The IRS's Current Offshore Voluntary Disclosure Program: Is This the Only Option Available for An "Accidental American"?

1. – *General overview*

Since primarily 2008, the Department of Justice (DOJ) and the Internal Revenue Service (IRS), through their well-publicized international tax enforcement initiative, have targeted, among others.

As conspirators, bankers, including notably Swiss bankers, as well as foreign banks, have also been targets of the U.S. government's recent international tax enforcement. On Aug. 29, 2013, the DOJ announced a new program involving Swiss banks which may lead to such banks resolving their own exposure to criminal charges by the U.S. government in exchange for helpful information relating to Tax Cheats[1].

As a matter of fact, U.S. individual taxpayers who have *knowingly* failed to disclose offshore financial accounts (*e.g.*, indicated "no" foreign financial accounts on tax returns and did not file Report of Foreign Bank and Financial Accounts ("FBAR"))[2] and - Under the Bank Secrecy Act - U.S. residents or a person in and doing business in the U.S. must file a report with the government if they have a financial account in a foreign country with a value exceeding $10,000 at any time during the calendar year.

Taxpayers comply with this law by noting the account on their income tax return and by filing Form TD F 90-22.1, the FBAR. "Willfully"; failing to file an FBAR can be subject to both criminal sanctions as well as civil

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[1] www.justice.gov/iso/opa/resources/8592013829164213235599.pdf.

[2] Report of Foreign Bank and Financial Accounts (FBARs), TD F 90-22.1. *See* 31 USC §5314; IRM Section 4.26.16.

penalties equivalent to the greater of $100,000 or 50 percent of the balance in an unreported foreign account.

Furthermore, U.S. individual taxpayers who *knowingly* failed to report and pay U.S. income tax on income earned from such foreign financial accounts (the "Tax Cheats"), are expected to be involved in the Program mentioned above.

As discussed in this article, the DOJ and the IRS have apparently done a good job so far convincing many Tax Cheats to come forward and into U.S. tax compliance or face possible prosecution and large monetary fines. Nevertheless, to date, not all Tax Cheats have come forward or been identified by the IRS. This is all likely to change very soon with the enactment of the Foreign Account Tax Compliance Act (commonly known as "FATCA").

The aim of this article is to briefly discuss certain of the disclosure and tax compliance options currently available to "Accidental Americans," (defined below) who generally did not understand that as dual citizens (*e.g.*, U.S. citizen and – for instance - Mexican national) and residing their entire life outside the United States, they still had U.S. tax and reporting obligations.

Such options include:

1) entering the IRS's current Offshore Voluntary Disclosure Program ("2012 OVDP");
2) entering the 2012 OVDP before the IRS contacts the Accidental American and then opting out;
3) entering (or at least meeting the requirements) of the traditional voluntary disclosure program (Traditional VDP, as defined below);
4) making a quiet disclosure, as defined below; or
5) entering the 2012 OVDP Streamlined Procedure (which will be available to very few Accidental Americans due to the stringent requirements).

This article will also briefly discuss FATCA and how FATCA will cause many Tax Cheats to come forward and into U.S. tax compliance based on the common understanding that FATCA will likely cause their foreign financial institution ("FFI") to provide their name to the U.S. tax authorities. FATCA will also undoubtedly result in many foreign persons learning for the first time they are Accidental Americans and, therefore, have the same tax and reporting obligations as U.S. citizens having lived all their lives in the United States.

2. – *Preliminary landscape: implementation of the Foreign Account Tax Compliance Act (s.c. FATCA)*

On March 18, 2010, President Obama signed into law the Hiring Incentives to Restore Employment Act (the "HIRE Act").

The HIRE Act enacted FATCA. FATCA added a new Chapter 4 to Subtitle A of the Internal Revenue Code of 1986, as amended (hereinafter: the "Code") entitled "Taxes to Enforce Reporting on Certain Foreign Accounts", according to Code Secs. 1471-1474.

FATCA is probably the most significant change in U.S. international tax law in decades, and an aggressive, curious and very complicated tool to fight tax avoidance and tax evasion as well.

