was announced in January (see [IR-2012-5](#)). The IRS reopened the OVDP following continued strong interest from taxpayers and tax practitioners after the closure of the 2011 and 2009 programs.

This program – which helps bring people back into the tax system – will be open for an indefinite period until otherwise announced. The program is similar to the 2011 program in many ways, but with a few key differences. Unlike last year, there is no set deadline for people to apply. However, the terms of the program could change at any time going forward.

Under the current OVDP, the offshore penalty has been raised to 27.5 percent from 25 percent in the 2011 program. The reduced penalty categories of 5 percent and 12.5 percent are still available.

The IRS also announced a plan to help U.S. citizens residing overseas to catch up with tax filing obligations and assistance for people with foreign retirement plan issues. See [IR-2012-65](#) also issued today.

IRS News Release

Media Relations Office
www.irs.gov/newsroom

Washington, D.C.

Media Contact: 202.622.4000
Public Contact: 800.829.1040

IRS Announces Efforts to Help U.S. Citizens Overseas, Including Dual Citizens and Those with Foreign Retirement Plans

IR-2012-65, June 26, 2012

WASHINGTON — The Internal Revenue Service today announced a plan to help U.S. citizens residing overseas, including dual citizens, catch up with tax filing obligations and provide assistance for people with foreign retirement plan issues.

"Today we are announcing a series of common-sense steps to help U.S. citizens abroad get current with their tax obligations and resolve pension issues," said IRS Commissioner Doug Shulman.

Shulman announced the IRS will provide a new option to help some U.S. citizens and others residing abroad who haven't been filing tax returns and provide them a chance to catch up with their tax filing obligations if they owe little or no back taxes. The new procedure will go into effect on Sept. 1, 2012.

The IRS is aware that some U.S. taxpayers living abroad have failed to timely file U.S. federal income tax returns or Reports of Foreign Bank and Financial Accounts (FBARs). Some of these taxpayers have recently become aware of their filing requirements and want to comply with the law.

To help these taxpayers, the IRS offered the new procedures that will allow taxpayers who are low compliance risks to get current with their tax requirements without facing penalties or additional enforcement action. These people generally will have simple tax returns and owe \$1,500 or less in tax for any of the covered years.

The IRS also announced that the new procedures will allow resolution of certain issues related to certain foreign retirement plans (such as Canadian Registered Retirement Savings Plans). In some circumstances, tax treaties allow for income deferral under U.S. tax law, but only if an election is made on a timely basis. The streamlined procedures will be made available to resolve low compliance risk situations even though this election was not made on a timely basis.

Taxpayers using the new procedures announced today will be required to file delinquent tax returns along with appropriate related information returns for the past three years,

and to file delinquent FBARs for the past six years. Submissions from taxpayers that present higher compliance risk will be subject to a more thorough review and potentially subject to an audit, which could cover more than three tax years.

The IRS also announced its offshore voluntary disclosure programs have exceeded the \$5 billion mark, released new details regarding the voluntary disclosure program announced in January and closed a loophole used by some U.S. citizens. See IR-2012-64 for more details.

HO, FOIA, OS, P
Mail Stop C2-23
5000 Ellin Road
Lanham, MD 20706

Official Business
Penalty for Private Use, \$300



Patrick W. Martin
Procopio, Cory, Hargreaves & Savitch LLP
525 B Street, Suite 2200
San Diego, CA 92101

RECEIVED
DEC 17 2012
PCH & S, LLP



^A **FAQ 5.** What are some of the civil penalties that might apply if I don't come in under the OVPD and the IRS examines me? How do they work? Depending on a taxpayer's particular facts and circumstances, the following penalties could apply:

