

FBAR's and Amended Tax Returns

U.S. Taxpayers who fail to report offshore accounts by filing FBAR (TD F 90.22-1) face criminal and civil penalties:

1. Failure to Report Income
(3 Felonies and 1 Misdemeanor) up to 14 years in jail, plus 75% Civil Tax Fraud Penalty, 25% Failure to Pay Tax Penalty
2. Failure to File FBAR's
(a maximum annual penalty of 50% of the account balance, up to 10 years in jail a \$500,000 fine)
3. Perjury
Taxpayers Form 1040/Schedule B must declare whether Taxpayers have any authority over, or interest in foreign accounts with a total of more than \$10,000.

In the IRS 6/24/09 FAQ update, the IRS stated:

What is the distinction between filing amended returns to correct errors and filing a voluntary disclosure?

An amended return is the proper vehicle to correct an error on a filed return, whether a taxpayer receives a refund or owes additional tax. A voluntary disclosure is a truthful, timely and complete communication to the IRS in which a taxpayer shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining the taxpayer's correct tax liability and makes arrangements in good faith to fully pay that liability. Filing correct amended returns is normally a part of the process of making a voluntary disclosure under IRM 9.5.11.9.

Taxpayers and practitioners trying to decide whether to simply file an amended return with a Service Center or to make a formal voluntary disclosure under the process described in IRM 9.5.11.9 and the March 23, 2009 memoranda should consider the nature of the error they are trying to correct. Taxpayers with undisclosed foreign accounts or entities should consider making a voluntary disclosure because it enables them to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution. Making a voluntary disclosure also provides the opportunity to calculate, with a reasonable degree of certainty, the total cost of resolving all offshore tax issues. It is anticipated that the voluntary

disclosure process is appropriate for most taxpayers who have underreported their income with respect to offshore accounts and assets. However, there will be some cases, such as where a taxpayer has reported all income but failed to file the FBAR (FAQ 9), or only failed to file information returns (FAQ 42), where it remains appropriate for the taxpayer to simply file amended returns with the applicable Service Center (with copies to the Philadelphia office listed in FAQ 9).

The IRS stated position is that a Taxpayer's voluntary disclosure entitles the Taxpayer to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution.

In reality, a taxpayer who makes a voluntary disclosure may:

1. Spotlight their "tax crimes"
2. If the voluntary disclosure is not accepted, jeopardize them and subject them to criminal prosecution

The IRS SBSE 3/23/09 memorandum, Subject: Routing of Voluntary Disclosure Cases, which addresses a change in the processing of voluntary disclosure requests containing offshore issues.

- 1) Such requests will continue to be initially screened by Criminal Investigation to determine eligibility for voluntary disclosure, and, if involving only domestic issues will be forwarded to Area Planning and Special Programs for Civil Processing;
- 2) Voluntary disclosure eligibility for offshore issues will be initially screened by Criminal Investigation and forwarded to the Philadelphia Offshore Identification Unit (POIU) for processing.

Voluntary Disclosure risks include:

1. Heightened risk of criminal prosecution (since initial screening is by the IRS Criminal Investigation Division);
2. A voluntary disclosure may be used as an evidentiary admission of Taxpayer's unreported income;
3. A voluntary disclosure may waive Taxpayer's 5th Amendment right against self-incrimination;
4. While a voluntary disclosure is pending the IRS may request more information, commence an audit or initiate criminal prosecution.

As an alternative strategy to a voluntary disclosure, the “quiet filing” (for the Tax Years at issue) of an amended tax return (or original tax return) may instead:

- 1. Pre-empt criminal charges for the failure to file FBAR returns, Form 1040 tax returns and failure to pay tax;**
- 2. Pre-empt a 75% civil tax fraud penalty, for failure to file or pay tax and a 25% failure to pay tax penalty;**
- 3. If the income is properly reported (i.e., no substantial understatements which are subject to a 6 year statute of limitations), the tax filing will commence the 3 year statute of limitations (for each year) for IRS audit.**

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