The provisions of FATCA will likely apply to millions of U.S. citizens residing abroad. FATCA will in all probability "flush out" or expose the currently unknown Tax Cheats.

This is because under FATCA, in short and overly simplified, an FFI (*e.g.*, foreign bank) must enter into an agreement with the U.S. government.

An FFI is any "financial institution" which is a foreign entity.

A "financial institution" is any entity that accepts deposits in the ordinary course of a banking or similar business, holds financial assets for the account of others as a substantial portion of its business, or is engaged, or holding itself out as being engaged, primarily in the business of investing, reinvesting or trading in securities, partnership interests, commodities or any interest in such[3].

The definition is very wide.

The agreement mentioned above, ("FFI Agreement"), includes disclosing U.S. individuals (which can include Tax Cheats) or face the negative financial consequences of having 30 percent withheld from certain U.S. source gross payments made to such noncomplying FFIs. In general, by entering into the FFI Agreement, the FFI agrees to conduct due diligence to discover if the FFI has any U.S. persons as customers.

Such information is then provided to the U.S. tax authorities.

According to these provisions, an FFI need not enter into an FFI agreement if the FFI is from a foreign jurisdiction, and the U.S. government has entered into an intergovernmental agreement ("IGA") with this jurisdiction. Overly simplified, an FFI in a jurisdiction with an IGA will provide the information of U.S. accountholders to its own government. The foreign government will in turn provide this information to the IRS. As part of the IGA

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[3] See Code Sec. 1471(d)(4) and (5).

terms, the IRS will provide the foreign jurisdiction with information of accountholders in the United States that are from such jurisdiction.

Although FATCA will likely do an excellent job of exposing the undisclosed Tax Cheats, one of the likely unintended consequences of FATCA (but perhaps still warranted) is both what to do with and how to handle the case of the Accidental American[4].

3. – *The Typical Accidental American: concept and definition*

For the purpose of this article, the "Accidental American" is a term loosely encompassing those individuals permanently residing outside the United States and who acquired American *citizenship*: (i) by virtue of their birth in the United States; or (ii) "derivatively" when born overseas to U.S. citizen parents. Stated another way, the Accidental American is any individual physically residing outside the United States who innocently and truthfully did not realize that as a result of being a dual citizen of their home country domicile and the United States, he or she had: (a) a U.S. tax filing and payment requirement; and/or (b) a requirement to disclose his or her foreign financial accounts (*i.e.*, file FBARs). Accidental Americans may also include, though much fewer in number, those who innocently did not understand they were a U.S. citizen and, therefore, had U.S. tax and reporting obligations. Most Accidental Americans also do not have direct family, business or personal ties to the United States. Importantly, for the purpose of this article, U.S. citizens, including Accidental Americans, are subject to U.S. tax on their worldwide income, regardless of where they physically live. *Obviously, the U.S. tax consequences based on worldwide income and U.S. information reporting (including FBARs) will come as a big surprise to an Accidental American*.

As noted above, the typical Accidental American has physically lived outside the United States almost all of his or her entire life and does not have direct family, business or personal ties to the United States. Some of the Accidental Americans have even been issued visas to enter the United States (which visa is not required for a U.S. citizen to enter the United States).

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[4] FATCA will likely result in Tax Cheats proclaiming to the U.S. tax authorities: "You Got Me!" (an intended consequence of FATCA) versus the Accidental Americans proclaiming to the U.S. tax authorities: "What?; As a U.S. Citizen and never having lived in the United States other than to be born there, I am taxable on my worldwide Income?" (a likely unintended consequence of FATCA).