- A penalty for failing to file the Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts, commonly known as an "FBAR"). United States citizens, residents and certain other persons must annually report their direct or indirect financial interest in, or signature authority (or other authority that is comparable to signature authority) over, a financial account that is maintained with a financial institution located in a foreign country if, for any calendar year, the aggregate value of all foreign accounts exceeded \$10,000 at any time during the year. Generally, the civil penalty for willfully failing to file an FBAR can be as high as the greater of \$100,000 or 50 percent of the total balance of the foreign account per violation. See 31 U.S.C. § 5321(a)(5). Non-willful violations that the IRS determines were not due to reasonable cause are subject to a \$10,000 penalty per violation.
- Beginning with the 2011 tax year, a penalty for failing to file form 8938 reporting the taxpayer's interest in certain foreign financial assets, including financial accounts, certain foreign securities and interests in foreign entities, as required by I.R.C. §6038D. The penalty for failing to file each one of these information returns is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return.
- A penalty for failing to file Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts. Taxpayers must also report various transactions involving foreign trusts, including creation of a foreign trust by a United States person, transfers of property from a United States person to a foreign trust and receipt of distributions from foreign trusts under IRC § 6048. This return also reports the receipt of gifts from foreign entities under section 6039F. The penalty for failing to file each one of these information returns, or for filing an incomplete return, is the greater of \$10,000 or 35 percent of the gross reportable amount, except for returns reporting gifts, where the penalty is five percent of the gift per month, up to a maximum penalty of 25 percent of the gift.
- A penalty for failing to file Form 3520-A, Information Return of Foreign Trust With a U.S. Owner. Taxpayers must also report ownership interests in foreign trusts, by United States persons with various interests in and powers over those trusts under IRC § 6048(b). The penalty for failing to file each one of these information returns or for filing an incomplete return, is the greater of \$10,000 or 5 percent of the gross value of trust assets determined to be owned by the United States person.
- A penalty for failing to file Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations. Certain United States persons who are officers, directors or shareholders in certain foreign corporations (including International Business Corporations) are required to report information under IRC §§ 6035, 6038 and 6046. The penalty for failing to file each one of these information returns is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return.
- A penalty for failing to file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Taxpayers may be required to report transactions between a 25 percent foreign-owned domestic corporation or a foreign corporation engaged in a trade or business in the United States and a related party as required by IRC §§ 6038A and 6038C. The penalty for failing to file each one of these information returns, or to keep certain records regarding reportable transactions, is \$10,000, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency.
- A penalty for failing to file Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation. Taxpayers are required to report transfers of property to foreign corporations and other information under IRC § 6038B. The penalty for failing to file each one of these information returns is ten percent of the value of the property transferred, up to a maximum of \$100,000 per return, with no limit if the failure to report the transfer was intentional.
- A penalty for failing to file Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships. United States persons with certain interests in foreign partnerships use this form to report interests in and transactions of the foreign partnerships, transfers of property to the foreign partnerships, and acquisitions, dispositions and changes in foreign partnership interests under IRC §§ 6038, 6038B, and 6046A. Penalties include \$10,000 for failure to file each return, with an additional \$10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of \$50,000 per return, and ten percent of the value of any transferred property that is not reported, subject to a \$100,000 limit.
- Fraud penalties imposed under IRC §§ 6651(f) or 6663. Where an underpayment of tax, or a failure to file a tax return, is due to fraud, the taxpayer is liable for penalties that, although calculated differently, essentially amount to 75 percent of the unpaid tax.

- A penalty for failing to file a tax return imposed under IRC § 6651(a)(1). Generally, taxpayers are required to file income tax returns. If a taxpayer fails to do so, a penalty of 5 percent of the balance due, plus an additional 5 percent for each month or fraction thereof during which the failure continues may be imposed. The penalty shall not exceed 25 percent.
- A penalty for failing to pay the amount of tax shown on the return under IRC § 6651(a)(2). If a taxpayer fails to pay the amount of tax shown on the return, he or she may be liable for a penalty of .5 percent of the amount of tax shown on the return, plus an additional .5 percent for each additional month or fraction thereof that the amount remains unpaid, not exceeding 25 percent.
- An accuracy-related penalty on underpayments imposed under IRC § 6662. Depending upon which component of the accuracy-related penalty is applicable, a taxpayer may be liable for a 20 percent or 40 percent penalty.

^B **FAQ 51.1** Under what circumstances might a taxpayer consider opting out of the civil settlement structure of the OVD? The following scenarios are provided to illustrate the effect of a taxpayer opting out of the civil settlement structure. Opting out of the civil settlement structure does not affect the status of a taxpayer's voluntary disclosure under Criminal Investigation's Voluntary Disclosure Practice, so long as the taxpayer is fully cooperative in the examination process, by providing all requested foreign records and submitting to interviews, as requested, and as long as no new issues are uncovered that were previously not disclosed. The facts of each example were chosen to illustrate particular issues and do not represent a full analysis of a taxpayer's particular situation. Consequently, they may not be relied upon in dealing with any taxpayer's actual case. For all of the following examples, assume a 35% tax rate on all unreported income and assume a voluntary disclosure started in January 2012 for a voluntary disclosure period of 2003 through 2010.

