Examination

By Kevin E. Thorn

After Voluntary Disclosure Initiative Closes, IRS Moves on to Information Document Requests for Offshore Account Holders

In 2009, the IRS and U.S. Department of Justice launched a highly publicized investigation into Swiss bank UBS AG and its U.S. accountholders who failed to disclose their foreign assets to the U.S. government. However, the investigation did not end with UBS. According to the U.S. Department of Justice, the government is looking at information sharing agreements with other banks around the world, similar to the agreement it entered into with UBS. Also, IRS information-gathering efforts were bolstered by the response to its recently closed settlement initiative, which encouraged taxpayers to come forward and make a voluntary disclose of their foreign assets at UBS and other offshore banks in exchange for reduced penalties.

In the wake of the UBS AG fallout and the closing of the IRS Offshore Voluntary Disclosure Initiative on October 15, 2009, the IRS plans to continue to wage its attack on offshore tax evasion. It is clear that offshore tax evasion remains a top IRS enforcement priority. So what can U.S. taxpayers expect next? Taxpayers investigated by the IRS for having an interest in previously undisclosed offshore accounts will likely be audited by the IRS and issued an Information Document Request—or IDR.

Audits and Information Document Requests

An audit is an examination of a taxpayer's assets and financial records by the IRS to verify a taxpayer's correct tax reporting, including foreign asset reporting. The IRS selects taxpayers for examination based on a variety of methods. Taxpayers with offshore accounts will likely be identified through recent investigations into offshore tax evasion, including the John Doe Summons issued to UBS

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ordering the bank to disclose U.S. accountholder information. Further, the IRS acknowledged it received voluminous information as a result of taxpayer participation in the Offshore Settlement Initiative. No doubt the IRS is harvesting the information it received as a result of UBS prosecution as well as through the Offshore Settlement Initiative to identify account holders who have not yet come forward.

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If a taxpayer is identified by the IRS and is being audited, they will receive a formal audit notification letter. The audit notification letter will include information regarding a taxpayer's rights, including the following:

- A right to professional and courteous treatment by IRS employees
- A right to privacy and confidentiality about tax matters
- A right to know why the IRS is asking for the information, how the IRS will use it and what will happen if the information requested is not provided
- A right to representation, by oneself or an authorized representative
- A right to appeal disagreements, both within the IRS and before the courts

Often included with the audit notification letter is an Information Document Request. The Information Document Request is a formal and structured process for the IRS to request and secure information from taxpayers, including information regarding offshore bank accounts. An IDR requests the necessary books, papers, records and other data relevant to the IRS examiner's inquiry into the validity of a tax return.

Increase in Information Document Requests

There has been a sharp increase in the number of IDRs requesting information specifically related to the taxpayer's foreign bank accounts. Among other information requested by the IDR will be a request for materials and information related to the taxpayer's foreign bank accounts. This trend will likely continue for at least the next three to six months.

If IRS agents discover that a taxpayer has not reported an interest in an offshore account or income accruing on such accounts during the course of an audit, the IRS may impose steep penalties—including the greater of $100,000 or 50 percent of the offshore account balance for willful failure to file an FBAR for each account. These penalties, compounded with interest and fraud penalties, can essentially wipe out the taxpayer's foreign assets. Additionally, taxpayers could be subject to criminal prosecution and jail time for tax evasion.

Although the deadline to participate in the Offshore Settlement Initiative has passed, U.S. taxpayers with undisclosed offshore accounts can still make a voluntary disclosure. The penalties may be higher now than those paid by Initiative participants. However, under the IRS's traditional Voluntary Disclosure procedures, taxpayers disclose previously undisclosed assets and pay back taxes, interest as well as a civil penalty. In return, taxpayers avoid the most severe civil penalties, which can often exceed the value of the assets in the account in a given year, and, most importantly, taxpayers can avoid criminal prosecution.