

March 2013

OFFSHORE TAX EVASION

IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion



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Why GAO Did This Study

Tax evasion by individuals with unreported offshore financial accounts was estimated by one IRS commissioner to be several tens of billions of dollars, but no precise figure exists. IRS has operated four offshore programs since 2003 that offered incentives for taxpayers to disclose their offshore accounts and pay delinquent taxes, interest, and penalties. GAO was asked to review IRS's second offshore program, the 2009 OVDP. This report (1) describes the nature of the noncompliance of 2009 OVDP participants, (2) determines the extent IRS used the 2009 OVDP to prevent noncompliance, and (3) assesses IRS's efforts to detect taxpayers trying to circumvent taxes, interests, and penalties that would otherwise be owed. To address these objectives, GAO analyzed tax return data for all 2009 OVDP participants and exam files for a random sample of cases with penalties over \$1 million; interviewed IRS Offshore officials; and developed and implemented a methodology to detect taxpayers circumventing monies owed.

What GAO Recommends

Among other things, GAO recommends that IRS (1) use offshore data to identify and educate taxpayers who might not be aware of their reporting requirements; (2) explore options for employing a methodology to more effectively detect and pursue quiet disclosures and implement the best option; and (3) analyze first-time offshore account reporting trends to identify possible attempts to circumvent monies owed and take action to help ensure compliance. IRS agreed with all of GAO's recommendations.

View [GAO-13-318](#). For more information, contact James R. White, (202) 512-9110 or whitej@gao.gov.

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What GAO Found

As of December 2012, the Internal Revenue Service's (IRS) four offshore programs have resulted in more than 39,000 disclosures by taxpayers and over \$5.5 billion in revenues. The offshore programs attract taxpayers by offering a reduced risk of criminal prosecution and lower penalties than if the unreported income was discovered by one of IRS's other enforcement programs. For the 2009 Offshore Voluntary Disclosure Program (OVDP), nearly all program participants received the standard offshore penalty—20 percent of the highest aggregate value of the accounts—meaning the account value was greater than \$75,000 and taxpayers used the accounts (e.g., made deposits or withdrawals) during the period under review. The median account balance of the more than 10,000 cases closed so far from the 2009 OVDP was \$570,000. Participant cases with offshore penalties greater than \$1 million represented about 6 percent of all 2009 OVDP cases, but accounted for almost half of all offshore penalties. Taxpayers from these cases disclosed a variety of reasons for having offshore accounts, and more than half of them had accounts at Swiss bank UBS.

Using 2009 OVDP data, IRS identified bank names and account locations that helped it pursue additional noncompliance. Based on a review of cases, GAO found examples of immigrants who stated in their 2009 OVDP applications that they were unaware of their offshore reporting requirements. IRS officials from the Offshore Compliance Initiative office said they have not targeted outreach efforts to new immigrants. Using information from the 2009 OVDP, such as the characteristics of taxpayers who were not aware of their reporting requirements, to increase education and outreach to those populations could promote voluntary compliance.

IRS has detected some taxpayers with previously undisclosed offshore accounts attempting to circumvent paying the taxes, interest, and penalties that would otherwise be owed, but based on GAO reviews of IRS data, IRS may be missing attempts by other taxpayers attempting to do so. GAO analyzed amended returns filed for tax year 2003 through tax year 2008, matched them to other information available to IRS about taxpayers' possible offshore activities, and found many more potential quiet disclosures than IRS detected. Moreover, IRS has not researched whether sharp increases in taxpayers reporting offshore accounts for the first time is due to efforts to circumvent monies owed, thereby missing opportunities to help ensure compliance. From tax year 2007 through tax year 2010, IRS estimates that the number of taxpayers reporting foreign accounts nearly doubled to 516,000. Taxpayer attempts to circumvent taxes, interest, and penalties by not participating in an offshore program, but instead simply amending past returns or reporting on current returns previously unreported offshore accounts, result in lost revenues and undermine the programs' effectiveness.

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Abbreviations

AGI	Adjusted Gross Income
CDW	Compliance Data Warehouse
CI	Criminal Investigation
CIMIS	Criminal Investigation Management Information System
DOJ	Department of Justice
EIN	Employer Identification Number
ERIS	Enforcement Revenue Information System
FATCA	Foreign Account Tax Compliance Act
FBAR	Report of Foreign Bank and Financial Accounts
FinCEN	Financial Crimes Enforcement Network
IRS	Internal Revenue Service
NAICS	North American Industry Classification System
OVDP	Offshore Voluntary Disclosure Program
PAIR	Planning, Analysis, Inventory and Research
PFIC	Passive Foreign Investment Company
SOI	Statistics of Income

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Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

March 27, 2013

The Honorable Max Baucus
Chairman
The Honorable Orrin G. Hatch
Ranking Member
Committee on Finance
United States Senate

The Honorable Dave Camp
Chairman
Committee on Ways and Means
House of Representatives

By law, U.S. citizens are required to report worldwide income from all sources, including income from offshore accounts.¹ While taxpayers can hold offshore accounts for a number of legitimate reasons, some use them to illegally reduce their tax liabilities, often by not reporting the income earned on these accounts. There is no precise estimate of how much money the U.S. Treasury loses due to unreported income from offshore accounts. Former Internal Revenue Service (IRS) Commissioner Charles O. Rossotti said at a congressional hearing in 2002 that he believed offshore noncompliance to be several tens of billions of dollars, but did not have a precise number.² IRS has been limited in its ability to uncover and pursue taxpayers with unreported offshore accounts by traditional means, in part because the reporting requirements that apply to domestic financial institutions do not generally apply to foreign institutions.³

Since 2003, IRS has carried out four offshore voluntary disclosure programs, collectively referred to in this report as “offshore programs,”

¹For purposes of this report, offshore refers to any foreign jurisdiction outside of the United States.

²U.S. Senate Committee on Finance, “Schemes, Scams and Cons: The IRS Strikes Back,” hearing on April 11, 2002.

³U.S. financial institutions are required to report account earnings to IRS. For years, IRS has compared this information to the information taxpayers report on their tax returns to ensure accuracy.

that offer incentives for taxpayers to disclose their offshore accounts and pay delinquent taxes, interest, and penalties.⁴ Generally, the programs offered somewhat reduced penalties and no risk of criminal prosecution if eligible taxpayers fully disclosed their previously unreported offshore accounts and paid taxes due plus interest. As of December 2012, these offshore programs have resulted in more than 39,000 disclosures and over \$5.5 billion in revenues.

Some taxpayers with unreported foreign accounts may have chosen not to participate in one of IRS's offshore programs, and attempted to circumvent some taxes, interest, and penalties owed. One technique, which IRS calls a "quiet disclosure," is to file amended tax returns that report offshore income from prior years. Another technique is for taxpayers to declare existing offshore accounts for the first time with their current year's tax return, but not amend prior year returns. If successful, these techniques result in lost revenue for the Treasury, and undermine the offshore programs' fairness and effectiveness.

You asked us to review IRS's 2009 Offshore Voluntary Disclosure Program (OVDP)—IRS's second offshore program and the most recent program with enough closed cases for analysis. In this report we (1) describe the nature of the noncompliance of taxpayers participating in the 2009 OVDP, (2) determine the extent to which IRS used data from the 2009 OVDP in order to better prevent and detect future noncompliance, and (3) assess IRS's efforts to identify taxpayers who may have attempted quiet disclosures or other ways of circumventing some of the taxes, interest, and penalties that would otherwise be owed.

To describe the characteristics of the population of taxpayers participating in the 2009 OVDP, we analyzed six years of tax return data from all participants. To get additional information about taxpayers with large offshore accounts, we analyzed IRS's case files from a random sample of closed 2009 OVDP cases with penalties of \$1 million or greater. To determine the extent to which IRS used data from the 2009 OVDP to better prevent and detect future noncompliance, we reviewed changes that IRS made to subsequent offshore programs. We also interviewed IRS officials from the Offshore Compliance Initiative office about actions

⁴The first three programs occurred in 2003, 2009, and 2011. The fourth program, which started in 2012, remains open.

taken to identify and target additional offshore noncompliance. To assess IRS's efforts to detect quiet disclosures, we used IRS tax return data from the tax years covered by the 2009 OVDP, tax year 2003 through tax year 2008, to identify potential quiet disclosures and compared our results with those from IRS. We also used tax return data from tax year 2003 through tax year 2010 from IRS and Report of Foreign Bank and Financial Accounts (FBAR) data from the Financial Crimes Enforcement Network (FinCEN) to assess other ways taxpayers may be circumventing some of the taxes, interest, and penalties owed.⁵ For the purposes of this review, we determined that the data used in our analyses were reliable. Our data reliability assessment included reviewing relevant documentation, conducting interviews with IRS officials knowledgeable about the data, and conducting electronic testing of the data to identify obvious errors or outliers. See appendix I for more information on our scope and methodology.

We conducted this performance audit from June 2011 to March 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Reporting Requirements for Offshore Accounts

U.S. taxpayers can hold offshore accounts for a number of non-tax reasons, including access to funds while living or working overseas, asset protection, investment portfolio diversification, enhanced investment opportunities, and to facilitate international business transactions. U.S.

⁵FinCEN is a bureau of the U.S. Department of the Treasury. FinCEN's mission is to enhance the integrity of the financial systems by facilitating the detection and deterrence of financial crime. FinCEN carries out its mission by receiving and maintaining financial transactions data; analyzing and disseminating that data for law enforcement purposes and building global cooperation with counterpart organizations in other countries and with international bodies. The Bank Secrecy Act requires that U.S. taxpayers file FBARs if they have a financial interest in or signature authority over offshore accounts with an aggregate value exceeding \$10,000, a threshold set by the Secretary of the Treasury. 31 U.S.C. § 5314; 31 C.F.R. § 1010.350.