Example 1 – Unreported Income But No Tax Deficiency

The taxpayer, a U.S. citizen who worked and resided in Country A, had a brokerage account in Country A that he opened in 1999. The account had a high balance of \$2 million and generated income of \$150,000 each year. The taxpayer did not report any of the income on his U.S. return because he mistakenly assumed he only had to report it on a Country A tax return. The taxpayer's amended Form 1040 returns showed that, after applying the foreign tax credit for taxes paid to the government of Country A, he had no tax deficiency with respect to the unreported income. Because the taxpayer had unreported income, he does not qualify for FAQ 17. In addition, assume the taxpayer does not otherwise qualify for a reduced penalty under FAQ 52 or 53.

The Offshore Penalty under OVD is \$550,000 (i.e., 27.5% of \$2 million), even though there was no tax owed to the U.S. Government and no other indication of wrongdoing.

If the taxpayer elected to opt out and, upon examination, IRS determined that the FBAR violation was not willful, he would be subject to an FBAR penalty of up to \$10,000 per year (\$60,000 total for six years). If IRS determines that the violation was due to reasonable cause (for example, the taxpayer reasonably acted on the written advice of an independent legal advisor after having disclosed the account to the advisor), the taxpayer would be subject to no FBAR penalty.

The penalty for a nonwillful failure to file an FBAR would apply with respect to FBARs that were due on or after June 30, 2006. For this example, this would include FBARs that were filed to report foreign financial accounts maintained during calendar years 2005 through 2010.

	Civil Settlement Structure	Opt out and 6 years nonwillful FBAR penalty
Income Tax Due (not including interest)	0	0
20% Accuracy-related penalty	0	0
27.5% Offshore Penalty	\$550,000	0
FBAR Penalty	0	\$60,000
Total	\$550,00	\$60,000

Example 2 - Unreported Income and Failure to File FBAR

The taxpayer is a U.S. citizen, who lived abroad in 2007, 2008 and 2009. While living abroad, the taxpayer opened an account in 2007 with a bank located in Country X. Assume that the highest account balance during the three years (2007, 2008 and 2009) was \$200,000. The taxpayer filed U.S. income tax returns for all years but only filed an FBAR for 2008 and 2009, not for 2007. The taxpayer was unaware of his FBAR filing obligation until having his return professionally prepared in 2008. The taxpayer

failed to report approximately \$2,000 of interest income from the account, and, is therefore, unable to simply file a delinquent FBAR for 2007 as provided in FAQ 17. The tax deficiency was \$700. In addition, assume the taxpayer does not otherwise qualify for a reduced penalty under FAQ 52 or 53.

The Offshore Penalty under OVDP will be \$55,000 (i.e., 27.5% of \$200,000). The taxpayer would also be required to pay the tax deficiency for each year, interest on the deficiency, and the 20% accuracy-related penalty on the deficiency.

If the taxpayer elected to opt out, the taxpayer will be subject to tax, penalties, and interest on the unreported income and, if, upon examination, IRS determines that the failure to file the FBAR was not willful, the taxpayer will be subject to a non-willful FBAR penalty of no more than \$10,000 for failing to file an FBAR for 2007. If IRS determines that the FBAR violation was due to reasonable cause, then no FBAR penalty will be imposed.

	Civil Settlement Structure	Opt out and 1 year nonwillful FBAR penalty	Opt out and assume the civil fraud penalty applied
Income Tax Due (not including interest)	\$700	\$700	\$700
20% Accuracy-related penalty	\$140	\$140	0
27.5% Offshore Penalty	\$55,000	0	0
Civil Fraud Penalty	0	0	\$525
FBAR Penalty	0	\$10,000	\$10,000
Total	\$55,840	\$10,840	\$11,225

Example 3 - Unreported Controlled Foreign Corporation

The taxpayer, a U.S. citizen who lives in the United States, owns a 100% interest in a foreign corporation that has substantial operations in Country A and a foreign bank account. The foreign corporation is not required to file an FBAR and does not file one. The taxpayer also has signature authority over the foreign bank account. The taxpayer did not file an FBAR to report his financial interest in, or signature authority over, the foreign bank account of the corporation that he controls. The interest income earned on the foreign account was \$5,000 for each year. The tax deficiency for each year was \$1,750. The balance in the foreign bank account during the calendar years 2003 through 2010 was a constant \$1 million. The value of the taxpayer's controlling interest in the foreign corporation is determined to be \$100 million (including the value of the \$1 million foreign bank account).