Although there are many low-income Accidental Americans living outside the United States, for example in Mexico, who may not have a U.S. tax and reporting obligations, this is not always the case. For example, there is estimated to be a large number of Accidental Americans living in Mexico who are high-end professionals, entrepreneurs and businessmen that have built a significant amount of lifetime wealth without the knowledge they had U.S. tax and reporting obligations. We understand that many high-net worth individuals who fall under this category frequently retain sophisticated Mexican tax and financial advisors who, because such advisors are unaware of their client's citizenship, provide complicated (and appropriate) estate, gift and income tax planning under Mexican laws, without ever giving any thought to U.S. tax implications. Unknown to such advisors and their Accidental American clients, such estate, gift and income tax planning can have disastrous tax implications when applying U.S. tax laws. Had the Accidental American known the tax consequences of his U.S. citizenship, he or she would have had their financial planning done entirely differently. Admittedly, there are a number of individuals claiming to be "Accidental Americans" (as defined in this article) but are not. In other words, there may be a number of American citizens living abroad who knew their U.S. tax obligations but decided not to comply.

4. – *Certain Options Currently Available to Accidental Americans*

In light of their probable disclosure to U.S. tax authorities under FATCA, assuming the FFI properly determines the Accidental American is a U.S. person for U.S. tax purposes, Accidental Americans, who have not done so to date, should determine through competent U.S. tax counsel what U.S. tax obligations, including tax and FBAR filings, are required in order to become compliant with the U.S. tax laws. Once the Accidental American has determined what tax and reporting obligations exist, he or she must then determine the best way to properly disclose such information to the IRS for the purpose of avoiding, if possible, any unwarranted and inappropriate penalties. As discussed below, the 2012 OVDP may or may not be the best option for a "true" Accidental American (*i.e.*, one whose failure to comply with the U.S. tax laws was not willful or negligent under any possible standards or readings of the law). Of course, the 2012 OVDP may be the best option for an Accidental American with a low tolerance for risk who wants some sense of certainty regarding their tax and penalty exposure, especially if they meet the requirements for the reduced five-percent offshore penalty, as defined below.

After a close reading of the IRS's website and other news sources, as well as attending presentations made by highly respected tax professionals (government and private practice), the impression one walks away with is that perhaps the 2012 OVDP is the *only* option available to an Accidental American attempting to become compliant with his U.S. tax obligations, including filing tax returns, paying tax, penalties, interest and filing FBARs. If one assumes, however, that an Accidental American did not know of his or her U.S. tax obligations (based on not knowing the tax implications of being a U.S. citizen), then the 2012 OVDP is not the only viable option for such Accidental American. Of course, every case must be analyzed on its own particular facts and circumstances. The following discusses the terms of the 2012 OVDP and briefly mentions certain (but not all) other options available to an Accidental American to become compliant with the U.S. tax laws.

4.1. – *Option 1: Enter The Offshore Voluntary Disclosure Program (the "2012 OVDP")*[5]

Since 2009, the IRS has offered a series of voluntary disclosure programs, including the Offshore Voluntary Disclosure Program of 2009 (OVDP), the Offshore Voluntary Disclosure Initiative of 2011 (OVDI) and the 2012 OVDP, which is currently available to taxpayers. The IRS has not established a final date for participation in the 2012 OVDP, as it did in prior versions of the program. To date, over 39,000 taxpayers have participated in the various OVDP or OVDI programs resulting in over $*5.5 billion in revenues*[6]. Nevertheless, once a taxpayer, including an Accidental American, is disclosed to the IRS and under examination, such individual is ineligible to apply for the 2012 OVDP[7].

According to the IRS, "the objective remains the same as the 2009 OVDP and 2011 OVDI—to bring taxpayers that have used undisclosed foreign accounts and undisclosed foreign entities to avoid or evade tax into compliance with the United States tax laws"[8]. More specifically, the 2012 OVDP established a procedure to encourage U.S. taxpayers to come forward

[5] See www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program.

[6] *See* Government Accountability Office, *Offshore Tax Evasion—IRS has Collected Billions of Dollars, but May Be Missing Continued Evasion*, Mar. 2013.

[7] FAQ #14 of the OVDP Frequently Asked Questions, available online at www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers.

