



## **US IRS OFFERS NEW (2011) VOLUNTARY DISCLOSURE PROGRAM FOR OFFSHORE ACCOUNT OWNERS**

By: Ricardo Muñiz, Esq.

**T**he United States Internal Revenue Service (“IRS”) has issued a new Offshore Voluntary Disclosure Initiative (“OVDI”) for United States (“US”) citizens and US residents (collectively, “US Persons”), including Puerto Rico (“PR”) residents, that have, or have had in past years, unreported offshore accounts and entities.

This second IRS voluntary disclosure initiative follows the 2009 program that was elected by 15,000 taxpayers. Its goal is “to get people back into the U.S. tax system”, as “combating international tax evasion is a top priority for the IRS”.

US Persons may hold offshore accounts directly, or indirectly through controlled foreign entities, such as corporations and trusts organized in offshore jurisdictions. These offshore jurisdictions include such well known tax-haven jurisdictions as Panama, Cayman Islands, Luxembourg and Liechtenstein, as well as financial centers such as Great Britain, Switzerland, Netherlands, Spain and Canada, among others.

The traditional offshore bank secrecy that has allowed taxpayers to avoid paying taxes on their offshore accounts is rapidly disappearing, as offshore jurisdictions have been increasingly willing to share such information with the US and European Union countries. Foreign banks are even refusing their services and closing the accounts of US Persons.

US Persons with offshore accounts that do not submit to the OVDI run an increased risk of detection by the IRS, as the IRS is actively engaged in identifying foreign accounts. More information will be forthcoming to the IRS in part as a result of the Foreign Account Tax Compliance Act of 2010 (“FATCA”). Pursuant to new section 6038D of the US Internal Revenue Code (“US-IRC”), US Persons will be subject to a new foreign financial asset reporting requirement if they have an interest in “specified foreign financial assets” with an aggregate value of more than \$50,000. This report must be attached to the US income tax returns of the account owner.

PR Residents, including those that are not US citizens (i.e., US resident aliens that are residents of PR), are subject to US income taxation on their US and foreign/offshore source income. Pursuant to US-IRC section 933, bona fide PR residents generally can only exclude from US income taxation the income derived from PR sources.

### **Penalties for Failure to Disclose – FBAR Report.**

US Persons, including PR residents, who have a financial interest in, or signature or other authority over, any “foreign financial account” , if the aggregate value of such foreign financial accounts exceeds \$10,000 at any time during the calendar year, must fully disclose details of such relationships each calendar year by filing a report titled “Foreign Bank and Financial Accounts” (commonly known as “**FBAR**” – US Treasury form TD F 90-22.1) with the US Department of the Treasury on or before June 30 of the succeeding year. Foreign financial accounts include bank, securities, or other types of financial accounts, in a foreign country. The FBAR report has been required since the 1990s, and it is in addition to the new section 6038D report described above. A US Person can have a financial interest in, or signature or other authority over, accounts that are not in the US Person’s name, such as those owned by trusts, corporations or other entities controlled by or set-up for the benefit of such US Persons.

Civil and criminal penalties, including in certain circumstances a fine of not more than \$500,000 and imprisonment of not more than five years, are provided for failure to file the FBAR report, supply information, and for filing a false or fraudulent report.

In addition, a US Person that fails to disclose to the IRS income from offshore accounts and the holdings of such accounts, risks payment of back-taxes, no statute of limitation when fraud is involved, interest charges, and an array of highly punitive penalties that combined could exceed the principal amounts held in the offshore accounts. These taxpayers also face the threat of federal criminal prosecution for US tax evasion, or for failure to annually file the FBAR report. PR residents are also exposed to the risk of PR income taxation, interest and penalties, and PR criminal prosecution, as the US Treasury Department will likely share with the PR Treasury any information that it obtains regarding offshore accounts or foreign entities.

### **Benefits of OVDI.**

Pursuant to the OVDI, taxpayers with offshore accounts will have until August 31, 2011 to file a Voluntary Disclosure Request with the IRS.

The OVDI disclosure period include tax years 2003 through 2010 (the “**Period**”).