The taxpayer did not file a Form 5471 to report his interest in the controlled foreign corporation. Instead, he wrongly treated the foreign corporation as a disregarded entity and reported the corporation's income on a Schedule C. The income he reported from the foreign corporation did not include interest income earned on the corporation's foreign bank account. Otherwise, the individual was fully compliant in reporting all other taxable income, including income from the controlled foreign corporation. The statute of limitations for assessing tax and tax penalties with respect to the controlled foreign corporation remained open under IRC § 6501(c)(8) because the Form 5471 was not filed.

	Civil Settlement Structure	Opt out and 6 years of the § 6038(a) penalty plus 6 years of the FBAR nonwillful penalty	Assume the civil fraud penalty applied for six years and the FBAR willful penalty applied for 6 years
Income Tax Due (not including interest)	\$14,000	\$14,000	\$14,000
20% Accuracy-related penalty	\$2,800	\$2,800	0
27.5% Offshore Penalty	\$27,500,000	0	0
§ 6038(a) Penalty	0	\$60,000	\$60,000
Civil Fraud Penalty	0	0	\$10,500
FBAR Penalty	0	\$60,000	\$3,000,000
Total	\$27,516,800	\$136,800	\$3,084,500

Example 4 –The taxpayer is a dual citizen of the United States and Country A. Taxpayer lived and worked in Country A during 2000 through 2010. He had checking and savings accounts in country A with an aggregate balance of approximately \$50,000 in each year. He had no income from U.S. sources during the period. The taxpayer complied with Country A's tax laws and fully reported his salary and the interest on his bank accounts. Although Taxpayer earned income in excess of the applicable exemption amount and standard deduction, he did not timely file U.S. income returns or FBARs for any of the years he lived in Country A. After learning of his U.S. filing obligations, taxpayer consulted with counsel, who concluded that he did not qualify for FAQ 17 relief because of his tax non-compliance. Taxpayer made a voluntary disclosure, filing income tax returns reporting tax of approximately \$400 each year. He also filed delinquent FBARs.

The taxpayer qualifies for a reduced penalty of 5 percent under FAQ 52, part 3, below. The Offshore Penalty under OVDP will therefore be \$2,500 (i.e., 5% of \$50,000). The taxpayer would also be required to pay the tax deficiency for each year, interest on the deficiency, and the 20% accuracy-related penalty on the deficiency. If the taxpayer elects to opt out, the taxpayer will still be subject to tax and interest on the unreported income but, upon examination, IRS is not likely to assert accuracy related or FBAR penalties.

See Fact Sheet 2011-13 (December 2011).

Non-resident taxpayers should also review the New Filing Compliance Procedures for Non-Resident U.S. Taxpayers to determine if they qualify for the new compliance procedures.

Example 5 – The facts are the same as in Example 4, except that, the taxpayer also has interests in offshore entities for which Forms 5471 or 3520 should have been filed. The value of the taxpayer's interest in the entities is approximately \$200,000 in each year. The taxpayer acquired his interest in the entities with tax compliant funds, and the entities' assets produce no income. The taxpayer does not qualify for FAQ 18 relief because of the tax noncompliance discussed in Example 4, and decides to make a voluntary disclosure including, in addition to the items in Example 4, delinquent Forms 5471 and 3520.

The Offshore Penalty under OVDP will be \$2,500 (i.e., 5% of \$50,000). The taxpayer would also be required to pay the tax deficiency for each year, interest on the deficiency, and the 20% accuracy-related penalty on the deficiency. If the taxpayer elects to opt out, the taxpayer will still be subject to tax and interest on the unreported income but upon examination, IRS is not likely to assert accuracy related, FBAR, or information return penalties.

See Fact Sheet 2011-13 (December 2011).

