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Clearing Up the Confusion Between the events that trigger an increase in the offshore penalty from 27.5% to 50% with the events that disqualify a taxpayer from participating in OVDP altogether

There is no better example of the confusion that exists in the bowels of OVDP today than that of taxpayers who are inadvertently confusing the events that trigger an increase in the offshore penalty from 27.5% to 50% with the events that disqualify a taxpayer from participating in OVDP altogether. Contrary to popular belief, they are not one and the same.

Let's set the stage. You have an undisclosed foreign account and want to disclose that account so that you can come into compliance with your U.S. tax obligations. Certainly, that is a worthy goal and one which is consistent with the IRS's stated mission of encouraging voluntary compliance and self-policing.

After evaluating your options, you decide to apply to the OVDP. However, because of some procrastination, August 3, 2014 has come and gone without you submitting your request for pre-clearance. It's now December 11, 2016 and you still want to apply.

Effective August 4, 2014, the offshore penalty within the OVDP program increased from 27.5% to 50% for taxpayers who held foreign accounts at financial institutions that the IRS had relegated to a "special list." If you're wondering what all the "to do" is about this list, you need only know that it contains the names of those financial institutions who have agreed to cooperate with the U.S. government by exchanging U.S. accountholder information in order to avoid a potential criminal investigation and astronomical fines and penalties.

Taxpayers are subject to a 50-percent offshore penalty if any one of the following events has occurred that constitutes a "public disclosure":

1. Your foreign financial institution has become a target of investigation by the IRS or the Department of Justice; or

2. Your foreign financial institution is cooperating with the IRS or the Department of Justice to help them locate tax evaders; or

3. Your foreign financial institution has been identified in a court-approved summons seeking information about U.S. taxpayers who may hold financial accounts at that institution.

These requirements stand in stark contrast to the requirements that coalesce to form an

apocalypse: one that categorically bars a taxpayer from participating in OVDP. Taxpayers will be deemed ineligible to participate in OVDP if at least one of the following events occurs *before* a request for pre-clearance is made:

1. The IRS commences a civil or criminal examination or investigation of the taxpayer;

2. The IRS receives information from a third-party – as the result of a John Doe summons or treaty request – that provides evidence of the taxpayer's non-compliance;

3. The IRS commences a civil or criminal investigation that is directly related to the taxpayer's liability; or

4. The IRS acquires information related to the taxpayer's liability from a criminal enforcement action such as a search warrant or grand jury subpoena.

A simple comparison of the requirements that trigger the enhanced 50% offshore penalty with the requirements that bar a taxpayer from participating in the OVDP program reveals that they are different. For example, the mere fact that the IRS receives "nameless aggregates" from a financial institution complying with its FATCA requirements – *prior* to the taxpayer making a pre-clearance request – does *not* render a taxpayer with unreported accounts at that financial institution ineligible from participating in the OVDP, so long as the government is not in possession of information that specifically relates to that taxpayer's noncompliance. What this *does* mean, however, is that the taxpayer now faces a 50% miscellaneous offshore penalty instead of a 27.5% penalty.

Similarly, the mere fact that the IRS served a John Doe Summons or made a treaty request does not make every member of the John Doe class or group identified in the treaty request ineligible to participate in the OVDP.

But why tempt fate? If you know that your financial institution has received a John Doe summons from the U.S. government demanding the names and accountholder information of its U.S. customers and you suspect that it will acquiesce to these demands and provide the requested information, there is no sense sitting back and waiting to see what happens – regardless of how much reassurance the bank provides that it will "safeguard your privacy."

Faced with the choice between divulging accountholder information or paying exorbitant criminal and/or civil penalties, most financial institutions will choose the former, thus throwing you and the rest of its U.S. clients under the bus in order to save its own hide.

Procrastination is the equivalent of playing Russian Roulette. If you lose, you are no longer eligible to participate in OVDP. And if OVDP is no longer an option, you lose any possibility of being cloaked with immunity from criminal prosecution.