

Are Public Leaks Enough for the Higher OVDP Penalty?

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Public leaks, such as the Panama Papers, that are being mined for leads by the IRS and the Justice Department may not be an appropriate cutoff for applying the higher penalty under the IRS's offshore voluntary disclosure program, according to some practitioners.

Under OVDP FAQ 7.2, a taxpayer who is the client of or holds an undeclared account at one of the facilitators or financial institutions [listed](#) on the IRS website will face a 50 percent miscellaneous offshore penalty, rather than the standard 27.5 percent. That list originally consisted primarily of financial institutions, many of which entered into non-prosecution agreements (NPAs) under the Justice Department's Swiss bank program. However, [over 40 individuals were added](#) last October.

In the [legacy phase](#) of the Swiss bank program, the Justice Department and the IRS Criminal Investigation division are poring over the disclosures from the 78 NPAs for investigative leads. CI officials [said](#) that these [data mining efforts](#) have included public leaks such as the Panama Papers.

FAQ 7.2 lists three reasons for placing an institution or facilitator on the higher penalty list: past or present investigation by the IRS or Justice Department connected to accounts beneficially owned by U.S. persons; cooperation by the institution or facilitator with the IRS or Justice Department in connection with those U.S. person accounts; or being subject to a court-approved John Doe summons concerning U.S. taxpayer accounts.

Some practitioners expressed concern about the prospect of that list being expanded to include conduct outed by public leaks. Jeffrey A. Neiman of Marcus Neiman & Rashbaum LLP said that the higher penalty is associated with OVDP submissions viewed as less "voluntary" because of the public exposure of suspect behavior by the financial institutions and facilitators listed in accordance with FAQ 7.2. "I don't think it's fair, necessarily, to assume that just because there has been a leak, that that information is usable by the government and usable in a form to open up investigations," he said.

Neiman, a former tax prosecutor, said that while the IRS is free to amend FAQ 7.2, "they also need to balance the severity of the penalty with the desire to come forward, and at some point the penalty just becomes so severe that folks are more willing to just roll the dice."

Eventually, the list could include every firm worldwide that provides the sort of evasion services that have become an issue for the companies and individuals already on it, at which point the exception will swallow the rule, Neiman said. "You just hope that they are somewhat careful about who they add to the list and the timing of when they add to the list; otherwise, it's going to be too severe of a penalty for anyone to really take advantage of it, especially with all the other options for coming into compliance," he said.

Josh O. [Unger](#) of Meadows, Collier, Reed, Cousins, Crouch & [Unger](#) LLP said that expanding the FAQ to include public leaks as another trigger for the higher 50 percent OVDP penalty risks a chilling effect on potential

program participants. "The IRS approach to bringing taxpayers with undisclosed assets back into compliance through their offshore voluntary disclosure programs has been expansive," he said.

Compared with the current FAQ triggers involving IRS or Justice Department activity, using public leaks would "put the cart before the horse," **Unger** said. Because leaked information may be inaccurate or incomplete and has not been subject to IRS classification and verification, it would be unfair to include public leaks as a condition for the increased OVDP penalty, he said. "Unless and until the IRS or Department of Justice takes action with respect to the leak, a qualified taxpayer who decides to participate in the OVDP should only be subjected to a 27.5 percent offshore OVDP penalty," he said.

Scott D. Michel of Caplin & Drysdale Chtd. compared the possibility of using public leaks as the basis for inclusion on the list to the subjective timeliness criteria that had been used for voluntary disclosure practice before the current version of Internal Revenue Manual section 9.5.11.9 shifted to objective criteria regarding when the IRS receives information. The three triggers in FAQ 7.2 are "largely clear and specific benchmarks" comparable to the objective timeliness criteria in the IRM, he said.

The current criteria rely on fixed determinations by the government concerning the institutions and facilitators that get added to the list, Michel said. In a typical bank case leading to an NPA, the bank will warn account holders that it may be required to disclose information to the U.S. government and sends them letters encouraging them to make voluntary disclosures under the OVDP, including descriptions of potential civil and criminal consequences, he said. The IRS determined that at some point, an account holder has enough notice of the potential for disclosure that there should be a price for waiting and that the fixed determination — in the bank example, the publication of the completed NPA — serves as that point, he said.

The problem with using public leaks for justifying the higher penalty is that when leaks occur, neither the validity of the information nor the presence of actual noncompliance is assured, Michel said. "If you are going to say that a taxpayer is gaming the system by waiting until their names are in the Panama Papers or they are mentioned in some kind of a media leak, then you are on a slippery slope — should the taxpayer whose spouse threatens to go to the IRS suddenly be in the 50 percent group?" he said. "There could be any leak or public or private disclosure to the IRS about any account or any bank or any asset manager anywhere in the world at any time." Michel said the publication of leaked information would be better thought of as serving the same function as the advance warning banks moving toward an NPA provide to their clients.

Jay R. Nanavati of Kostelanetz & Fink LLP said that the list includes individuals and institutions under investigation and not just those who have been convicted or entered into a resolution such as an NPA with the government. Therefore, if the government can satisfy itself on the reliability of the information, "I don't see any good reason not to include institutions that are the subject of leaks like the Panama Papers" in the higher penalty list, he said.

"The penalty is too low in the OVDP now that you have that huge safety valve in the streamlined program," Nanavati said, adding that if the miscellaneous penalty is increased, there may be no need to designate specific financial institutions and facilitators at all.

Nanavati, also a former prosecutor with the Justice Department Tax Division, said that if the definition of willfulness for choosing the OVDP over the streamlined filing procedures is the same as with criminal tax cases, there may be no more need for the lower 27.5 percent rate. If the taxpayer meets the criminal definition of

willfulness, any complicity by a bank or facilitator would seem more likely to mitigate the taxpayer's bad behavior than to exacerbate it, he said. The distinction based on which institutions and advisers a willful taxpayer used does not make much sense when non-willful taxpayers can use the streamlined filing procedures, he added.

According to Nanavati, that line of thought applies only if the distinction between the two programs is based on the criminal definition of willfulness as "intentional violation of a known legal duty" rather than the "reckless disregard" standard that the government [has been successfully applying](#) for the higher civil foreign bank account report penalties.

Nanavati said that another potentially interesting alternative would be to designate specific financial institutions as suspect countries. "That would make just as much analytical sense as including those banks that are in leaks or those banks that are under investigation," he said. However, with Bank Leumi and HSBC India already on the higher penalty list, switching to a country approach could lead to a surprising designation of some countries or an omission of some banks, he said.

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