Non-resident taxpayers should also review the New Filing Compliance Procedures for Non-Resident U.S. Taxpayers to determine if they qualify for the new compliance procedures.

FAQ 51.2 Under what circumstances might opting out of the civil settlement structure of the 2011 OVDI be a disadvantage for the taxpayer? The following scenarios are provided to illustrate the effect of a taxpayer opting out of the civil settlement structure. Opting out of the civil settlement structure does not affect the status of a taxpayer's voluntary disclosure under Criminal Investigation's Voluntary Disclosure Practice, so long as the taxpayer is fully cooperative in the examination process, by providing all requested foreign records and submitting to interviews, as requested, and as long as no new issues are uncovered that were previously not disclosed. The facts of each example were chosen to illustrate particular issues and do not represent a full analysis of a taxpayer's particular situation. Consequently, they may not be relied upon in dealing with any taxpayer's actual case. For all of the following examples, assume a 35% tax rate on all unreported income and assume a voluntary disclosure started in January 2012 for a voluntary disclosure period of 2003 through 2010.

Example 6 - Large Unreported Gain

The taxpayer, a U.S. citizen, opened a checking account in Country A in 2008 with funds upon which U.S. taxes were previously paid. The taxpayer discloses that he had failed to report the sale, in 2008, of an apartment building in Country A that he owned. The apartment building was valued at \$10 million and the taxpayer's unreported gain on the sale was \$6 million. The related tax deficiency was \$2,100,000. The taxpayer deposited the entire \$10 million, from the sale, in the checking account with the foreign bank. \$10 million represented the highest balance in the foreign checking account during the year and was the balance in the account as of June 30 of the following year, the date that an FBAR was due. The apartment building that was sold was held in a foreign trust that was a grantor trust (with the taxpayer as the grantor). The taxpayer established the trust in 2008, just prior to the sale of the apartment building, and transferred the building to the trust. The taxpayer did not file a Form 3520 to report the creation of the trust and the transfer of property into the trust.

The Offshore Penalty under OVDP will be \$2,750,000 (i.e., 27.5% of \$10 million). The taxpayer would also be required to pay the \$2,100,000 tax deficiency, interest, and a 20% accuracy-related penalty. A 20% penalty on a \$2,100,000 deficiency is \$420,000.

If the taxpayer elected to opt out, he could face an FBAR penalty with respect to the 2008 calendar year of \$5,000,000 (i.e., a 50% willful FBAR penalty on the balance in the checking account as of June 30, the date that the FBAR was due). Taxpayer will also owe tax, penalties, and interest with respect to the \$2,100,000 deficiency. The taxpayer would also be subject to FBAR penalties for all other open years, if the aggregate balance in the checking account exceeded \$10,000 during each year.

Upon examination, the revenue agent may determine that the nonreporting was due to fraud. In that case, the civil fraud penalty on the \$2.1 million tax deficiency attributable to fraud would be \$1,575,000 (i.e., 75% of \$2,100,000). The IRC § 6677 penalty for failing to file the Form 3520 information return would be an additional \$3.5 million (i.e., 35% of \$10 million).

	Civil Settlement Structure	Opt out and 1 year willful FBAR penalty	Opt out and assume the civil fraud penalty applied
Income Tax Due (not including interest)	\$2,100,000	\$2,100,000	\$2,100,000
20% Accuracy-related penalty	\$420,000	\$420,000	0
27.5% Offshore Penalty	\$2,750,000	0	0
Civil Fraud Penalty	0	0	\$1,575,000
§ 6677 Penalty	0	\$3,500,000	\$3,500,000
FBAR Penalty	0	\$5,000,000	\$5,000,000
Total	\$5,270,000	\$11,020,000	\$12,175,000

Example 7 – Civil Fraud Penalty Warranted

In 2002, Taxpayer sold a building located in Country X for \$400,000 short term capital gain, which he intentionally failed to report on his 2002 Form 1040. Assume the taxpayer's basis in the building was zero. He deposited the sales proceeds in an offshore account with a bank located in Country Y. The account with the bank in Country Y is in the name of a trust the taxpayer established in Country Z in 2000. The account earned \$12,000 in interest each year from 2003 through 2010. The taxpayer closed the account with the bank in Country Y in 2010 and brought the funds back into the United States, disguising the funds as a loan from an allegedly unrelated entity.