[8] 2012 OVDP, FAQ #2.

and avoid criminal prosecution while agreeing to provide detailed information about their offshore assets and activities, file corrected tax forms and pay tax, interest and penalties under a specified framework. Because the purpose of the 2012 OVDP is to provide a way for taxpayers who did not report taxable income in the past to come forward voluntarily and resolve their tax matters, a taxpayer who has properly reported all of their taxable income, but not filed FBARs, is *not* eligible for the 2012 OVDP[9].

4.2. – *Benefit and terms of the 2012 OVDP*

According to the IRS, "[m]aking a voluntary disclosure also provides the opportunity to calculate, with a reasonable degree of certainty, the total cost of resolving all offshore tax issues … [and those who do not] run the risk of detection by the IRS and the imposition of substantial penalties, including the fraud penalty, and foreign information return penalties, and an increased risk of criminal prosecution"[10]. [Emphasis added.].

The 2012 OVDP penalty framework requires participants to file both amended returns (or original tax returns if delinquent) and FBARs for the past eight years; pay the appropriate tax and interest; pay a 20-percent accuracy-related penalty on such tax; pay a failure-to-file penalty and/or failure-to-pay penalty, if applicable; and pay an offshore penalty of 27.5 percent of the highest aggregate balance in the unreported foreign accounts during the eight full tax years prior to the disclosure (the "27.5-percent offshore penalty")[11].

As discussed in this article, certain taxpayers may qualify for the five-percent reduced penalty, including: taxpayers who have inherited foreign bank accounts and have not used the foreign account; individuals who were not aware of their U.S. citizenship; and some individuals residing overseas who have complied with the tax obligation in the country in which they are residing (and who have no U.S. source income). A 12.5-percent penalty may be imposed to the taxpayer having less than $75,000 in foreign accounts[12].

A participant in the 2012 OVDP must also agree to cooperate with the IRS including providing information about bankers, banks, *etc*.

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[9] 2012 OVDP, FAQ #17.

[10] 2012 OVDP, FAQ #4.

[11] 2012 OVDP, FAQ #7.

[12] See FAQs #52 and #53 of the OVDP.

4.3. – *Penalty Reduced for Accidental Americans*

Some taxpayers will be eligible for a "reduced five-percent offshore penalty" or "reduced 12.5-percent offshore penalty". The eligibility requirements for these reduced rates remains the same as in the 2011 OVDI. Thus, a taxpayer with offshore accounts or assets that, in the aggregate, did not exceed $75,000 in any calendar year during the eight-year look-back period may qualify for a reduced 12.5-percent penalty rate. The reduced five-percent rate will apply in certain limited circumstances (e.g., in the case of foreign residents who were unaware that they were U.S. citizens)[13]. The requirements for each of the reduced five-percent offshore penalty and reduced 12.5-percent offshore penalty are described briefly below.

4.4. – *Reduced Five-Percent Offshore Penalty*

There are a couple different circumstances in which a taxpayer may be eligible for the reduced five-percent offshore penalty.

The following individuals may, among certain others, be eligible for the reduced five-percent offshore penalty relief[14]:

1. Taxpayers who are foreign residents and who were unaware they were U.S. citizens.

Example 1: The taxpayer was born in the U.S. to parents of foreign citizenship. She grew up in a foreign jurisdiction, unaware that she had been born in the U.S. She has a $60,000 account in the foreign jurisdiction. She has never filed U.S. returns or FBARs. She became aware she was a U.S. citizen when she had to get a birth certificate in order to obtain a passport from the foreign jurisdiction where she resides. Unless she decides to opt out, she is entitled to the reduced 5% offshore penalty.

Example 2: The facts are the same as in example 1, except that the taxpayer always knew she was a U.S. citizen and never inquired about her U.S. tax obligations. The taxpayer is *not* entitled to the reduced 5% offshore penalty, unless she qualifies under … [certain other exceptions].[Emphasis added.] Also, the following individuals may also be eligible for the reduced five-percent offshore penalty relief[15] :

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[13] *See* FAQs #52 and #53 of the OVDP Frequently Asked Questions, available online www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers.

[14] 2012 OVDP, FAQ #52 (See Examples #1 and #2).