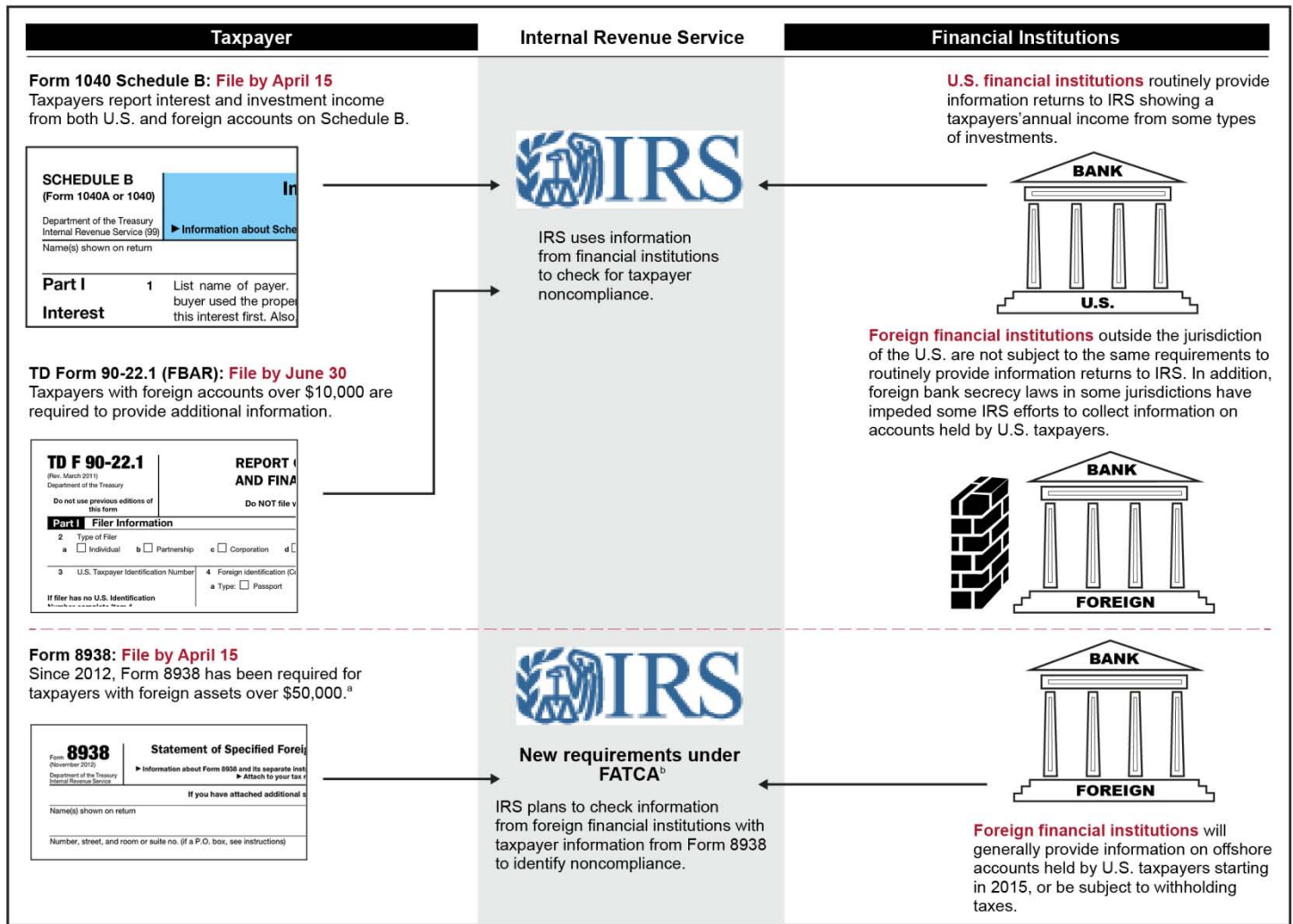
taxpayers must report whether they have offshore accounts on Schedule B of IRS Form 1040 and pay taxes on income from the offshore accounts at their individual tax rates. Some taxpayers with large offshore account balances are also required to report additional account information, such as the name and location of their bank, by filing a form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR). Failure to report the existence of offshore accounts or pay taxes on these accounts can lead to civil and criminal penalties.

U.S. financial institutions are required to submit to IRS information returns that report income earned by account holders.⁶ IRS uses the information to check whether taxpayers are reporting investment earnings and other income correctly. Unlike the reporting requirements for U.S. financial institutions, there has been no reporting regime for foreign financial institutions, and this lack of information has limited IRS's ability to ensure taxpayers were reporting offshore income accurately (see fig. 1). IRS has begun implementing provisions of the Foreign Account Tax Compliance Act (FATCA), which requires, beginning in 2015, U.S. financial institutions to withhold a portion of certain payments made to foreign financial institutions that have not entered into a specific agreement with IRS to report information on their U.S. clients.⁷ It is expected that IRS will use this information to identify noncompliant taxpayers. While IRS officials do not anticipate that FATCA will replace the offshore programs, they do believe that future programs may shift in focus to identifying promoters of offshore tax schemes that are not associated with the financial institutions that will be subject to FATCA reporting requirements.

⁶26 U.S.C. § 6049. An information return is a return filed with the IRS by a person or other entity to report some economic information other than the tax liability of the filing person or entity.

⁷Subtitle A of title V of the Hiring Incentives to Restore Employment Act is commonly referred to as FATCA. Pub. L. No. 111-147, 124 Stat. 71, 97-117 (2010). We issued a report on IRS's implementation of FATCA in April 2012. See GAO, *Foreign Account Reporting Requirements: IRS Needs to Further Develop Risk, Compliance, and Cost Plans*, [GAO-12-484](#) (Washington, D.C.: April 16, 2012).

Figure 1: Illustration of Taxpayer and Information Reporting on Offshore Accounts



Source: GAO analysis of foreign account filing requirements.

^aDifferent thresholds apply based on whether a filer files a joint income tax return or resides outside the United States, and whether asset values exceed a certain threshold at any point during the year. If the end of year aggregate value filing threshold is not met, a higher threshold applies during the year. 26 U.S.C. § 6038D; 26 C.F.R. § 1.6038D-0T to 1.6038D-8T.

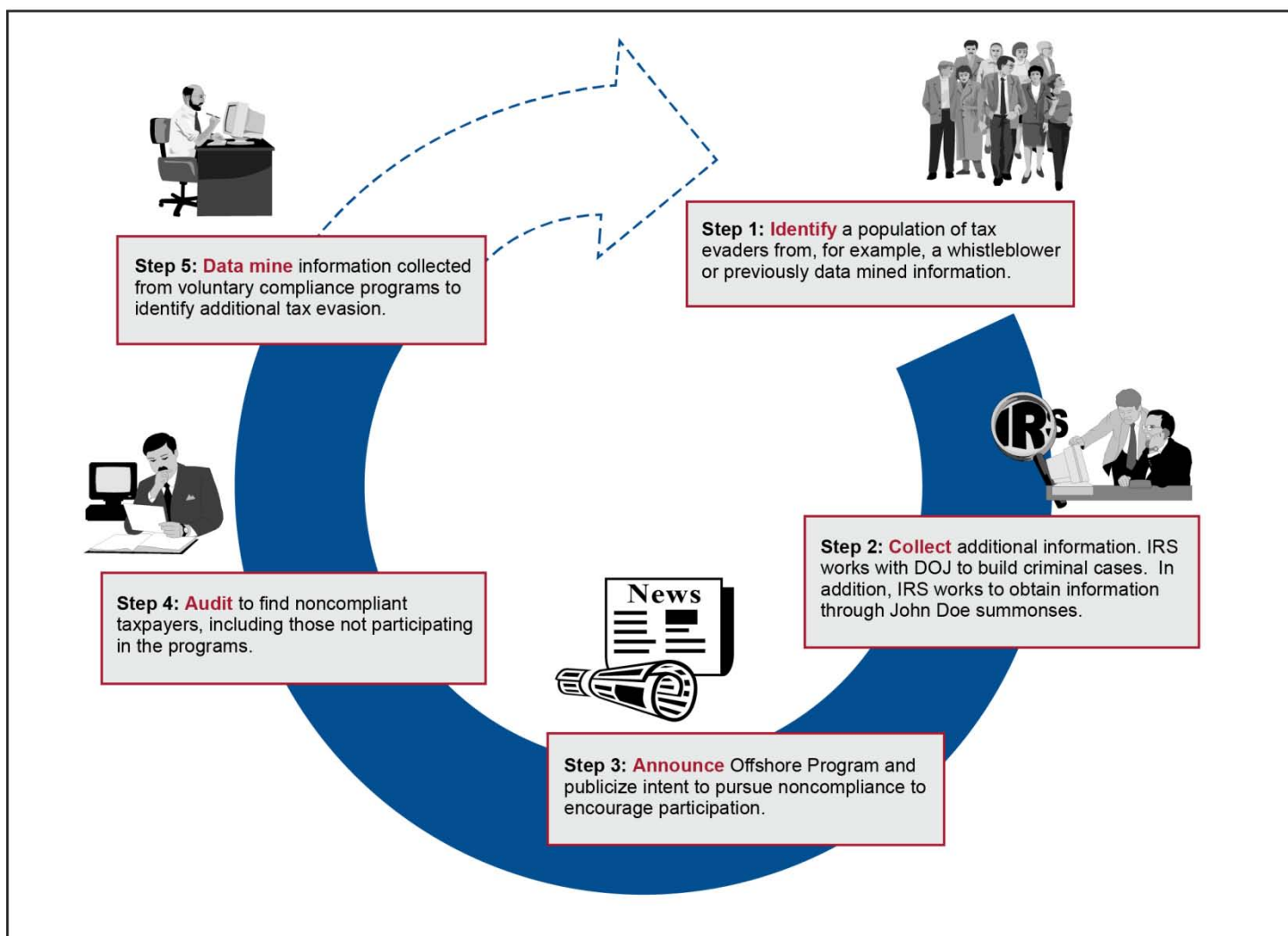
^bFATCA stands for the Foreign Account Tax Compliance Act.

