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Information Reporting

IRS ‘Skeptical’ of Taxpayers Seeking Entry To Streamlined OVDP With Offshore Annuities

The IRS will be wary of taxpayers with offshore annuities who want to qualify for a lower-penalty, streamlined version of the agency’s offshore voluntary disclosure program, an agency official said.

“We’re going to be a little bit skeptical,” John C. McDougal, a senior special trial attorney in the IRS Office of Chief Counsel, said May 12. “You have to look at the annuity and if it’s really an insurance product. The question is, who’s going to want to go offshore to get an annuity?”

McDougal said the Internal Revenue Service will look at who the taxpayer relied on to make the representation that their failure to disclose the annuity wasn’t willful and thus eligible for the streamlined program. “If they’re relying on the person who set up the annuity, that’s troublesome,” he said. “If you’re relying on an independent adviser and you share all the facts,” that might qualify as non-willful, he said.

Specific Facts. Both McDougal and David W. Horton, IRS director of international individual compliance, spoke at a forum on offshore disclosure sponsored by several sections of the American Bar Association.

Horton said more generally, taxpayers who want to qualify for the streamlined program need to provide specific facts when asserting that their conduct wasn’t willful.

“We are getting folks sending in their statements of non-willfulness but not providing adequate details,” he said. “Just saying ‘I didn’t live in the country’ isn’t enough. We need specific reasons as to why this happened and it needs to be on your certification,” he said at the forum.

The regular OVDP allows taxpayers to disclose their offshore accounts and assets to the government in exchange for a set penalty and audit protection, but

doesn’t require taxpayers to certify that their failure to disclose wasn’t willful. The streamlined program, with its non-willfulness certification, allows for far lower penalties but doesn’t provide the audit protection.

No Pre-Clearance for Streamlined OVDP. Horton said taxpayers are still trying to send in pre-clearance requests to get into the streamlined program, and emphasized that won’t work.

Kathryn Keneally, a partner at DLA Piper LLP in New York, who co-moderated the panel with Charles Rettig of Hochman, Salkin, Rettig, Toscher & Perez PC in Beverly Hills, Calif., said, “Sending in a pre-clearance letter if you believe your taxpayer is going to go streamlined is not helpful. It’s something the Service prefers you not do because it runs the risk of clogging up the system.”

Officials and practitioners at the forum discussed a host of issues and questions surrounding both versions of the OVDP and the Report of Foreign Bank and Financial Accounts.

Scott Michel, a member of Caplin & Drysdale in Washington, cautioned that taxpayers who want to enter the OVDP need to act fast before the Department of Justice starts making more of its offshore bank investigations known to the public.

Once those investigations or resulting agreements have been publicized, the OVDP penalty faced by account holders at those banks jumps from 27.5 percent to 50 percent, he warned.

‘Quickly Changing Landscape.’ The Justice Department has already announced two non-prosecution agreements with Swiss banks that have agreed to pay hefty fines and turn over account information in order to avoid charges of tax evasion. Michel said more are likely to be coming soon as part of a program involving dozens of banks.

“There will be a quickly changing landscape over the next few months,” Michel said. He said with the data the government has already gleaned from its crackdown on Swiss and other banks, “it seems to be the

case over the past two or three months that new investigations have been spawned.”

He said although banks over the past year have been actively encouraging voluntary disclosures to reduce their own penalties under the NPAs, that activity has waned, and banks’ incentives to go into the OVDP are drying up.

“If anybody’s sitting on the fence thinking that they’re going to get a better deal from their Swiss bank, I wouldn’t recommend it,” Michel said.

Global Risk. Keneally, the most recent assistant attorney general of the DOJ Tax Division, said it goes beyond Switzerland, and there is no telling when the Justice Department will disclose the next investigation or agreement. “You could find that any bank in the world has made that list,” she said.

Both Horton and McDougal fielded a host of questions.

A key question for the streamlined program is what the government would consider non-willful, practitioners said. McDougal said the government doesn’t plan to provide more detail than the definition already offered in the program, which is that non-willful behavior results from negligence, inadvertence, mistakes, or conduct that is the result of a good-faith misunderstanding of the requirements of the law.

However, he said, taxpayers applying for the streamlined program don’t have to show reasonable cause for their failure to disclose their offshore assets. “Non-willful means non-willful, regardless of the name of the bank,” McDougal said.

McDougal Urges Caution. McDougal said taxpayers should err on the side of caution if they think they might be close to the “willful” line. “If you’re really struggling with whether or not you’re willful, maybe you belong in OVDP,” which mitigates the risk of examination, he said.

Horton said it is important for taxpayers to be very forthcoming and set out both good and bad facts when seeking entry to the streamlined program.

The question of taxpayers who are trying to transition from the OVDP to the streamlined program is one the IRS is working to address, officials said.

Questions on Transition. They said the IRS is trying hard to have a unified process, and said taxpayers should raise issues with agents’ managers if they feel they aren’t being treated consistently or fairly. The officials cautioned, however, that those who want to transition should be prepared for tough questions.

Panelist Jeffrey A. Neiman, a founding partner with Marcus Neiman & Rashbaum LLP, Fort Lauderdale, Fla., said he has frustrated clients who are trying to transition and who are seeing taxpayers who went into the program after they did getting a better deal. He asked whether it would be possible to withdraw from the OVDP and then go into the streamlined program. The IRS’s Horton said that isn’t an option.

Rettig praised the IRS for offering taxpayers the ability to transition, and said the government is “to be highly commended for bringing us forward.”

Non-Filers. On another subject, Keneally asked how the IRS would view taxpayers who had received a contact letter from the agency asking where their tax returns are, since the streamlined program isn’t available to taxpayers under audit. McDougal said a contact from an IRS service center isn’t the same thing as an audit, and those non-filers would still be eligible for the program.

A big question raised during the forum was how to treat taxpayers who want to come into the streamlined program but don’t have a Social Security number.

Social Security Number Issues. McDougal said the IRS is working on the problem, but currently, “there is no good advice to give.” He said the Social Security Administration and the State Department are aware of the problem and are interested in hearing about “trouble spots”—countries where the problem may be worse than others.

“We’re on their radar screen and working with them,” he said.

Horton said the IRS has seen and heard of instances where people just go ahead and file and write on their submissions that they don’t have the required number.

McDougal said that isn’t a good idea because the IRS won’t see these filers as U.S. citizens and there are some items where “you may be buying yourself an audit or adjustments down the road. It can be done, but I wouldn’t recommend it except as a last resort.”

Horton said if taxpayers just aren’t eligible for a Social Security number but want to apply for an individual taxpayer identification number (ITIN), they can include the ITIN application along with their submission to get into the streamlined program. The ITIN application “has to be filled out in its entirety,” Horton said.

Prior-Year Audits. Another question, raised by Rettig, was whether the IRS would look at taxpayers’ filing history prior to the three years of returns required to be filed with a streamlined application.

“How much does the streamlined program fix the past?” he said. “Will the government look at year four?”

McDougal said IRS generally would have to open up an examination to do that and the IRS typically doesn’t audit more than three years back, but both Horton and McDougal cautioned that the streamlined program doesn’t carry audit protection and taxpayers should carefully look at their compliance history.

“If you had a big problem five years ago, I think you’re running a risk,” McDougal said.

Rettig said in his view, “the implication is that we’re basically all good if the filings are good. It’s a way to move forward. The intent of streamlined is to get non-willful people into compliance and stay in compliance.”

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