[15] 2012 OVDP, FAQ #52 (#3).

Taxpayers who are foreign residents and who meet all three of the following conditions for all of the years of their voluntary disclosure:

(a) taxpayer resides in a foreign country;

(b) taxpayer has made a good faith showing that he or she has timely complied with all tax reporting and payment requirements in the country of residency; and

(c) taxpayer has $10,000 or less of U.S. source income each year… .

This exception only applies if the income tax returns filed with the foreign tax authority included the offshore-related taxable income that was not reported on the U.S. tax return. [Emphasis added.]

In summary, an individual who *did not know* he or she was an Accidental American, because he or she did not know he or she was a U.S. citizen, should generally be eligible for the reduced five-percent offshore penalty. This exception will likely not apply to many Accidental Americans as most Accidental Americans understood they were a dual citizen.

An individual who knew he was a U.S. citizen, but did not know he was an Accidental American because he did not understand his U.S. tax obligations, had $10,000 or less of U.S. source income each year and properly reported and paid tax in his country of residency, is also generally eligible for the five-percent reduced offshore penalty. This exception could apply to an Accidental American. Nevertheless, this exception may be difficult to fall under as it requires both: $10,000 or less of U.S. income per year; and proof of proper tax reporting in his home country.

4.5. – *Reduced 12.5 Percent Offshore Penalty*

Unless the taxpayer qualifies for the reduced five-percent offshore penalty, taxpayers whose highest aggregate account balance (including the fair market value of assets in undisclosed offshore entities and the fair market value of any foreign assets that were either acquired with improperly untaxed funds or produced improperly untaxed income) in each of the years covered by the 2012 OVDP (the past eight years) is less than $75,000, will qualify for a 12.5-percent offshore penalty[16].

The 2012 OVDP; FAQ #53 provides the following example applying the reduced 12.5-percent offshore penalty:

Example 1: The taxpayer was born in a foreign jurisdiction and is now a U.S. citizen. He has a landscaping business in the U.S. He sends money to an

[16] 2012 OVDP, FAQ #53.

account in the foreign jurisdiction that he owns jointly with his mother (who is a resident of that jurisdiction). The account never has more than $75,000 in it. He has never filed an FBAR or paid U.S. tax on the earnings from the account. He is entitled to the reduced 12.5% offshore penalty. The result would be the same for taxpayers who are U.S. citizens by birth. In summary, an individual who knew he or she was a U.S. citizen, but did not know he or she was an Accidental American because he or she did not understand their U.S. tax obligations and did *not* report and pay tax on their U.S. income earned from foreign (offshore accounts), is generally eligible for the 12.5-percent reduced offshore penalty assuming the offshore account balance(s) never exceeded $75,000 in total during the past eight years. This exception will be difficult to apply for many Accidental Americans who had a foreign account balance in excess of $75,000 during the past eight years.

4.6. – *Certain Pros and Cons of the 2012 OVDP as Applied to an Accidental American*

The principal advantage of the 2012 OVDP is the decreased criminal exposure in the event that a taxpayer's conduct was willful or fraudulent. Nevertheless, based on our assumptions the Accidental American actions or inactions are innocent (and reasonable), criminal exposure should not be a concern, as well as the concern over the possible civil penalties and FBAR penalties.

The clear benefit of the 2012 OVDP to an Accidental American is some degree of certainty in the cost of resolving all of their offshore tax obligations. Otherwise, as a technical point, the statute of limitations to assess income tax for all tax years in which a tax return has not been filed is open indefinitely[17].

An Accidental American should be eligible for the reduced five-percent offshore penalty if the Accidental American: (i) did not know they were a U.S. citizen, *or* (ii) had $10,000 or less of U.S. source income each year and properly reported and paid tax in their country of residence.

If such reduced five-percent offshore penalty does not apply, the reduced 12.5-percent offshore penalty may apply if the Accidental American had less than $75,000 in total in their foreign accounts during the past eight years.

[17] Code Sec. 6501(b)(3).