Key Features of IRS's Offshore Programs

IRS's offshore programs were designed to encourage taxpayers with undisclosed income from offshore accounts to become current with their tax liabilities. Although the offshore programs differed in details, all four followed a cycle similar to the one illustrated in figure 2. The offshore programs fit into IRS's larger compliance efforts, which are intended to

both detect noncompliance and to encourage voluntary compliance, in part by minimizing the burden for taxpayers to understand their tax obligations and file tax returns every year.

Figure 2: IRS Process for Developing Offshore Disclosure Programs



Source: GAO analysis of IRS information on offshore filing requirements and process information provided by IRS's Offshore Compliance Initiative office; and Art Explosion clip art.

Step 1: Identifying a Population of Taxpayers with Suspected Offshore Account Noncompliance

While open and intended to attract all noncompliant taxpayers with offshore accounts, the four offshore programs to date all started with IRS identifying a particular group of taxpayers suspected of having unreported offshore accounts. The group might be account holders at a particular

bank or in a particular country. Sometimes IRS obtains such information from whistleblowers.⁸ In 2007, a whistleblower provided details to the U.S. government about how his employer, Swiss bank UBS, was actively assisting and facilitating U.S. taxpayers' concealment of taxable income.⁹ (See app. II for more information on the UBS whistleblower.) IRS may also use information gathered through prior offshore programs to identify other banks or countries where U.S. taxpayers may be hiding offshore income.

Step 2: Identifying Some Specific Individuals from the Step 1 Population

The next step is to learn the identities of some of the taxpayers suspected of noncompliance. One technique is to use John Doe summonses.¹⁰ In 2008, prior to the announcement of the 2009 OVDP, a federal court granted IRS permission to serve a John Doe summons to UBS for information on its U.S. customers. As a result of the summons, and subsequent government negotiation and agreement, UBS turned over information on approximately 4,450 accounts held in Switzerland by U.S. persons. This was a partial list of all U.S. UBS account holders with accounts in Switzerland. In other cases, IRS has been able to get client lists from promoters of offshore tax evasion schemes.

Step 3: Publicizing Steps 1 and 2 and Offering an Offshore Disclosure Program

In order to encourage program participation, IRS publicizes the fact that it knows, or soon will know, the names of some offshore account holders. IRS also publicizes the terms of its offshore programs, which offer incentives to taxpayers who voluntarily disclose their accounts before IRS learns about them. As described later, the offshore programs offer a reduced risk of criminal prosecution, and lower penalties than taxpayers could receive if unreported offshore accounts were discovered in an audit. In this report we refer to the reduced penalty offered as part of an

⁸The Internal Revenue Code provides whistleblowers with a significant financial incentive to report noncompliance. It provides for awards up to 30 percent of the collected proceeds that arise from the whistleblower's information. 26 U.S.C. § 7623.

⁹Although not publicly confirmed by IRS, attorneys for the UBS whistleblower reported that he was awarded \$104 million.

¹⁰A John Doe summons is a court ordered summons that allows IRS to seek information about all taxpayers in a certain group, such as those with accounts at a certain financial institution, without knowing individual identities beforehand. The law authorizing a John Doe summons requires IRS to establish in a federal court proceeding that the summons relates to the investigation of a particular person or ascertainable group or class of persons; there is a reasonable basis to believe that the targeted person or group may fail or may have failed to comply with tax laws; and that the information is not readily available from other sources. 26 U.S.C. § 7609(f).

offshore program as the “offshore penalty.” In the 2009 OVDP the offshore penalty was typically 20 percent of the highest aggregate value of the unreported offshore accounts between 2003 and 2008.

Step 4: Review Case Files of Offshore Program Participants and Audit Nonparticipants

Provided that they meet certain criteria, taxpayers are accepted into one of IRS’s offshore programs by responding to IRS questions about the nature of their offshore noncompliance in an application letter and filing amended or late tax returns and FBARs.¹¹ (See app. III for sample application letters.) Investigators from IRS’s Criminal Investigation division generally review applications to verify that taxpayers are not already under investigation, that the offshore income was from legal sources, and that the taxpayer has made a complete and truthful disclosure. Taxpayers’ amended or late returns that are submitted as part of an offshore program are reviewed and certified by IRS examiners who calculate the delinquent taxes, interest, and penalties, and who may request additional documents and information from taxpayers.

Taxpayers who did not participate in an offshore program but are known to IRS (perhaps because they were on the list of names IRS identified in Step 2) run the risk of being audited outside of an offshore program. These taxpayers could be subject to substantially greater penalties and increased risk of criminal prosecution. Since 2009, IRS and the Department of Justice (DOJ) have publicized more than 40 prosecutions of UBS clients and UBS bankers.

Step 5: Data Mining Information Collected in Step 4

Through data mining, or analyzing, information from offshore program application letters, and reviewing the case files of program participants and auditing nonparticipants, IRS is able to identify new groups of taxpayers suspected of hiding income offshore. IRS can then choose to continue offering offshore programs and encourage these newly identified groups of taxpayers, as well as all taxpayers with unreported offshore accounts, to disclose their accounts voluntarily, repeating the cycle illustrated in figure 2. For example, taxpayers that participated in the 2009 OVDP named other Swiss banks and financial advisors who had assisted them with hiding offshore income. As a result, IRS and DOJ took actions to compel other Swiss banks to name their U.S. customers. To date, some Swiss banks have announced that they are cooperating with U.S.

¹¹In the 2009 OVDP, the application letter was optional, and taxpayers could provide alternate documentation containing similar information; the letter was required for subsequent programs.

government investigations. One Swiss bank ceased operating after it pleaded guilty to helping U.S. taxpayers hide income offshore and agreed to pay approximately \$74 million in fines, restitution, and civil forfeiture. IRS and DOJ are also pursuing other banks in Liechtenstein, Israel, and India, which had been named by 2009 OVDP participants.

Terms of IRS's Offshore Programs

Each of IRS's four offshore programs had a slightly different structure, including a higher standard offshore penalty rate for each subsequent program, as shown in table 1. In the 2009 OVDP, the standard offshore penalty was 20 percent. The offshore programs offer participating taxpayers a lower penalty than they could have been subject to if IRS had discovered their offshore account outside of the program. According to IRS, the offshore penalty is in lieu of all other liabilities for tax, interest, and penalties that IRS would not pursue. Taxpayers that do not participate in an offshore program could potentially face penalties that total more than 100 percent of the value of their unreported offshore accounts. These penalties could include FBAR, accuracy-related and/or delinquency, fraud, and foreign information return penalties.¹²

Most of the offshore programs also offered taxpayers mitigated penalties at lower rates, generally for taxpayers with small accounts or accounts that were not accessed, also shown in table 1.

Many offshore accounts were presumably open for decades, something that we confirmed in our review of 2009 OVDP cases, but practical reasons prevented IRS from auditing and collecting unpaid taxes from all of those years. The standard 2009 OVDP 20 percent offshore penalty was calculated based not on additional taxes assessed, but on the highest aggregate value of the offshore accounts. As a result, the penalty has been described by tax practitioners as "rough justice," in part because the amount in an account might include decades of tax-free buildup. (See app. IV for hypothetical examples illustrating tax-free build up and penalties for accounts of different ages.)

¹²A taxpayer who willfully fails to properly file an FBAR may be subject to a penalty equal to the greater of \$100,000 or 50 percent of the balance in the account at the time of the violation, for each year of violation. Willful violations may also be subject to criminal penalties. For a full list of potential penalties for taxpayers with unreported offshore accounts or activities who do not participate in an offshore program see Internal Revenue Service, "Voluntary Disclosure: Questions and Answers," accessed March 13, 2013, <http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers>, Q15.

Under the 2003, 2009, and 2011 programs, taxpayers had a specified period of time to join a program. The 2012 program is, at present, open ended. In each program, delinquent taxes and interest were assessed and collected for a limited number of prior years, which varied from four to eight tax years. Taxpayers were typically assessed accuracy-related and/or delinquency penalties for the delinquent taxes assessed in an offshore program, in addition to the offshore penalty described earlier.

