
Disclosure of Offshore Financial Interests – State Tax Obligations

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Taxpayers intending to comply with the federal program for voluntary disclosure of offshore financial accounts should make certain that they also comply with any state tax requirements as a result of the federal compliance. In a memorandum dated March 23, 2009, the Internal Revenue Service announced "a penalty framework to be applied to voluntary disclosure requests containing offshore interests." Among other things, those taking advantage of the program must pay back taxes and interest for 6 years as well as certain accuracy and delinquency penalties and an additional penalty of 20% of the amount in foreign bank accounts in the year with the highest aggregate account or asset value. Persons complying with the IRS program will avoid any potential federal criminal prosecution. The deadline for compliance with the federal program is October 15, 2009.

Many states require a taxpayer to report any change in the taxpayer's federal taxable income. Some states such as Massachusetts and California have issued releases reminding taxpayers that the "federal change" rules will apply to the changes resulting from compliance with the federal disclosure program. Although not explicitly stated in these releases, compliance with the federal change rules on a voluntary basis will presumably reduce the risk of state criminal prosecution. At least one other state – Connecticut – has announced its own program for taxpayers to voluntarily disclose offshore assets.

It is important for taxpayers to determine and comply with the requirements of states where they were subject to tax jurisdiction for the years covered by the federal program in order to reduce the risk of criminal prosecution and minimize civil penalties at the state level.

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