Certain Cons (Burdens) of entering the 2012 OVDP are applied to an Accidental American, as follows.

Assuming a "reasonable cause" argument exists (which we assume it does for an Accidental American who truthfully and reasonably was unaware of his or her U.S. tax and reporting obligations), the regular penalties that apply outside of the 2012 OVDP probably do *not* apply to (and cannot be assessed against) the Accidental American. Thus, the penalties under the 2012 OVDP, even if the reduced five-percent or 12.5-percent offshore penalties apply, may be higher to those that could be imposed under the Code for failing to timely file tax returns and FBARs.

The professional costs of hiring a competent tax advisor to assist the Accidental American with the 2012 OVDP process can be high as the result of the many administrative requirements under the program (*e.g.*, attorney fees).

Even if the Accidental American is entitled to the reduced five-percent offshore penalty, such penalty will, as an example, cost the Accidental American $50,000 if their highest foreign account balance during the applicable period was $1 million. Thus, it is clear that the higher the balance in the foreign accounts (due to the Accidental American's individual financial situation and unrelated to their degree of culpability), the greater the cost of entering the 2012 OVDP.

5. – *Option #2: Enter the 2012 OVDP and Then Opt Out*

In some cases, before a decision can be made which option to pursue, a taxpayer may want to enter the 2012 OVDP before he or she has been contacted by the IRS regarding an examination (which contact would preclude being admitted to the 2012 OVDP)[18]. If the taxpayer ultimately does not agree with the application of the 2012 OVDP penalties, he or she may "opt out" of the 2012 OVDP and request that tax and penalties be determined under the standard audit process (*i.e.*, full scope audit)[19].

The IRS understands that a taxpayer may enter the 2012 OVDP and decide to opt out. "It should be recognized that in a given case, the opt out option may reflect a preferred approach. That is, there may be instances in which the results under the applicable voluntary disclosure program appear too severe given the facts of the case. There will be other instances where

[18] 2012 OVDP; FAQ #4.
[19] 2012 OVDP, FAQs #51 and #51.1.

this is less clear …. In either case, opting out is at the sole discretion of the taxpayer and the taxpayer should not be treated in a negative fashion merely because he or she chooses to opt out”[20].

The IRS has noted, however, that an opt out is still eligible for the IRS's Traditional Voluntary Disclosure Practice (Traditional VDP) (*i.e.*, generally no criminal exposure, but there is no guarantee, as long as the taxpayer is cooperative with the IRS and makes a good faith effort to pay the tax due)[21].

5.1. – *Certain Pros and Cons of Entering the 2012 OVDP and Then Opting Out as Applied to an Accidental American*

Certain Pros (Benefits) of Entering the 2012 OVDP and Then Opting Out can be summarize as follows.

By entering the 2012 OVDP before being contacted by the governmental authorities, the Accidental American will have extra time to determine what option is best for them. Ultimately, the 2012 OVDP may be the best, or at least the preferred, option under the circumstances.

Entering the 2012 OVDP before contact from the governmental authorities should significantly reduce any concern of criminal prosecution (which would not be warranted for a true Accidental American anyways).

As for the Cons (Burdens) of Entering the 2012 OVDP and Then Opting Out, the Accidental American must then likely deal with a full blown audit including the related professional fees, as discussed above.

6. – *Option #3. Enter (and Treat as Entering) to the Traditional Voluntary Disclosure Program*

The underlying voluntary disclosure program has been in place for decades (“Traditional VDP”)[22]. In addition, the IRS has a longstanding internal practice to consider “voluntary disclosure”, along with other factors, in determining whether criminal prosecution will be recommended. Although there is no guarantee, voluntary disclosure may generally result in prosecution not being recommended. For this purpose, the requirements for Traditional VDP include a “voluntary disclosure which means a truthful, timely,

[20] 2012 OVDP, FAQ #51
[21] IRM Section 9.5.11.9; *supra* note 20
[22] See IRM Section 9.5.11.9.

and complete communication, when: (A) the taxpayer shows a willingness to cooperate with the IRS in determining her tax liability, and (B) the taxpayer makes good faith arrangements to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable"[23].