Table 1: Comparison of IRS's Offshore Voluntary Disclosure Programs

	2003 Offshore Voluntary Compliance Initiative	2009 Offshore Voluntary Disclosure Program	2011 Offshore Voluntary Disclosure Initiative	2012 Offshore Voluntary Disclosure Program
Factors that influenced participation	Promoters identified and John Doe summons for information on taxpayers who used bank cards to access hidden offshore income	John Doe summons for UBS accounts in Switzerland	IRS actions against many foreign banks, including HSBC, which provided IRS information on accounts in India	FATCA and increased actions against a number of foreign financial institutions
Application period	January 14, 2003, to April 15, 2003	March 23, 2009, to October 15, 2009 ^a	February 8, 2011, to September 9, 2011	January 9, 2012, to present ^b
Tax years for which delinquent taxes were collected	4 years (1999 to 2002)	6 years (2003 to 2008)	8 years (2003 to 2010)	8 years ^c
Standard offshore penalty rate ^d	No offshore penalty	20%	25%	27.5%
Mitigated offshore penalty rate	No offshore penalty	5% for passive account holders. ^e Beginning in February 2011, 2009 OVDP participants could receive 2011 OVDI mitigated penalties, which they were allowed to apply for retroactively.	12.5% for accounts valued less than \$75,000. 5% for passive account holders. ^e	12.5% for accounts valued less than \$75,000. 5% for passive account holders. ^e
Other penalties	Accuracy-related penalty (up to 20% of unpaid taxes) and/or Delinquency penalty (up to 25% of unpaid taxes)			
IRS reported number of disclosures	1,321	15,000	18,000	Approximately 5,000 to date
Total collected (unpaid taxes, penalties and/or fees) as reported by IRS	\$200 million	\$4.1 billion (as of December 31, 2012)	\$1.4 billion (as of December 31, 2012)	Not available

Source: GAO analysis of IRS offshore voluntary disclosure program information.

^aThe IRS granted a one-time extension of the original September 23, 2009, deadline for certain voluntary disclosures. Those taxpayers had until October 15, 2009.

^bThe 2012 OVDP has no set deadline for taxpayers to apply. Additionally, IRS stated that the terms of the program could change at any time. For example, IRS could increase penalties associated with the

program for all or some taxpayers or a defined class of taxpayers, or decide to end the program at any point.

^cTax years covered are determined by the last closed tax year when the taxpayers apply to the program, plus the seven previous tax years.

^dThe offshore penalty rate is applied to the highest aggregate account balance during the calendar years that correspond to the tax years covered by the program.

^eA 5 percent penalty rate was generally allowed if taxpayers did not open or cause the account to be opened, had no account use, and had paid all applicable U.S. taxes on funds deposited to the accounts, with only account earnings having escaped U.S. taxation. In later program years, minimal account activity was allowed, for example, to update address information, or to withdraw a minimal amount of funds, defined as less than \$1,000 in any program year for which the taxpayers was noncompliant. This limit did not include transfers back to the United States upon closing an offshore account.

Attempts to Circumvent Some of the Taxes, Interest, and Penalties that Otherwise Would Be Owed in Offshore Programs

Despite the significant risks of not coming forward through one of IRS's offshore programs, some taxpayers decide to do nothing and remain noncompliant. Other taxpayers have attempted to disclose their offshore accounts without paying all the delinquent taxes, interest, and penalties required by the programs. In a quiet disclosure, taxpayers file amended tax returns for all or some of the tax years covered by an offshore program, and report the income from the previously unreported accounts. The taxpayers would generally pay interest and either accuracy-related or delinquency penalties on the newly reported income, but would avoid the higher offshore penalty.¹³ At the same time, taxpayers attempting quiet disclosures would file late FBARs, if they had not previously filed FBARs, or amended FBARs, if they had, to disclose the offshore accounts that they had not previously reported. Taxpayers might also try to circumvent some of the taxes, interest, and penalties that would otherwise be owed in offshore programs by reporting the existence of any offshore accounts and any income from the accounts on their current year's tax return, without amending prior years' returns. These taxpayers would also likely disclose the existence of the accounts by filing FBARs for the current calendar year. This filing would appear similar to the opening of a new account. Such a taxpayer would avoid paying any delinquent taxes, interest, or penalties, unless audited. As described earlier, taxpayers who are caught disclosing offshore accounts outside of one of IRS's offshore programs risk steeper penalties and criminal prosecution, based on the facts and circumstances of their cases.

¹³The offshore penalty is not a penalty established by statute that taxpayers with undisclosed foreign accounts are required to pay by law. It is an amount voluntary participants in the offshore programs agree to pay in exchange for the benefits associated with participation in those programs, and its collection is authorized by the IRS's settlement authority conferred in IRC sections 7121 and 7122.

**Almost All 2009 OVDP
Participants Received
the Maximum
Offshore Penalty,
Almost Half Had
Accounts in
Switzerland, and
About Half of the
Revenue Collected
Came from a Small
Percentage of High
Penalty Cases**

**Summary of All 2009
OVDP Closed Cases**

Participants in IRS's 2009 OVDP had offshore accounts that varied considerably in size. Of the 10,439 closed 2009 OVDP cases, we estimate based on penalty data that the bottom 10 percent of the participants had account balances of less than \$79,000 and the top 10 percent had balances over \$4 million, as shown in table 2.¹⁴ The amount of offshore penalties also varied widely, which reflected the range of account balances. Some taxpayers were assessed an offshore penalty of a few thousand dollars while others were assessed several million dollars. The average offshore penalty assessed was about \$376,000 while the median was approximately \$108,000.

¹⁴We identified 19,337 total participants in IRS's 2009 OVDP. Those participants had 10,439 closed cases, as of November 29, 2012, that we could analyze. The 19,337 participants we identified as participating in IRS's 2009 OVDP differs from the number released publicly by IRS, which has been 15,000. The number released publicly by IRS reflects the total applicants accepted into OVDP by CI, while our figure represents the total number of taxpayers reviewed within the 2009 OVDP civil penalty structure, meaning that we added some spouses and other taxpayers that were assessed offshore penalties. See appendix I for more information on our methodology. Of the 19,337 participants that we identified, 200 (or 1 percent) were businesses. See appendix V for characteristics of these businesses.

Table 2: Selected Penalty Information for 2009 OVDP Individual Taxpayers with Closed Cases as of November 29, 2012

	Mean	10th percentile	25th percentile	Median	75th percentile	90th percentile
Offshore account(s) balance ^a	\$1,923,310	\$78,315	\$190,365	\$568,735	\$1,595,805	\$4,054,505
2009 OVDP penalty	375,879	13,320	35,670	107,949	310,476	793,166
Additional tax owed, tax years 2003-2008	97,681	103	1,661	12,748	60,449	190,399
Interest, tax years 2003-2008	29,645	52	482	3,486	17,398	57,129
Other penalties ^b	24,014	84	605	3,457	14,290	45,163
Total penalties, interest and taxes	\$433,840	\$2,318	\$22,120	\$95,982	\$330,185	\$923,300

Source: GAO analysis of IRS's Enforcement Revenue Information System (ERIS) and Individual Returns Transaction File.

Note: Totals may not equal sum of components due to variation in the component populations.

^a2009 OVDP offshore account balance is an estimated number based on penalty amounts. It represents the highest aggregate balance of all offshore accounts between 2003 and 2008.

^bOther penalties primarily included accuracy-related penalties and delinquency penalties.

Of the 10,439 closed cases, most were assessed offshore penalties and 96 percent of those assessed penalties received the standard offshore penalty—20 percent of the highest aggregate value of the offshore accounts, which was also the maximum offshore penalty rate in the 2009 OVDP. The 20 percent penalty was generally levied when the total account value was greater than \$75,000 and when taxpayers used the accounts (e.g., made deposits or withdrawals) during the period under review (2003 to 2008). See table 3.

Table 3: Type and Amount of Offshore Penalties for 2009 OVDP Closed Cases (Individual Taxpayers) as of November 29, 2012

	Percent of closed cases with penalties	Total penalty dollars	Median penalty amount
20 percent penalty	96	\$2.786 billion	\$116,393
12.5 percent penalty	less than 1	0.002 billion	5,831
5 percent penalty	4	0.021 billion	18,478
All penalty rates		\$2.810 billion	\$107,949

Source: GAO analysis of IRS's ERIS.

Note: Total for penalty dollars may not equal sum of components due to rounding.

5 Percent Mitigated Penalty Case

A taxpayer and his wife inherited offshore accounts from the wife's parents who were not U.S. citizens or residents. The inherited funds in the accounts were from the parents' foreign savings and not from U.S. sources. The taxpayers did not make any deposits or withdrawals from the accounts after inheriting them. The taxpayers paid foreign taxes to the country where the accounts were located, but did not pay U.S. taxes on the income for some of the years covered by the offshore program. The taxpayers did not file a FBAR and claimed they did not know about the FBAR filing requirement.

