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The Streamlined Procedures: Traps for the Unwary

Despite the seemingly taxpayer-friendly incentives, the streamlined procedures – both domestic and foreign – have many shortcomings. The devil is in the details. Here are a few of its shortcomings:

a. They do not provide an ironclad guarantee of immunity from prosecution.

b. A day doesn't go by that I am not asked if there is any risk of audit under the streamlined procedures. Returns submitted under either the foreign or domestic offshore procedures are not automatically selected for audit. Instead, they are subject to "verification." Through verification, the examining agent can request account statements and other relevant documents to *verify* the information reported. However, this does not mean that an examination is impossible. On the contrary, such returns may be selected for audit under the existing audit selection processes applicable to any U.S. tax return.

c. An IRM Procedural Update dated August 13, 2014 sheds some light on what type of submissions might be ripe for examination under the streamlined procedures. If there are at least five foreign information returns in the taxpayer's streamlined submission (i.e., Forms 3520, 3520-A, 5471, 5472, 8938, 926, or 8621), then the agent must refer the case to the Large Business and International division of the Service (LB&I). The purpose of such a referral is not so the taxpayer can be entered into a drawing for a three-day cruise aboard the Disney "Magic." Instead, it likely means that an examination is on the horizon, one that could lead to the assertion of multiple willful or nonwillful FBAR penalties.

d. Taxpayers who are eligible to use the streamlined procedures and who follow all of the instructions are not subject to failure-to-file and failure-to-pay penalties, accuracy-related penalties, information return penalties, or FBAR penalties, even if their returns are subsequently selected for audit. However, immunity from *other* penalties comes with a few caveats. First, any

previously assessed penalties relating to the years that are selected for audit will *not* be abated. Second, to the extent that the IRS determines an additional tax deficiency for a return submitted under the procedures, it can assert additional tax and penalties relating to that additional deficiency. Finally, the IRS will unleash the full arsenal of penalties if it determines that the original tax noncompliance was due to fraud and/or that the FBAR violation was willful.

e. Tax returns will be processed no different than any other returns submitted to the IRS. Reading between the lines, this means that the taxpayer should *not* expect confirmation for receipt of the returns. Even more important, unlike OVDP, the streamlined filing process will not culminate in the signing of a closing agreement with the IRS.

f. Taxpayers who think that they can outsmart the fox by seeking shelter in the OVDP bunker in the event that the IRS rejects their non-willful certification are sadly mistaken. Once a taxpayer makes a submission under the streamlined procedures, it is too late to apply to its sister program, the Offshore Voluntary Disclosure Program. In other words, it's "either or," but not both. Attempting to "sneak" into the streamlined compliance program in "the dark of the night" when a taxpayer cannot legitimately certify non-willfulness is like cutting off one's nose to spite his face. When the smoke clears, such a taxpayer may end up paying a far steeper price than the miscellaneous penalty that he sought to avoid in the first place when he dismissed the idea of applying to the Offshore Voluntary Disclosure Program. The only remaining option for a taxpayer to come into compliance in the wake of a streamlined rejection is to file amended 1040s and delinquent international returns in what is collectively known as a "quiet disclosure." Taxpayers who find themselves in as precarious a situation as having to choose between streamlined and OVDP might look to the eminent archaeologist, Indiana Jones for some practical and sound advice. In the same way that "Indie" had to choose between the "real" Holy Grail and the "fake" Holy Grail with the latter resulting in a gruesome death (i.e., decaying into dust)

and the former resulting in eternal life, you must choose "wisely."

g. Assuming a taxpayer's streamlined submission is rejected, the only remaining option to come into compliance with one's U.S. tax obligations is to file amended 1040s and delinquent international returns in what is collectively known as a "quiet disclosure." This poses a number of risks, from an examination that has the potential to be as painful as a root canal in the sense that the IRS could assert multiple FBAR penalties that catapult the taxpayer's penalties into the stratosphere to the possibility of a referral to the Criminal Investigation (CI) division of the IRS. CI, in turn, could refer the case to the Department of Justice – Tax, with a recommendation for prosecution.

h. The nonwillful certification –including *all* statements made in the streamlined submission (even those relating to the non-residency requirement for streamlined foreign) – must be signed under penalties of perjury. This means that the IRS could reject a taxpayer's streamlined submission on more than one ground. For example, it can send a taxpayer packing not only if it obtains evidence that directly contradicts a taxpayer's certification that he was not willful, but also if it obtains evidence that directly contradicts the taxpayer's representation that he satisfied the non-residency requirement of the streamlined foreign procedures for the years in question. As if that was not bad enough, the IRS could refer the matter to the Department of Justice with a recommendation that the taxpayer be prosecuted for perjury.

i. With respect to the Streamlined Domestic Offshore Procedures, the five-percent miscellaneous penalty is imposed on a broader base of foreign assets – not just those relating to FBAR reporting.