The Traditional VDP instructions provide that a taxpayer may submit the pertinent tax returns under a cover letter with an offer to pay all applicable taxes, interest and penalties. Although it is not entirely clear, the filing of all delinquent tax returns including the outstanding tax with the appropriate Service Center, may fall under the protection of the Traditional VDP as it meets the above requirements. (*See* the discussion below under the quiet disclosure option.)

6.1. – *Certain Pros and Cons of Entering the Traditional VDP as Applied to an Accidental American*

The most important benefit is undoubtfully the protection against criminal exposure. Nevertheless, again, this should not be a concern for a true Accidental American.

The ultimate consequence of entering the Traditional VDP is probably the same as entering the 2012 OVDP and then opting out. Of course, entering the 2012 OVDP at least provides the Accidental American with additional time to determine his or her options, including the option of remaining in the 2012 OVDP. Furthermore, there is no 27.5-percent or less offshore disclosure penalty associated with a Traditional VDP.

As for Certain Cons (Burdens) of Entering the Traditional VDP, can be pointed out that similar to an opt out, all other civil penalties may apply. Nevertheless, unlike the 2012 OVDP where the IRS has stated they will likely perform a full blown audit, it is not clear whether this will always be done under the Traditional VDP. Unlike the 2012 OVDP, there are a lot of unknowns about the Traditional VDP (*i.e.*, no comparable FAQ guidance as in existence with the 2012 OVDP).

7. – *Option #4: Quiet Disclosure*

On April 26, 2013, the U.S. Government Accountability Office ("GAO") issued a report (the "GAO Report") that encouraged the IRS to seek out tax-

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[23] IRM Section 9.5.11.9(3)(the Traditional VDP requirements).

payers who have circumvented the IRS's recent OVDP programs in favor of "quiet disclosure"[24]. The GAO is an independent, nonpartisan agency that works for Congress and is known as the "congressional watchdog". It investigates how the federal government spends taxpayer dollars and makes recommendations on how a governmental agency (*e.g*., the IRS) can be more efficient and effective.

To date, the term "quiet disclosure" is not a defined term. Nevertheless, it is generally understood to mean when a taxpayer files delinquent or amended tax returns outside the OVDP. The GAO Report, however, specifically referred to amended income tax returns (*not* delinquent income tax returns) being filed by possible (over 10,000) Tax Cheats suspected of circumventing the OVDP programs in favor of a quiet disclosure. The GAO Report does note, however, that Tax Cheats are filing delinquent/late FBARs.

The IRS agreed with the GAO Report's recommendation. The IRS's disdain for quiet disclosures, however, has been generally well known even before the GAO Report. The 2012 OVDP frequently asked questions warns taxpayer's considering quiet disclosure as follows:

Taxpayers are strongly encouraged to come forward under the OVDP to make timely accurate, and complete disclosures. Those taxpayers that make "quiet" disclosures should be aware of the risk of being examined and potentially prosecuted for all applicable years[25].

The IRS is reviewing *amended* returns and could select any amended return for examination. The IRS has identified, and will continue to identify, amended tax returns reporting increases in income. The IRS will closely review these returns to determine whether enforcement action is appropriate. If a return is selected for examination, the 27.5 percent offshore penalty would not be available. When criminal behavior is evident and the disclosure does not meet the requirements of a voluntary disclosure under IRM 9.5.11.9 [Traditional VDP] the IRS may recommend criminal prosecution to the Department of Justice[26].

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[24] "*Offshore Tax Evasion: IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion*," GAO-13-318 (the GAO Report), Mar. 27, 2013.

[25] 2012 OVDP, FAQ #15.

[26] 2012 OVDP, FAQ #16.