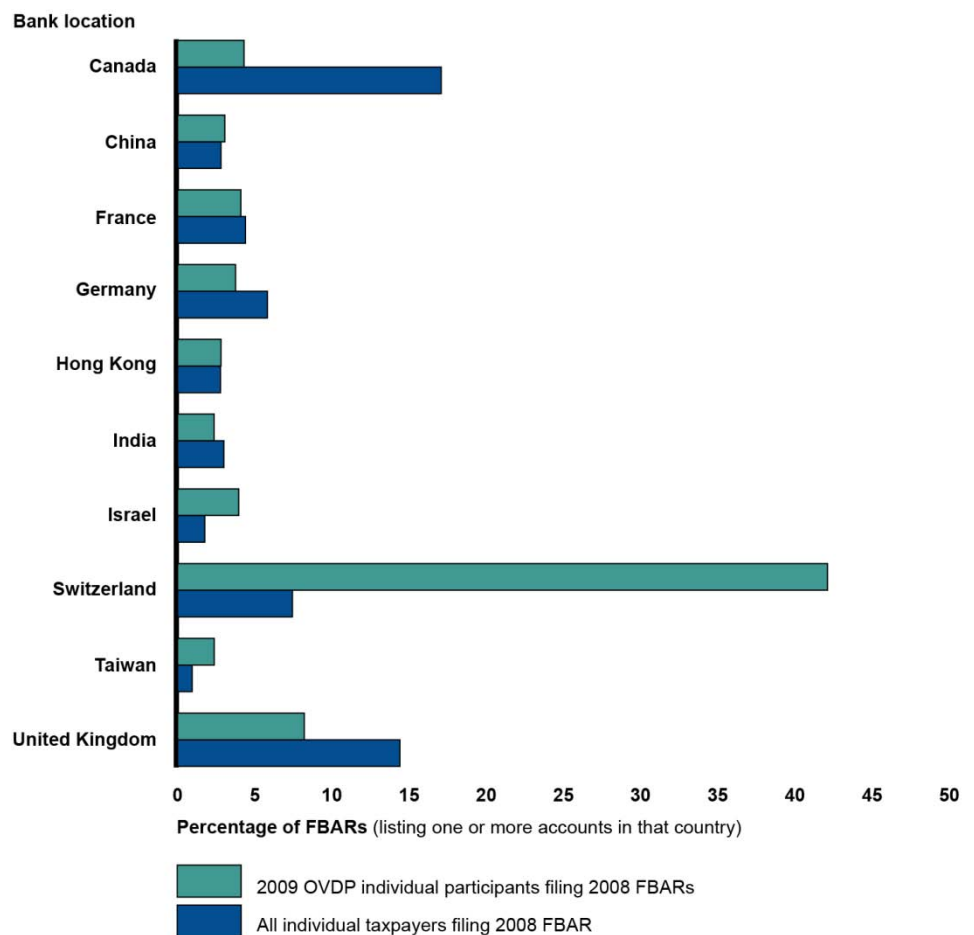
12.5 Percent Mitigated Penalty Case

A U.S. citizen, married to a non-U.S. citizen, and living overseas for an extended period of time, maintained accounts in the taxpayer's country of residence for local banking needs. In aggregate, the accounts were less than \$75,000. The taxpayer had not filed U.S. tax returns for a number of the tax years covered by the offshore program. By participating in the 2009 OVDP, the taxpayer paid delinquent taxes, interest, and delinquency penalties, in addition to the mitigated offshore penalty.

Fewer than 5 percent of 2009 OVDP participants received one of the mitigated offshore penalties, 12.5 percent or 5 percent, also shown in table 3. (See sidebars for representative examples of mitigated penalty cases.)

Consistent with IRS's enforcement efforts and the design of the 2009 OVDP, we found that the population of participants was more likely to report offshore accounts in Switzerland than the average foreign account holder who filed an FBAR (see fig. 3). Taxpayers with closed cases also had higher incomes than the average taxpayer, were older, and were more likely to use the married filing jointly status. (See app. VI.)

Figure 3: Top Ten Locations of Offshore Accounts on 2008 FBARs Filed by 2009 OVDP Participants Compared to All 2008 Individual FBAR Filers



Source: GAO analysis of FinCEN data.

Note: OVDP stands for Offshore Voluntary Disclosure Program and FBAR stands for Report of Foreign Bank and Financial Accounts.

Results from Sample of Large Penalty Cases

About half of the revenues collected through the 2009 OVDP, as of March 30, 2012, came from 378 cases where taxpayers received offshore penalties of \$1 million or greater, meaning they had account balances of \$5 million or greater. This group, which we refer to as “large penalty cases”, accounted for about 6 percent of the closed 2009 OVDP cases, but the penalties they received amounted to 49 percent of the total \$1.9 billion in offshore penalties that had been assessed by IRS at that time.¹⁵ Given this group’s high share of penalties assessed, we selected a random sample of 30 of them for further examination and to obtain a better understanding taxpayers’ noncompliance.

More than Half of Taxpayers Receiving Large Penalties Had Accounts at Swiss Bank UBS and Some First Transferred Funds from UBS to Other Swiss Banks before Entering the 2009 OVDP

For large penalty cases, we estimate that more than 50 percent of taxpayers had one or more bank accounts with Swiss bank UBS.¹⁶ (See app. VII for detailed information on the location of these taxpayer’s offshore accounts, including country and bank names.) Some of these taxpayers with UBS accounts transferred funds from Swiss bank UBS in 2008—the time when the U.S. government was actively trying to compel UBS to name its U.S. account holders. The funds were often transferred to other, smaller Swiss banks that generally did not operate in the United States. A few taxpayers claimed that they transferred funds at the recommendation of their UBS financial advisors. Taxpayers transferring funds to other banks may have been attempting to keep their offshore accounts hidden before deciding to participate in the 2009 OVDP.

¹⁵Throughout the rest of our report, we use an updated November 29, 2012, figure. As of that date, 56 percent of the total \$2.8 billion in offshore penalties assessed were from cases with penalties of \$1 million or greater.

¹⁶The 95 percent confidence interval for the estimated 70 percent of taxpayers receiving large penalties with accounts at Swiss bank UBS is 51 percent to 85 percent. See appendix I for more information on our scope and methodology and appendix VII for more counts by case file.

Taxpayers Receiving Large Penalties Disclosed a Variety of Reasons for Having Offshore Accounts

Moving U.S. Funds Offshore

A taxpayer and his wife first opened financial accounts in a Caribbean country in the early 1990s to protect their assets from potential professional services claims (malpractice) in the United States. They reported that Swiss bankers met them in the United States and helped them open these accounts. Several years later, the same bankers met them again in the United States and recommended they close the Caribbean accounts and transfer the funds to Switzerland. In 2008, the bankers recommended that the taxpayers close their accounts at one Swiss bank and transfer the funds to other Swiss banks, which they did before ultimately applying to the 2009 OVDP.

Use of Sham Foreign Entities

A taxpayer and her siblings inherited offshore accounts in Switzerland from their father. The family's Swiss bank accounts were first opened by another family member decades ago before the family immigrated to the United States. Over time, the family continued to make contributions to the accounts from family businesses in the United States and overseas. To transfer money from Switzerland to the United States, the family used a series of foreign accounts and sham foreign entities to disguise the flow of funds. The transfer route for the family's funds typically went from banks in Switzerland through banks in other countries associated with the various foreign entities, before eventually being deposited in the United States and split among the taxpayer and other family members.

Political/War Refugees

A taxpayer and her late husband immigrated to the United States in the 1980s. Prior to a revolution in their native country, the taxpayers opened bank accounts in Europe to safeguard the family's business assets from potential seizure. The taxpayer applied to the 2009 OVDP after her husband's death.

Many taxpayers in the 30 large penalty cases that we reviewed had resided outside the United States for extended periods of time—either as U.S. citizens or prior to obtaining U.S. citizenship.¹⁷ Many taxpayers who disclosed extended periods of non-U.S. residency reported that they had opened their offshore accounts with income earned outside of the United States. A few of these taxpayers had been living and working overseas as U.S. citizens for decades. Others within this group opened accounts before immigrating to the United States. Although some taxpayers in these cases became U.S. residents decades ago, they maintained their offshore accounts and did not disclose them on tax returns or FBARs. Some taxpayers reported opening bank accounts in Switzerland as a means of protecting family assets during periods of war or instability in their native country. Further, a few taxpayers who immigrated to the United States reported that they had been unaware of their FBAR reporting requirements, that they had to state that they had foreign accounts on the Form 1040, Schedule B, or that the United States taxes the worldwide income of its residents, including overseas investment income. (See sidebars for representative examples from our case file reviews.)

Taxpayers in some of the cases that we reviewed disclosed that the original source of funds for their offshore accounts came from post-tax U.S. source income. A few of these taxpayers cited family histories or personal fears about the safety of U.S. banks as their reasons for moving savings offshore. Others reasons cited included the need to protect or shelter assets from possible U.S. lawsuits.

We estimate that 47 percent of taxpayers receiving large penalties inherited offshore accounts from a parent, spouse, or other relative—some of whom were not U.S. citizens or residents.¹⁸ In many instances, taxpayers reported inherited accounts that were jointly owned or managed by extended family members, such as siblings and cousins, who also applied to the 2009 OVDP and sometimes split the penalties. Regardless of how taxpayers in the large penalty cases came to own offshore accounts, many maintained but did not disclose offshore account

¹⁷Under the U.S. worldwide tax system, U.S. citizens and residents generally must report income, wherever it is earned, including income from foreign bank accounts, to the IRS.

¹⁸The 95 percent confidence interval for the estimated 47 percent of taxpayers receiving large penalties who inherited offshore accounts is 29 percent to 65 percent.

Long-term Expatriates

A taxpayer and his wife (both U.S. citizens) had been living and working in a foreign country since the 1980s. When applying to the 2009 OVDP, they reported several foreign financial accounts valued at over a million dollars; some were opened for their personal local banking needs, while others were related to the couple's businesses. The taxpayers had reported some, but not all, of their income from these accounts on their tax returns, and they had not filed FBARs.

Multiple Family Members

A taxpayer was one of several family members to participate in the 2009 OVDP. Together they had inherited foreign financial accounts from older-generation family members, who owned and operated a family business with operations in the United States and several European countries. Their family had set up family foundations, trusts, and corporations to manage the family finances decades ago. These entities were located in offshore tax havens, but the entities' bank accounts remained at banks in Switzerland. The younger-generation family members, including the taxpayers, continued to modify the ownership structures and create new investments, after inheriting the accounts.

