

MP&S TAX ALERT: IRS OFFERS NEW GUIDANCE ON THE OVDP; TAX RELIEF FOR US CITIZENS LIVING ABROAD

IRS OFFERS NEW GUIDANCE ON THE OVDP

The IRS recently issued guidance on its current Offshore Voluntary Disclosure Program (OVDP) and tightened eligibility requirements. The program allows taxpayers with undisclosed foreign accounts and assets to “come clean” in exchange for reduced penalties and protection against criminal prosecution. The IRS also announced new procedures, effective September 1, 2012, which provide US citizens living abroad with an opportunity to catch up with their tax filings — in many cases penalty-free if they have little or no US tax due.

A \$5 Billion Program

As a general rule, US citizens or residents are subject to federal tax on all of their income, regardless of the source. This includes foreign income, subject to certain exemptions and exclusions. Many taxpayers unknowingly violate federal tax laws by failing to report income from foreign accounts, assets or earnings.

According to the IRS, the current OVDP, together with similar programs in 2009 and 2011, have resulted in more than \$5,000,000,000 in collections. To participate, you must file all original and, if necessary, amended tax returns for the past eight years, pay all back taxes and interest for that period, and pay any accuracy- or delinquency-related penalties.

In addition to the above, participants in the current program generally must pay a “miscellaneous offshore penalty” equal to 27.5 percent of the highest aggregate balance in unreported foreign accounts during an eight-year “look-back” period. Some participants will be eligible for reduced penalties if there are mitigating circumstances.

For example, if the highest aggregate balance of foreign accounts during the look-back period is less than \$75,000, you’ll qualify for a 12.5 percent penalty instead of the 27.5 percent penalty. A 5 percent penalty is available under certain circumstances, such as a taxpayer who inherits a foreign account with minimal activity or a foreign resident who is unaware that he or she is considered a US citizen.

Certain Taxpayers Ineligible

In the new guidance, presented in a frequently asked questions (FAQ) format, the IRS outlines two situations in which taxpayers may become ineligible for the OVDP. The first, which the IRS describes as closing a “loophole,” involves taxpayers who file appeals in foreign courts challenging a foreign tax administrator’s decision to disclose tax information to the IRS. Under existing US law, taxpayers must notify the US Department of Justice of such appeals. The IRS states that taxpayers who fail to provide this notice at the time they file their appeals are ineligible for the OVDP.

The second situation involves taxpayer groups that have or had accounts at certain financial institutions that are the subject of US government actions. The IRS may announce that members of these groups will become ineligible for the OVDP on a specified future date.

Relief for Foreign Residents

The IRS recognizes that many US citizens living abroad — including dual citizens — are (or were) unaware of their US filing obligations. These citizens are required to file US federal income

tax returns even if they have no US tax liability — for example, because US taxes are offset by a credit for taxes paid to foreign countries. They're also required to file reports of foreign bank and financial accounts (FBARs) with the IRS if the aggregate value of such accounts exceeds \$10,000.

To provide relief to foreign residents and encourage them to come forward, the IRS has announced new procedures, effective September 1, 2012, that will allow them to file delinquent tax returns and FBARs, often penalty-free. Taxpayers who wish to take advantage of the new procedures will have to file tax returns for the past three years and FBARs for the past six years and pay any federal taxes and interest due. The new procedures are an *alternative* to the OVDP; once you take advantage of them, you're no longer eligible for the OVDP.

Generally, taxpayers whose returns (or amended returns) show less than \$1,500 in tax due for each year are considered "low risk" and won't be subject to penalties. But penalties may be imposed if there are "high risk factors." The IRS will provide additional details about specific risk factors before September 1, but in general the risk level will increase as a taxpayer's income and assets increase, or if there are "indications of sophisticated tax planning or avoidance."

The new procedures may also be used to resolve issues involving foreign retirement plans (such as the Canadian Registered Retirement Savings Plans). Under certain tax treaties, participants in these plans are eligible for income deferral for US tax purposes, but only if they file a timely election with the IRS. Taxpayers may use the new procedures to obtain retroactive relief for failure to file this election.

Proceed with Caution

There's no set deadline for taxpayers to apply for the OVDP; the IRS says the current program will be open for an indefinite period. Nevertheless, if you have undisclosed foreign accounts and would like to participate, it's a good idea to act soon. The IRS may terminate the program or change its terms at any time or, as noted above, make certain taxpayer groups ineligible.

The OVDP rules and eligibility requirements are complex, so give us a call to discuss the pros and cons of enrolling. And if you're a foreign resident eligible for the new procedures discussed above, we can help you evaluate your risk profile and determine the best course of action for you.

MP&S ONLINE TAX GUIDE

To facilitate ongoing access to the latest tax rules and regulations, Marks Paneth & Shron offers an online tax guide that is updated as changes occur. Please visit <http://www.webtaxguide.net/markspaneth/> to access the guide. If you have questions, please contact one of our specialists.

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