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US Foreign Tax Compliance – IRS Releases New Guidance Regarding Offshore Amnesty

As previously discussed in our April 7 [Private Wealth Alert](#), on March 23, 2009 the US Internal Revenue Service (IRS) released three internal memoranda offering limited relief to taxpayers that report their past failure to fully comply with US tax requirements regarding offshore bank accounts and similar interests and that rectify such noncompliance prior to September 23, 2009 (the Program). Although taxpayers that qualify for and participate in the Program must pay any unpaid tax on unreported income, together with interest on that tax and specified penalties, they can avoid criminal penalties and other civil penalties in excess of the amounts required by the Program.

On May 6, 2009 the IRS provided further guidance on the Program with the release of a list of [Frequently Asked Questions](#) (FAQs). The FAQs specify what a taxpayer must do to participate. Additionally, the FAQs re-emphasize that the touchstones of the Program are timeliness, completeness and truthfulness. Thus, a taxpayer is eligible for the Program if (i) the IRS has not yet commenced an examination of the taxpayer; (ii) the taxpayer makes a **timely, complete and truthful** disclosure of past noncompliance regarding offshore interests; and (iii) the source of the income in question was not illegal activity. Further, the FAQs stress that there is "no guarantee" that the IRS will extend the Program beyond September 23, 2009.

The FAQs clarify that the Program was created to standardize the IRS' treatment of taxpayers that voluntarily disclose their failure to comply with US tax requirements regarding offshore interests. The Program

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is thus designed to reduce uncertainty for taxpayers considering voluntary disclosure. The FAQs point out that the IRS believes that many taxpayers that have failed to report and pay tax on offshore interests are reluctant to correct their noncompliance because they cannot be sure what their maximum liability might be. The Program accordingly sets an upper limit on the total liability of a taxpayer that qualifies. To help taxpayers calculate this maximum liability under the Program's penalty structure, the FAQs provide a helpful example that calculates the total liability that a taxpayer with a given set of offshore interests would face under the Program. In contrast, the FAQs also describe in significant detail the potential sanctions that taxpayers may face if they have failed to comply with US tax requirements governing offshore interests and choose not to participate in the Program.

The FAQs specify that taxpayers should begin the disclosure required by the Program by writing a letter to the Special Agent in Charge of the nearest IRS Criminal Investigation unit. (Taxpayers can locate the nearest Criminal Investigation unit on the [Contact IRS About Voluntary Disclosure webpage](#).) The requirements and process for submitting this initial letter are set forth in the FAQs. Overall, the required contents of the initial letter are minimal, but the substance could be quite important – the taxpayer must provide identifying information and "include an explanation of any previously unreported or underreported income or incorrectly claimed deductions or credits related to undisclosed foreign accounts or undisclosed foreign entities, including the reason(s) for the error or omission." The explanation of the reason for the taxpayer's error or omission is critical because the Criminal Investigation unit must determine the taxpayer's initial eligibility for the Program including whether the income in question was the fruit of illegal activity. We highly recommend taxpayers contact a Squire Sanders lawyer for guidance in drafting this letter. Submitting this initial letter does not guarantee a taxpayer's eligibility for the Program but is merely the first step. After a taxpayer files this initial letter, the IRS will determine whether the requisite timely, complete and truthful disclosure has been made and whether the taxpayer otherwise qualifies for the Program. As long as the taxpayer's initial letter is submitted by the September 23, 2009 deadline, the taxpayer would be eligible for the Program even if subsequent submissions and the final resolution occur after that deadline.

If the IRS determines that the taxpayer is eligible for the Program, the taxpayer will have to file income tax returns (or amended returns if the taxpayer filed returns for prior years but such returns were incorrect) for the tax periods covered by the voluntary disclosure

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and certain additional returns or reports that could apply. The taxpayer will also be required to pay past due taxes, the interest thereon and certain penalties. The FAQs make clear that if a taxpayer cannot pay the amounts the Program requires, the taxpayer can still participate. As with other IRS settlement initiatives, the IRS will accept alternate payment arrangements under the Program if the taxpayer can demonstrate inability to pay the required amounts. However, taxpayers that want to participate must agree to pay the mandatory penalty that the Program provides, which is otherwise non-negotiable. If a taxpayer does not want to pay the mandatory penalty under the Program, the only alternative is to use the traditional approach of filing amended returns for the years in question that correctly state the taxpayer's liability. The risk of this approach is that the IRS can use its full array of enforcement mechanisms against the taxpayer, including criminal charges.

Another aspect of IRS international tax enforcement is the Foreign Bank Account Report (FBAR) system. If the required annual FBAR forms are not filed, taxpayers face penalties. Importantly, the FAQs clarify that taxpayers that have paid all income taxes arising from offshore interests and that "only recently learned" that they should have been filing FBAR forms need not use the Program to obtain relief. Instead, if such taxpayers promptly file all past due FBAR forms by September 23, 2009 no FBAR penalties will be assessed.

The FAQs conclude by advising a practitioner with a potentially eligible client that the practitioner has a duty under applicable professional responsibility requirements in [Circular 230](#) to advise the client of both the fact of noncompliance and the potential penalties for noncompliance and failure to enter the Program. Practitioners with additional questions about the Program or the FAQs can call the IRS' FAQs hotline at +1.215.516.4777.

In sum, the FAQs re-emphasize that the Program is a limited-time offer to those taxpayers that completely and truthfully disclose past noncompliance with US tax requirements governing offshore interests. Thus, we encourage taxpayers that believe they could have liability to the IRS with respect to their offshore interests and might benefit from the new voluntary disclosure Program to seek professional US tax advice as soon as possible. Because of the greater clarity that the FAQs provide, taxpayers that may have been reluctant to participate because of uncertainty about the Program should now be able to proceed with greater confidence that they are doing so in the proper manner.

IRS officials have stated that they may issue additional

sets of questions and answers similar to the FAQs as the Program progresses. We will, of course, continue to stay abreast of any additional guidance. If you would like to discuss the Program or the FAQs further, please contact your principal Squire Sanders lawyer or one of the individuals listed in this Alert.

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations. Counsel should be consulted for legal planning and advice.

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