Inheritance from Non-U.S. Person

A taxpayer reported that she had received monetary gifts from a parent who was not a U.S. citizen or resident. The taxpayer's parent had opened accounts in the taxpayer's name at Swiss banks decades ago. At the time, the taxpayer was not yet a U.S. citizen. The taxpayer reported that her parent made regular deposits to the Swiss accounts over a long period, but that she, herself, did not access the account. After the death of her parent, she became the sole account holder, but still did not report the account for tax purposes.

balances of several million dollars for many years. Some of these taxpayers did not pay U.S. taxes on income earned from these accounts for decades.

We estimate that 40 percent of 2009 OVDP participants receiving large penalties used complex arrangements to indirectly own or manage their offshore accounts.¹⁹ These arrangements involved the use of foreign corporations, foundations, trusts, and other entities in jurisdictions that have been designated as offshore tax havens and financial privacy jurisdictions, some of which were recommended by the taxpayers' foreign financial advisors.²⁰ In some cases, the entities were "sham" entities—i.e., entities created to conceal ownership from U.S. tax authorities—which participants in some case files that we reviewed used to conceal the ownership of accounts or disguise the repatriation of offshore funds back to the United States. Another complex arrangement present in several large penalty cases was passive foreign investment companies (PFIC). A PFIC is a type of mutual fund or investment company held outside of the United States.²¹ Some foreign bank accounts disclosed through OVDP were in the form of simple interest bearing accounts, but others were foreign mutual funds that would be treated as PFICs under the Internal Revenue Code. PFICs may, in some cases, receive less favorable tax treatment than U.S. entities holding similar assets or earning similar income.²² Taxpayers who did not disclose PFICs may not have paid the additional taxes on such investments. In many cases, a number of previously unreported investment entities were disclosed through the

¹⁹The 95 percent confidence interval for the estimated 40 percent of taxpayers disclosing the use of complex arrangements to indirectly own or manage their offshore accounts ranged from 23 percent to 59 percent.

²⁰For a list of tax havens and financial privacy jurisdictions sourced to the Organization for Economic Co-operation and Development, the National Bureau of Economic Research and a U.S. District Court order granting leave for IRS to serve a John Doe summons, see Table 1 in GAO, *International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*, [GAO-09-157](#) (Washington, D.C.: Dec. 18, 2008).

²¹Generally, a foreign corporation is considered to be a PFIC if certain percentages of the corporation's income or assets are passive. 26 U.S.C. § 1297.

²²Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, JCS-10-87, May 4, 1987. Also see GAO, *Cayman Islands: Review of Cayman Islands and U.S. Laws Applicable to U.S. Persons' Financial Activity in the Cayman Islands*, [GAO-08-1028SP](#) an E-supplement to [GAO-08-778](#) (Washington, D.C.: July 24, 2008).

2009 OVDP, and IRS decided to accept an alternative tax on all their associated PFIC gains—20 percent of the gain—potentially a much lower tax rate than would otherwise have been available to those taxpayers.

IRS Generally Has Used 2009 OVDP Data Strategically, But Has Not Used the Data to Identify Additional Opportunities to Educate Taxpayers on Offshore Filing Requirements

IRS Used 2009 OVDP Data to Identify Noncompliance Involving Additional Banks and Countries and to Improve Subsequent Offshore Voluntary Disclosure Programs

As previously discussed, one of the intended purposes of the 2009 OVDP was mining, or analyzing, data collected from OVDP applications and audits of participants and nonparticipants to identify entities and individuals who promoted or otherwise helped U.S. citizens hide assets and income offshore.²³ We found that IRS collected the names of offshore financial institutions, financial advisors, bankers, attorneys, and other promoters from the 2009 OVDP that were involved in hiding U.S. taxpayers' offshore income, and used the names to (1) identify patterns of noncompliance, (2) encourage banks and other promoters to cooperate with IRS and provide the names of U.S. taxpayers hiding income overseas, and (3) build cases for John Doe summonses.

IRS officials from the Offshore Compliance Initiative office told us that publicity from the John Doe summonses has been the most effective tool to increase participation in its offshore programs. They based their conclusion on the correlation between country specific or bank specific John Doe summonses and the locations of 2009 OVDP participants'

²³Internal Revenue Service, "FY 2011 Congressional Budget Submission," February 1, 2010.

accounts. Our case file analysis discussed previously in this report supports IRS's conclusion.

However, IRS officials also determined that data mining the 2009 OVDP applications would not provide IRS with all of the useful information it could get from participants. For taxpayers accepted into the program, responses on the 2009 OVDP applications varied widely in degree of detail, which we confirmed in our case file review. For example, some application letters included very detailed account information, such as the original source of funds, bank name, banker name, and country name, while other case files we reviewed did not contain any optional letter like the one suggested by IRS in its 2009 OVDP Questions & Answers. As a consequence, IRS sent surveys to 2009 OVDP participants to obtain more details about the offshore accounts. The survey included detailed questions about the taxpayer's financial institutions, bankers, advisors, attorneys, or other promoters' involvement in hiding offshore income. IRS program officials stated that the additional information they received from the surveys was useful and that they were using it, along with various analyses of voluntary disclosures, to identify particular banks, promoters, professionals, and others who promote, facilitate, or enable U.S. taxpayers in avoiding or evading payment of required U.S. taxes through the use of offshore accounts. According to IRS, these analyses have also been used to identify the foreign countries where the offshore accounts were maintained as well as the schemes being used and offshore structures.

Based on data that IRS collected from mining the 2009 OVDP case files and the survey, IRS

- obtained information on offshore accounts held by U.S. taxpayers at HSBC (India);
- continued investigations of additional foreign financial institutions in Switzerland, Asia, and the Caribbean;
- built cases for additional John Doe summonses, should they become necessary;
- expanded its investigations of non-bank entities, such as merchant accounts, which are a type of bank account that allows a business to

-
- accept payments by payment cards, such as credit or debit cards;²⁴
and
- improved subsequent offshore programs.

One lesson that IRS learned from the 2009 OVDP was that the applications sometimes did not contain enough information to allow IRS to understand the nature of the noncompliance. To obtain better information going forward, and as a condition of being accepted into the 2011 and 2012 programs, IRS required applicants to submit additional documents related to their offshore accounts.²⁵ This included additional account information about the original source of funds. In addition, applicants to the 2011 and 2012 programs that had offshore accounts with an aggregate balance of \$1 million or more were required to submit a separate statement for each foreign financial institution. These applicants were also required to submit a separate statement for each foreign account or asset listed in their voluntary disclosure. (See app. III for sample 2009 and 2012 application letters and, the new required attachment to the 2012 application letter.) IRS officials from the Offshore Compliance Initiative office told us that they have begun to use data from these additional submissions to improve offshore compliance.

Based in part on its experience with the 2009 OVDP, IRS introduced streamlined offshore program filing procedures. These were, in part, intended to provide a less burdensome process for taxpayers with unreported offshore accounts that were small. As shown earlier in table 2, for the 10,439 2009 OVDP cases that we had data for, the account value for the 10th percentile was about \$78,000. According to IRS, some of these taxpayers with smaller accounts, and thus relatively low unpaid-tax obligations, were U.S. residents residing overseas, including dual citizens, who most likely did not owe substantial amounts of unpaid taxes, and who indicated to IRS that they did not understand their filing requirements. The standard offshore penalty for such taxpayers would likely be disproportionately high. The streamlined filing procedures that

²⁴According to IRS officials, some foreign banks have facilitated U.S. taxpayers in setting up merchant accounts offshore, in countries other than their countries of business, to hide income.

²⁵Additional required documents can be found on IRS's website, "Offshore Voluntary Disclosure Program Submission Requirements," <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Submission-Requirements>, accessed February 8, 2013.

began in September 2012 allow taxpayers with “low compliance risk” to become current with their offshore tax obligations without facing offshore penalties or additional enforcement action. IRS defined “low compliance risk” as taxpayers with simple tax returns, owing less than \$1,500 in taxes for each of the years covered by the streamlined procedures.²⁶

Despite the Successes of
IRS’s Overall Strategy, IRS
Might Benefit from
Additional Information to
Better Target Outreach and
Education

IRS efforts to publicize the 2009 OVDP included notices published in seven languages and outreach to professional tax practitioners. IRS officials from the Offshore Compliance Initiative office told us that they had not formally evaluated the success of these outreach efforts. We recently reported concerns about the complexity of foreign account reporting requirements, and that tax practitioners and taxpayers are confused about what foreign account information should be reported and how.²⁷

The offshore programs are part of IRS’s larger compliance efforts, which are intended to both detect noncompliance and to encourage voluntary compliance, in part by minimizing the burden for taxpayers to understand their tax obligations and file tax returns every year. Obtaining information on how taxpayers found out about IRS’s offshore voluntary disclosure programs could help IRS better identify populations that could benefit from additional taxpayer education and outreach and potentially improve voluntary compliance by taxpayers with new offshore accounts. Such information could also help IRS evaluate the success of its current outreach efforts. IRS’s 2009 OVDP application, however, did not contain a question on how the taxpayer became aware of the program. IRS made changes to the applications for subsequent programs, as described earlier, but did not consider adding questions on how participants became

²⁶In order to use the streamlined filing procedures, taxpayers must file amended or late tax returns for the previous three years, and file any delinquent FBARs for the previous six years. If taxpayers self-determine they are a low compliance risk, they can submit returns through these new procedures, and not through the current, ongoing offshore voluntary disclosure program. If IRS later determines any of these taxpayers have a higher compliance risk, the taxpayers are subject to a more thorough review, potentially subject to an audit outside of the offshore program, and subject to potentially steeper FBAR penalties. According to IRS officials, these new procedures will assist many U.S. taxpayers who are nonresident, nonfilers with relatively low additional taxes owed, and taxpayers with certain foreign retirement accounts.