7.1. – *Certain Pros and Cons of Making a Quiet Disclosure as Applied to an Accidental American*

Because an Accidental American by definition in this article should not have any exposure to criminal and civil penalties, the 2012 OVDP may be an unnecessary cost to the Accidental American (*i.e.*, both time and professional fees). It is not entirely clear that the quiet disclosure referred to in the GAO Report and in the IRS's Frequently Asked Questions (FAQs) is intended to pick up delinquent tax returns, certainly as it applies to Accidental Americans. The GAO Report seems to focus on the individuals who made a quiet disclosure by way of filing an amended tax return (and past due FBARs). In those situations, the authors understand the potential for culpability and possibility for abuse.

On the other side, if an Accidental American only files tax returns on a prospective basis, or only files a certain number of delinquent tax returns, the statute of limitations by which the IRS can assess additional tax is technically open indefinitely for unfiled tax returns. Thus, an Accidental American who has been a U.S. citizen for 40 years, but only files delinquent tax returns, for example the past six years, still runs the risk (no matter how unlikely) that the IRS could assess tax for the outstanding 34 tax years in which a tax return was required to be filed. Of course, whether the IRS would ever pursue such a case (as it relates to a truly innocent Accidental American) remains to be seen.

There is less certainty than if the Accidental American entered the 2012 OVDP.

8. – *Option #5: Streamlined Procedure Available to Very Few Accidental Americans*

Effective as of September 1, 2012, a special procedure[27] for U.S. citizens living abroad was put into place, known as "Streamlined Procedure".

The procedure was launched with the objective of bringing U.S. citizens living overseas into compliance with tax obligations. This procedure is applicable only for U.S. taxpayers living abroad who represent a low risk of tax evasion and who have not filed tax returns since 2009.

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[27] www.irs.gov/Individuals/International-Taxpayers/New-Filing-Compliance-Procedures-for-Non-Resident-U.S.-Taxpayers.

In order to be eligible for the Streamlined Procedure, a taxpayer must represent a low risk of tax evasion[28]. Generally, this means that the unpaid U.S. taxes are less than $1,500 per year, among other requirements; however, the $1,500 per year tax limit will not necessarily disqualify a taxpayer from admission in the streamlined procedure[29]. Taxpayers who choose the Streamlined Procedure must file information returns for the last three years (and six years of FBARs), as well as the payment of income tax and interest for each such tax years.

Because Accidental Americans are U.S. citizens and, therefore, taxable on their worldwide income, it is unlikely that many Accidental Americans will be eligible for the Streamlined Procedure because of the very low $1,500 U.S. tax limit per year.

9. – *Conclusions*

I think that one of the primary purposes of FATCA is to expose the typical U.S. citizen living in the United States trying to avoid U.S. taxes by hiding money overseas (the Tax Cheats). FATCA has made (or certainly will make, if it is implemented effectively) many Accidental Americans aware of their U.S. tax and reporting obligations.

The 2012 OVDP is clearly not the only, and probably not the best, option for every Accidental American. Assuming the taxpayer is eligible, entering the 2012 OVDP is generally advisable when there is potential criminal exposure (or prior knowledge of FBAR filing requirements), which should generally not be a concern for the true Accidental American. The obvious benefit of entering the 2012 OVDP, however, is certainty in terms of tax and penalties. Such benefit, however, diminishes relative to the possible amount of offshore penalty that is applicable.

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[28] Instructions for New Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer U.S. Taxpayers, available online *at www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers.*

[29] Frequently Asked Questions Regarding the Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer U.S. Taxpayers, available online at www.irs.gov/Individuals/International-Taxpayers/FAQReStreamlinedFilingComplianceProceduresNRNFTPs.

The so-called quiet disclosure has been generally disfavored by the IRS. The reason for the IRS's disfavor, however, may primarily relate to those taxpayers quietly filing amended tax returns to report income from offshore accounts. It is entirely not clear, however, whether the IRS's strong public opinion against quiet disclosures necessarily includes delinquent tax returns filed by Accidental Americans.

In the context of Accidental Americans, and the best approach to become compliant with the U.S. tax laws, every case is different, and the ultimate option chosen is dependent on the particular set of facts and circumstances. No two cases are exactly the same. As such, Accidental Americans should obtain competent U.S. tax advice before proceeding with any of the options.

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