



## **IRS VDP Guidance re Offshore Income**

The IRS previously announced a voluntary disclosure program (VDP) to give taxpayers an opportunity to disclose unreported offshore accounts and assets. (See "US Focus on Offshore Activity," *Canadian Tax Highlights*, April 2009.) Certain foreign bank and financial accounts generally must be reported by a US person (and others) by June 30 of each year on a form TD F 90-22.1 (FBAR). The program remains in place until September 23, 2009. Recognizing that a taxpayer may be reluctant to take advantage of the VDP without more detailed guidance on the program's administration and the potential civil and criminal penalties, on May 6, 2009 the IRS released 30 frequently asked questions (FAQs) providing more program details, which it recently revised.

The first of the May 6 FAQs highlighted the need to resolve cases in an organized, coordinated manner and to make exposure to civil penalties more predictable. A specific example detailed the VDP's penalty framework faced by a taxpayer who deposited US\$1,000,000 in an offshore account and earned thereon US\$300,000 of unreported income over the six-year lookback period; under the VDP, the taxpayer must pay US\$386,000 in tax and penalties, plus interest. In contrast, if the taxpayer did not come forward voluntarily, the IRS could impose US\$2,306,000 in accuracy-related and FBAR penalties, and the taxpayer might also face interest expense and possibly criminal prosecution.

The IRS disclosed in the May 6, 2009 FAQs that it will not recommend criminal prosecution to Justice if a taxpayer truthfully, timely, and completely complies with all the VDP rules. However, the VDP does not apply if the IRS has already initiated a civil examination of the taxpayer, regardless of whether it relates to undisclosed foreign accounts or undisclosed foreign entities.

With the FBAR filing deadline fast approaching, on June 24, 2009 the IRS revised the May 6 FAQs and posted to its Web site 21 new FAQs explaining in further detail the nature of a settlement offer for taxpayers who voluntarily and timely disclose unreported offshore income. The FAQs also provide more details of the mechanics of the six-year lookback, the 20 percent penalty, and the options for those who are non-compliant with FBAR reporting responsibilities. A taxpayer may have reported and paid taxes on all 2008 taxable income but have insufficient time to gather necessary information to fulfill an FBAR filing obligation of which he only recently learned; the IRS will allow the taxpayer to file his FBAR by September 23, 2009 with an explanation detailing the reason for the late filing and will impose no penalty for failure to file by June 30, 2009.

The June 24 revised FAQs also clarify that interest on the accuracy-related and delinquency penalties runs from the due date of the relevant return; interest on all other penalties runs from the date of the penalty's assessment. If several individuals have signature authority over a trust account, each of them must fulfill his FBAR filing responsibility, but only one 20 percent offshore penalty applies for voluntary disclosures relating to the one account.

The new FAQs iterate the IRS's warning against an attempt to cure past reporting failures of unreported offshore income by way of a "quiet disclosure"—merely filing amended returns and paying the tax and interest without otherwise informing the IRS. The original FAQs acknowledged that the IRS was aware of this practice and strongly encouraged those taxpayers to come forward under the voluntary disclosure offer: failure to do so carries the risk of examination and criminal prosecution for all applicable years. New FAQs 49 and 50 elaborate further. The IRS says that taxpayers and their advisers, when deciding whether to quietly disclose or take advantage of the VDP, should consider the nature of the error they are trying to correct. A taxpayer with undisclosed foreign accounts or entities who makes a voluntary disclosure will become compliant, avoid substantial civil penalties, and generally eliminate the risk of criminal prosecution. Moreover, the total cost of resolving all offshore tax issues can be calculated with reasonable certainty. That being said, the IRS recognizes that in limited cases—such as that of a taxpayer who reported all income but failed to file the FBAR or who only failed to file information returns—it may be appropriate to simply file amended returns with the applicable service centre.

A US citizen residing in Canada who failed to file US tax returns and who previously might have quietly disclosed by filing tax returns for the prior six-year period should engage in serious discussion with his tax adviser to outline an appropriate course of action in light of the VDP. The VDP was developed initially to deal with US citizens and residents who failed to report income earned on foreign bank accounts, but the broad language in the recent IRS announcements suggests that the VDP applies whenever an individual has unreported income and there are "offshore issues." Unfortunately, in this context, Canada is offshore.

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