²⁷GAO, *Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known, but Requirements Can Be Clarified*, [GAO-12-403](#) (Washington, D.C.: Feb. 28, 2012).

aware of the program. IRS officials from the Offshore Compliance Initiative office told us that this information would be useful in terms of allocating future resources, and that they would be open to considering a question on how taxpayers found out about the offshore programs. Presently, IRS has not decided to include this question in the 2012 program application.

In our case file review, we found examples of immigrants who stated in their 2009 OVDP applications that they were unaware of their FBAR filing requirements. We found they had often opened banks accounts in their home country prior to immigrating to the United States. IRS officials from the Offshore Compliance Initiative office stated that although there are several FBAR education programs, none are specifically targeted at new immigrants. Furthermore, these IRS officials were unaware of any IRS work with other federal agencies such as the State Department or the Department of Homeland Security to educate recent immigrants about their foreign account filing requirements. These officials stated that one of the challenges that they face in their office, which is part of IRS's Large Business and International Division, is that taxpayer education and outreach is the responsibility of IRS's Wage and Investment Division and that issues concerning FBARs fall under IRS's Small Business/Self-Employed Division.

IRS officials from the Offshore Compliance Initiative office agree that more could be done to improve taxpayer education and outreach about offshore reporting requirements. They, like us, recognize that multiple outreach efforts could help to draw additional taxpayers into the offshore programs, and that data mining information from the program applications can help identify these groups.

IRS May Not Be Identifying a Large Number of Quiet Disclosures or Other Attempts to Circumvent Some of the Taxes, Interest, and Penalties that would be Otherwise Owed by Not Participating in an Offshore Program

Taxpayer Use of Quiet Disclosures to Avoid Offshore Penalties Involves Significant Risk

Quiet disclosures matter because if IRS does not identify them, it undermines the incentive to participate in the offshore programs. IRS's offshore compliance enforcement efforts, including the offshore programs, deter taxpayers with noncompliance related to current offshore accounts, or offshore accounts that might be opened in the future. If taxpayers are able to quietly disclose and pay fewer penalties than they would have in an offshore program, the incentive for other noncompliant taxpayers to participate in a program is reduced. When quiet disclosures remain undetected, they also result in lost revenue for the government. Further, if quiet disclosures remain undetected, then IRS will not have information on the characteristics of these taxpayers and their accounts—characteristics such as bank names, country names, and promoter names—used to build cases against others.

IRS May Not Be Detecting Some Quiet Disclosures

Quiet Disclosure Detected

According to the criminal information and plea agreement, a taxpayer held an account at HSBC Bank Bermuda. With the assistance of a business partner, the taxpayer arranged to have investment income in the amount of \$297,816 wired to his business partner's secret account at UBS in Switzerland. From there, the taxpayer's share of the investment (\$99,273) was transferred to his HSBC Bank Bermuda account. The taxpayer did not report this taxable income, or the interest income that accrued in the account, thereby avoiding \$40,624 in taxes. Following the widespread media coverage of UBS's disclosure of account records to IRS, the taxpayer made a quiet disclosure by preparing and filing FBARs and amended Forms 1040 for tax year 2003 to tax year 2008, in which he reported the existence of the previously undeclared account. As part of the plea agreement, the taxpayer agreed to pay an FBAR penalty of \$76,283, which was 50 percent of the high balance in the account. The taxpayer also faces up to 5 years in prison and a \$250,000 fine.

We identified 10,595 potential quiet disclosures, a number much higher than the potential quiet disclosures identified by IRS.²⁸ In a series of Questions & Answers that IRS first released on February 8, 2011 to announce the 2011 offshore program, IRS reported that it had identified, and will continue to identify, taxpayers attempting quiet disclosures.²⁹ In the Questions & Answers, IRS stated that it would be closely reviewing amended tax returns to determine whether enforcement action is appropriate. (See sidebar for one example of a quiet disclosure being detected.³⁰)

IRS officials told us that the Offshore Compliance Initiative office tested several different methodologies to identify quiet disclosures. First, IRS looked at amended returns during tax year 2003 to tax year 2008, the period covered by the 2009 OVDP, and removed any non-offshore related adjustments, such as filings status changes and additional exemptions. IRS also looked at amended returns with increased tax assessments over an established threshold during tax year 2003 to tax year 2010.

The effectiveness of a third effort was questioned by IRS. In this effort IRS compared taxpayers with a history of filing FBARs in non-secrecy jurisdictions between tax year 2003 and tax year 2008 who filed delinquent FBARs processed in 2009 involving a secrecy jurisdiction along with an amended return.³¹

²⁸Only an IRS examination can determine actual quiet disclosures and there are many reasons why a potential quiet disclosure may turn out to be something else. According to IRS, these include taxpayers who had legally paid taxes on their offshore income, but had not previously filed FBARs, and who were paying additional taxes with their amended returns for reasons unrelated to the offshore accounts and newly filed FBARs.

²⁹Internal Revenue Service, "2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers," accessed February 5, 2013, <http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers>.

³⁰Unlike the other sidebars presented in this report, this is not drawn from an amalgamation of multiple cases in our case file review, but from publicly available information on one specific case.

³¹A secrecy jurisdiction refers to a jurisdiction, or country, that offers financial secrecy laws in an effort to attract investment from outside its borders.

In 2012, a fourth effort, which was not designed to detect quiet disclosures, but to reroute misaddressed amended returns sent in by participants in the 2011 offshore program, was the most successful effort to find them.

Together, these four efforts led to the review of several thousand tax returns. Of those, several hundred returns were identified as quiet disclosures. An IRS official told us that the tax returns that were identified as part of a quiet disclosure will be examined and that cases already examined had penalties assessed. Because they were quiet disclosures, the official said the taxpayers did not receive the reduced offshore penalty.

Given the importance of IRS's ability to detect quiet disclosures and evidence that they exist, we tested a different methodology to identify potential quiet disclosures, and found many more than IRS detected. Unlike IRS, we looked at all taxpayers who, for the tax years covered by the 2009 OVDP

- filed amended or late returns, **and**
- filed amended or late FBARs.

We then excluded 2009 OVDP participants from this population. While only an IRS examination can determine whether a potential quiet disclosure is an actual quiet disclosure, the 10,595 taxpayers that we identified have an unlikely combination of characteristics that could indicate that taxpayers are quietly disclosing. IRS agreed with our methodology as reasonable and appropriate. (See app. I for additional details about our methodology and app. VIII for a full breakout of our results.)

Although any of the 10,595 potential quiet disclosures could be actual quiet disclosures, certain subpopulations raised more questions. First, we found 3,386 taxpayers that filed amended or late returns, and filed amended or late FBARs for multiple years. Second, we found that 94 of these taxpayers met the same criteria for all six tax years covered by the 2009 OVDP.

IRS officials from the Offshore Compliance Initiative office told us that they had no additional work planned to identify potential quiet disclosures and had not yet decided to broaden the methodologies that they had tested, but they expressed strong interest in researching our methodology to identify taxpayers attempting quiet disclosures. We recognize that

there are additional costs to using a methodology such as the one we used, but IRS has already committed resources to identifying quiet disclosures. Moreover, without rigorously and systematically searching for potential quiet disclosures, IRS does not have reasonable assurance that it is controlling such disclosures and collecting the delinquent taxes, interest, and penalties due. Exploring different methodologies that include a systematic evaluation of amended returns or late filed returns, along with amended or late filed FBARs, without too narrowly restricting either the amended return or the FBAR populations, and implementing the best option could provide this assurance.

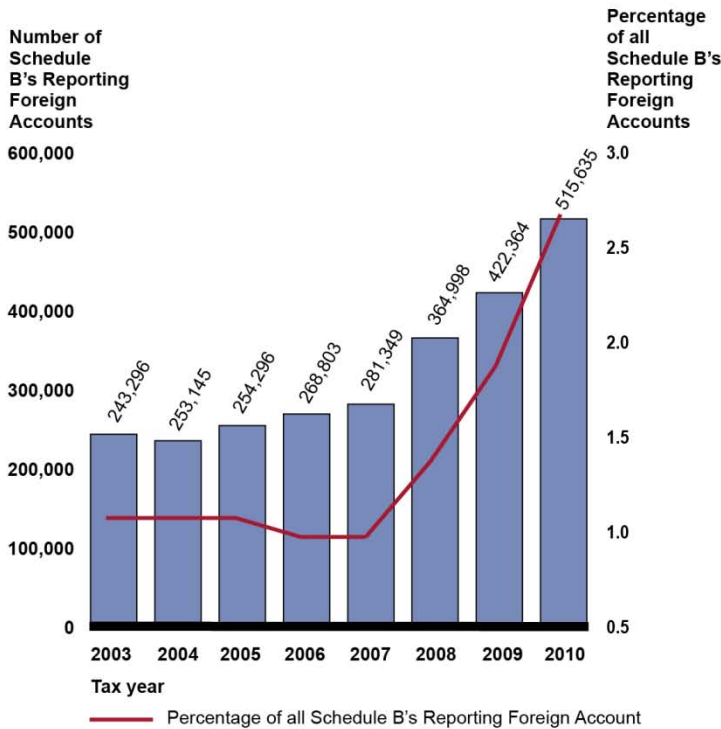
Increases in Taxpayers Reporting Offshore Accounts May Also Indicate Attempts to Circumvent Some Taxes, Interest, and Penalties that Would Otherwise be Owed

Data from IRS's SOI division and from FinCEN show that the number of taxpayers reporting offshore accounts on Form 1040, Schedule B and the number of taxpayers filing FBARs has increased significantly in recent years. From tax year 2007 to tax year 2010 (the most recent data available), IRS estimated that the number of taxpayers reporting offshore accounts on Form 1040, Schedule B nearly doubled to 516,000, as shown in figure 4. From tax year 2003 through tax year 2007, only about 1 percent of all taxpayers filing Form 1040, Schedule B checked a "yes" box in response to the question asking if they owned or controlled a foreign financial account, but that share increased to more than 2.5 percent by tax year 2010. Furthermore, FinCEN has reported that the number of FBARs filed more than doubled, as shown in figure 4. Both the increase in the number of foreign accounts reported on Form 1040, Schedule B and the increase in FBAR filings are significantly larger than the approximately 39,000 taxpayers that came forward in one of IRS's offshore programs.