The highest balance in the foreign account was \$496,000. The Offshore Penalty under OVDP is \$136,400 (i.e., 27.5% of \$496,000). The total of the tax deficiencies for the years 2002 through 2010 was \$173,600. This consisted of a tax deficiency of \$140,000 for the 2002 year (for the unreported gain of \$400,000) and a total of \$33,600 for the tax years 2003 through 2010 (for the unreported interest income). The 75% civil fraud penalty would otherwise apply with respect to the related tax deficiencies. There is no statute of limitations for assessments of tax attributable to fraud.

The total of the IRC § 6677 penalty for failing to file a Form 3520 to report the \$400,000 transfer to the account (35% of \$400,000) and the failure to file Forms 3520-A (5% of the \$400,000 plus the interest income added each year) was \$495,200.

The statute of limitations for assessing FBAR penalties for willful violations in each year is open for the 2005 through 2010 calendar years. The total amount of willful FBAR penalties that may be assessed is \$1,398,000 (50% of the balance in the account for each year, including the \$12,000 in interest income added to the account each year).

	Civil Settlement Structure	Opt out and 8 years § 6677 penalty and 6 years FBAR Penalty
Income Tax Due (not including interest)	\$33,600	\$173,600
75% Civil Fraud Penalty	0	\$130,200
20% Accuracy-related penalty	\$5,040	0
27.5% Offshore Penalty	\$136,400	0
§ 6677 Penalty	0	\$495,200
FBAR Penalty	0	\$1,398,000
Total	\$175,040	\$2,197,000

FAQ 51.3 If I opt out of the OVDP and undergo a regular examination, is there a chance my case could be referred back to Criminal Investigation for penalties or prosecution? Yes. Criminal Investigation's Voluntary Disclosure

Practice provides a recommendation that you not be prosecuted for violations up to the date of your disclosure. If your disclosure is ultimately determined to have not been complete, accurate, and truthful, or if you commit a crime after the date of your voluntary disclosure, you are potentially subject to penalties and prosecution.

FAQ 6 What are some of the criminal charges I might face if I don't come in under OVDP and the IRS examines me? Possible criminal charges related to tax returns include tax evasion (26 U.S.C. § 7201), filing a false return (26 U.S.C. § 7206(1)) and failure to file an income tax return (26 U.S.C. § 7203). Willfully failing to file an FBAR and willfully filing a false FBAR are both violations that are subject to criminal penalties under 31 U.S.C. § 5322.

A person convicted of tax evasion is subject to a prison term of up to five years and a fine of up to \$250,000. Filing a false return subjects a person to a prison term of up to three years and a fine of up to \$250,000. A person who fails to file a tax return is subject to a prison term of up to one year and a fine of up to \$100,000. Failing to file an FBAR subjects a person to a prison term of up to ten years and criminal penalties of up to \$500,000.

Although the information contained herein is provided by professionals at Procopio, the content and information should not be used as a substitute for professional services. If legal or other professional advice is required, the services of a professional should be sought.

Patrick W. Martin is the leader of the firm's tax team. His practice emphasizes international tax planning and related international law matters. He represents foreign individuals, multi-national families, companies, international athletes, entertainers, and entertainment groups in such areas as developing worldwide investment and financing structures, international tax treaty planning strategies, planning worldwide income, and estate and inheritance taxes. He helps resolve and plan for international tax controversies and develops international wealth preservation structures to compliment the client's international investments and business transactions. Mr. Martin is a Past Chair of the International Committee of the State Bar Taxation Section and an Executive Committee member of the State Bar of California, Taxation Section. He is the tax partner in charge of the tax practice at the San Diego based law firm Procopio et al LLP in San Diego, California. He practices exclusively in international tax related matters. He can be reached at patrick.martin@procopio.com or 619.515.3230

G. Michelle Ferreira counsels individuals, partnerships, estates and corporations in tax disputes with the Internal Revenue Service and state and local tax agencies, including the California Franchise Tax Board, the State Board of Equalization, the Employment Development Department and county assessment appeals boards. As a former tax litigator for the Internal Revenue Service, Michelle brings unique experience to clients who have complex and sensitive tax and penalty disputes. Michelle represents clients before the IRS, and state and local tax agencies at the audit, collection, appeals and litigation stages. She can be contacted at ferreiram@qtlaw.com