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Tax Advocacy Practice Group

Disclosing Foreign Assets to the IRS — A Significant New Option

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As of July 1, 2014, the IRS has substantially revised its streamline procedure for reporting foreign assets and now this option is available to U.S. taxpayers residing in the United States regardless of the amount of tax due once in the process. This new streamline procedure is intended to encourage more U.S. taxpayers to voluntarily come into compliance with the foreign asset disclosure obligations. Notably, this enhanced streamline procedure is specifically designed for "*non-willful*" violations of the foreign asset reporting rules. (Non-willful means conduct due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.) These new streamline procedure rules are much less onerous and costly than the foreign account disclosure options which have been in effect for the past several years; however, there is considerable risk if the failure to disclose is found to be willful. The significance of this change, and the considerations which should now factor into the disclosure of previously unreported foreign assets, are outlined below.

U.S. taxpayers, including U.S. citizens living abroad and resident aliens, are required to report and pay taxes on their worldwide income from all sources, including assets located outside of the United States. But reporting and paying tax on any such income is only part of the obligation associated with foreign assets. Even if assets held abroad do not generate taxable income, U.S. taxpayers have an obligation to disclose the existence of such accounts to the IRS. If an account has over \$10,000, then anyone having either a financial interest in or signature authority over the account must also disclose the account to the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) on Form 114, Report of Foreign Bank and Financial Assets (known as the "FBAR"). When such disclosures to the IRS and FinCEN do not happen, the consequences can be severe; the failure to disclose could lead to both criminal charges and civil penalties for as much as \$100,000 or more per year.

Over the past several years the IRS has offered a series of Offshore Voluntary Disclosure Programs (OVDP) which have been the primary means by which more than 45,000 U.S. taxpayers have come into full compliance with these foreign asset disclosure rules without incurring severe criminal and civil penalties. As a result of these programs, the IRS has collected \$6.5 billion. But the OVDP process has always been time-consuming, onerous, and costly. Under the current OVDP initiative, taxpayers accepted into the program must file amended returns for as many as 8 years and pay all the tax, interest and penalties, including a 20 percent accuracy-related penalty, on any unreported income from foreign assets. In addition, the taxpayer has to file all unfiled FBARs and pay a *separate* penalty equal to 27.5 percent of the highest aggregated value of such assets. (After August 4, 2014, this penalty goes to 50 percent if the IRS has disclosed it is investigating the foreign financial institution in question at the time of the OVDP submission.)

Before July 1, 2014, the IRS had offered a "streamline procedure" as an alternative to OVDP, but previously this option had been limited to U.S. citizens living abroad, and then only when the tax for the failure to disclose was below \$1,500 per year. Because of these prior limitations, the only real

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alternatives to OVDP for U.S. taxpayers living in the United States was continued noncompliance or what became known as "quiet disclosure" – in other words, file amended returns and previously unfiled FBARs and hope such filings did not lead to an audit or any further inquiry. The new streamline procedures now changes the playing field.

Taxpayers electing to use this new streamline procedure may now file amended returns (up to 3 years only) and unfiled FBARs (up to 6 years) and pay only tax and interest (no penalties) on unreported income and *only a 5 percent penalty* on the highest aggregate value of the foreign assets. Clearly, these new rules for the streamline procedure are much less costly than the OVDP. However, because the revised streamlined procedures are only for non-willful violations, unlike the OVDP, there is no closing agreement with the IRS and no assurance that further investigation will not take place should the IRS determine the failure to comply was willful.

If a taxpayer has been truly caught off guard by these foreign asset disclosure requirements, this new procedure is a welcomed development and may very well supplant the quiet disclosure option. However, although these new streamline procedure rules offer real economic savings, there is considerable risk if the failure to disclose is found to be willful; and once a streamline submission is made, the OVDP option is foreclosed. Accordingly, careful consideration of the circumstances surrounding the foreign assets in question will be important before any choice is made.



For more information and to discuss how either the OVDP or the new streamline procedures work, please contact Paul M. Predmore, Esq., Chair of our Tax Controversy Practice Group, at 315-701-6305, ppredmore@bhlawpllc.com.

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Tax disputes arise with or without careful planning. Filed tax returns can be audited and oftentimes disagreements ensue. Business operations with employees and sales taxable transaction may also create tax issues resulting in potential personal liability of the owners. Economic strains or reversals may lead to the underpayment of taxes, penalties and ultimately pressures from the collection agents of the taxing authorities. Our Tax Controversy Practice Group assists individuals and businesses in resolving differences with federal and state tax authorities in audit, administrative appeals, litigation, and collection activity. While an understanding of the tax law is essential when the IRS or a state or local tax authority is conducting an audit or pursuing collection, an understanding of the process and a rapport with the government agents is also invaluable. Our clients have the benefit of our extensive experience in dealing with the various taxing authorities at all levels.