There could be legitimate reasons for these trends. For example, taxpayers could be reporting new offshore accounts or taxpayers who had always reported income from offshore accounts on their tax returns could be filing FBARs and reporting the accounts on Form 1040, Schedule B for the first time. This could be an indication of more taxpayers coming into compliance as a result of IRS's efforts to combat offshore tax evasion.

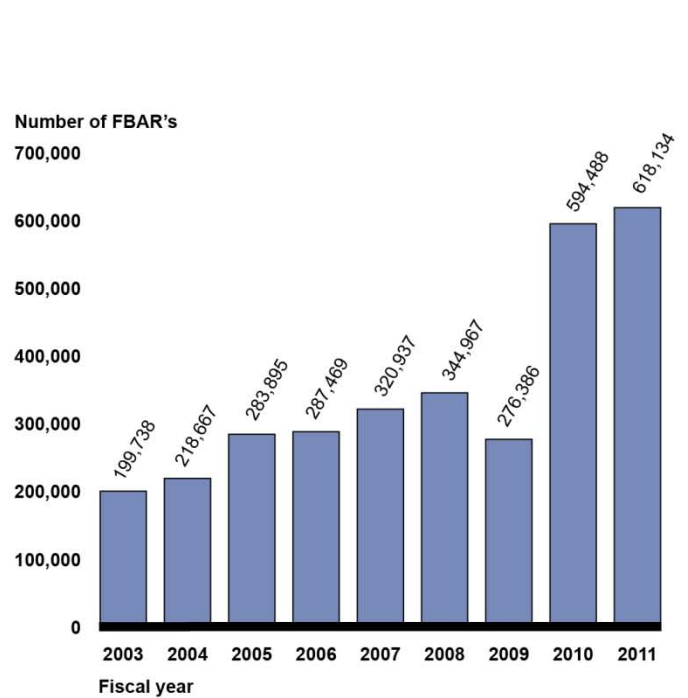
Figure 4: Taxpayers Reporting Foreign Financial Accounts

Form 1040 Schedule B Line 7a by Tax Year



Source: GAO analysis of IRS Estimated Data Line Counts Individual Income Tax Returns for tax years 2003 through 2010.

Report of Foreign Financial Accounts (FBARs) Filed by Fiscal Year



Source: GAO analysis of FinCEN annual reports.

Note: IRS Form 1040, Schedule B, Line 7a includes a yes/no question asking taxpayers if, at any time during the tax year, they had an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account. The figure contains IRS estimates of the number of forms in which a taxpayer answered "yes" to this question.

Under the Bank Secrecy Act, U.S. residents or citizens with a financial interest or signature authority over one or more foreign financial accounts with a total of more than \$10,000 are required to annually file form TD F 90-22.1 Report of Foreign Bank and Financial Accounts (FBAR) with Treasury. The FBAR must be filed for the calendar year by June 30 of the following year. The figures above are the number of FBARs filed during a fiscal year as reported in FinCEN annual reports.

However, such a sharp increase in foreign account reporting amidst the global economic recession and the publicity surrounding IRS's offshore programs raises the question whether some of these taxpayers may have attempted to circumvent some of the taxes, interest, and penalties that would otherwise be owed in the offshore programs. Unlike taxpayers attempting a quiet disclosure, who would still pay taxes plus interest on previously unreported income covered by the programs, and possibly an

accuracy-related or delinquency penalty, these taxpayers would only be paying taxes on the offshore income earned for the year reported.³²

An IRS official from the Offshore Compliance Initiative office told us that although the office has coordinated with IRS's Planning, Analysis, Inventory, and Research (PAIR) office, they had not discussed Form 1040, Schedule B or FBAR filing trends, and that he was not aware of the sharp increase. As of January 2013, no projects were planned to research Form 1040, Schedule B filing trends. However, the Offshore Compliance Initiative office has asked PAIR to determine whether taxpayers who reported their offshore income properly, but had not filed FBARs, recently started filing delinquent FBARs, as directed by the 2009 OVDP instructions.³³ This effort may not capture first time FBAR filers who are reporting existing offshore accounts as new.

Because the increase in recent years in Form 1040, Schedule B and FBAR reporting of foreign accounts is measured in the hundreds of thousands, we recognize that it may be too costly for IRS to audit all of those filings. A less costly approach could involve, for example, IRS drawing a random sample of those cases and auditing them to understand whether taxpayers are trying to circumvent some of the taxes, interest, and penalties that would otherwise be owed in the offshore programs. One of the things that IRS could look for in such an audit is the date that the offshore account was opened. Such a sample could provide an estimate of the magnitude of any problem. As was the case with quiet disclosures, without such information, it will be difficult for IRS to provide reasonable assurance that taxpayers are not reporting, for the first time, offshore accounts that had been open for years to avoid paying delinquent taxes, interest, and penalties.

Conclusions

Despite challenges in detecting offshore accounts, IRS's offshore programs have been effective in compelling taxpayers to disclose their

³²In a similar situation, taxpayers might be filing the new IRS Form 8938 for offshore accounts that are not in fact new, without fulfilling their FBAR filing requirement, if applicable. IRS Form 8938 resulted from a FATCA provision requiring certain taxpayers, beginning in 2012, to report foreign financial accounts.

³³See Internal Revenue Service, "Voluntary Disclosure: Questions and Answers," accessed February 8, 2013, <http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers, Q9>.

unreported offshore income. Through these programs, IRS has collected more than \$5.5 billion to date, brought tens of thousands of taxpayers into compliance, and gained increased information on offshore noncompliance. It is unclear how many additional U.S. taxpayers have undeclared foreign accounts and how much unreported income is associated with those accounts. However, the number of quiet disclosures IRS was able to find (some by accident), the number of potential quiet disclosures we identified, and the sharp upswing in Form 1040, Schedule B and FBAR filings all suggest that the amount of revenue to be collected from previously undisclosed offshore accounts could be significant.

We found two key issues that, if addressed, could make IRS's offshore programs even more successful.

- IRS has not used program information to identify populations of taxpayers that would benefit from education and outreach regarding their offshore tax reporting obligations. Such information could promote voluntary compliance and reduce the need for enforcement actions. Additionally, IRS does not obtain information on how taxpayers learned about offshore programs. Without this information, IRS cannot fully evaluate its efforts to promote taxpayer participation in offshore programs.
- IRS may have missed taxpayers attempting to circumvent some of the taxes, interest, and penalties that would otherwise be owed in its offshore programs. Our methodology to identify potential quiet disclosures found many more potential disclosures than IRS detected. IRS may also have missed other attempts at circumvention by not researching the upward trends of taxpayers reporting offshore accounts for the first time. While there would be costs to such efforts, the amount already collected by the offshore programs suggests that considerable additional revenue gains might be possible. By identifying taxpayers attempting to circumvent some of the taxes, interest, and penalties that would otherwise be owed in its offshore programs, and taking appropriate action, IRS could potentially increase revenues, bolster the overall fairness of the program, and have a more informed basis for improving voluntary compliance.

Recommendations for Executive Action

We recommend that the Acting Commissioner of Internal Revenue take the following four actions:

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- Use data gained from offshore programs to identify and educate populations of taxpayers that might not be aware of their tax obligations related to offshore income and FBAR filing requirements.
 - Obtain information that can help IRS test offshore program promotion strategies and identify new ones by adding a question to current and future programs to determine how participants found out about the program.
 - Explore options for employing a methodology for identifying and pursuing potential quiet disclosures to provide more assurance that actual quiet disclosures are not being missed and then implement the best option.
 - Conduct an analysis designed to measure the extent that taxpayers are reporting existing foreign accounts on the Form 1040, Schedule B or on FBARs for the first time and circumventing some of the taxes, interest, and penalties that would otherwise be owed, and take appropriate action based on the analysis.

Agency Comments and Our Evaluation

We provided a draft of this report to the Acting Commissioner of Internal Revenue for comment. In written comments, reproduced in appendix IX, IRS agreed with our four recommendations. IRS noted that it was pleased that we recognized the overall success of its offshore strategy and provided steps that they are taking to implement our recommendations and address any identified noncompliance, as warranted. IRS also provided technical comments on our draft report, which we incorporated, as appropriate.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to report to the Chairmen and Ranking Members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for IRS. We are also sending copies to the Acting Commissioner of Internal Revenue, the Secretary of the Treasury, the Chairman of the IRS Oversight Board, and the Deputy Director for Management of the Office of Management and Budget. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact me at (202) 512-9110 or whitej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix X.

A handwritten signature in black ink that reads "James R. White". The signature is written in a cursive style with a large, prominent initial "J".

James R. White
Director, Tax Issues
Strategic Issues