A Voluntary Disclosure Request, and entering into a Closing Agreement with the IRS concerning US income tax obligations arising from such offshore accounts or foreign entities, avoids criminal prosecution, but entails the following terms and conditions:

- (1) filing US income tax returns, or amended returns, for each year covered by the Period;
- (2) filing all required information reports, such as Forms 3520-A and 3520 for foreign trusts for each year covered by the Period;
- (3) full payment of any US taxes, and interest thereon, due for the Period, plus the accuracy related penalty of 20% on the full amount of the underpaid of taxes for all such years when US income tax returns were filed for those years, or the US-IRS section 6651(a)(1) or (2) penalty for failure to file a return if a US income tax return was not filed for any of such years;
- (4) filing complete and accurate offshore – related information returns, and the FBAR reports for those years covered by the Period;
- (5) in lieu of all other penalties that may apply (*i.e., the 5% to 35% penalties for failure to report or timely report the principal amount transferred to foreign trusts, and FBAR's prescribed maximum willful violation penalty of 50% of the highest annual balance of each account for the last three (3) years, among others*) the OVDI provides that the taxpayer will pay the following reduced penalty: 25% of such highest aggregate account/asset value during the Period; 12.5% of such value when the offshore accounts never held more than \$75,000; or 5% of such value, if the taxpayer meets all of the four following conditions: (i) did not open or cause any of the offshore accounts to be opened, (ii) exercised minimal, infrequent contact with the account; (iii) has not withdrawn more than \$1,000 from the account during any year covered by the voluntary disclosure; and (iv) can establish that all applicable US taxes have been paid on funds deposited to the accounts (where only account/entity earnings have escaped US taxation) ; and
- (6) the taxpayer will have to fully cooperate with the IRS, both civilly and criminally.

It should be noted that the penalties described in paragraph (3) above are based on the amount of US income taxes due. Meanwhile, those described in paragraph (5) are assessed on the highest value of the unreported offshore account assets during the applicable period. It should also be noted that offshore capital gains income of PR residents is considered PR source income, and as such will not be subject to US income taxation.

Even though the terms of the OVDI require the taxpayer to pay amounts described in paragraph (3) above with their submission, a taxpayer that is unable to make full payment of these amounts can request the IRS to consider other payment arrangements.

To the extent that PR taxation has also been avoided through the unreported offshore account/entities, it should be noted that PR has recently enacted an income tax amnesty that provides a 20% fixed income tax rate, and no interest, surcharges or penalties for taxable years commenced after June 30, 2003, and ended on or prior to December 31, 2009. The PR tax amnesty requires filing returns by April 15, 2011, and payment of taxes by June 30, 2011. A PR resident may also have the alternative of filing amended returns in PR, and enter into a closing agreement with the PR Treasury Department under the PR Treasury's general voluntary disclosure program.

Based on the expected continuing trend of IRS enforcement against US Persons with unreported offshore accounts or entities worldwide, those that fail to timely file a Voluntary Disclosure Request under the OVDI risk not only payment of taxes, interest, and penalties that far exceed the value of their offshore accounts, but also US and/or PR criminal prosecution.

\*\*\*\*\*

Should you have any questions with respect to the above, please contact Ricardo Muñiz, Esq. at (787) 281-1818.

The contents of PUERTO RICO BUSINESS LAW NOTES may not be reproduced, transmitted, or distributed without the express written consent of ADSUAR MUÑIZ GOYCO SEDA & PÉREZ-OCHOA, P.S.C.

The material contained herein is intended for information purposes only, is not to be considered legal advice, and it does not intend to consider all the tax and legal considerations that could be relevant to any particular person. Any person considering this investment should seek the advice of qualified counsel based on his/her particular circumstances.

As required by US IRS rules, please understand that any information contained herein is not written to be used and cannot be used for the purpose of avoiding penalties. We provide formal tax advice only upon completion of a formal written tax opinion in compliance with US Treasury Circular 230.

IRS Circular 230 Disclosure: To ensure compliance with requirements imposed by the IRS, we inform you that an U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party and transaction or matter addressed herein.