Do Not Ignore Latest IRS Offshore Account Amnesty

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Lawyers, law firms, companies, and their clients should be aware of the astounding developments in the Internal Revenue Service's continuing campaign to achieve full transparency of foreign banks accounts and financial assets. With a carrot and stick, the IRS has said again and again that these matters are serious and can even involve criminal prosecution. Do not ignore these rules.

U.S. taxpayers must report their worldwide income on their U.S. tax returns, even if the overseas funds are taxed by other countries. In addition, foreign bank and financial accounts must be reported on Foreign Bank Account Report ("FBAR") forms that are filed separately from tax returns. The penalties for failure to file an FBAR are worse than tax penalties. Failing to file an FBAR can carry a civil penalty of $10,000 for each non-willful violation. But, if your violation is found to be *willful*, the penalty is the greater of $100,000 or 50 percent of the amount in the account for *each* violation—and each year you didn't file is a *separate violation.*

Criminal penalties for FBAR violations are even more frightening, including a fine of $250,000 and five years of imprisonment. If the FBAR violation occurs while violating another law (such as tax law, which it often will) the penalties are increased to $500,000 in fines and/or ten years of imprisonment. Many violent felonies are punished less harshly.

Two IRS amnesty programs have ended: one in 2009 and another in 2011. In 2011, the IRS made it clear there would be no third bite at the apple.[1] But in January 2012, the IRS broke with its warning and announced a third voluntary disclosure program.[2] Unlike the prior two IRS programs, this one has no announced deadline.

Nevertheless, the IRS has made clear that it could close it any time.[3] Moreover, the IRS has said time and again that if it finds you before you come in from the cold, all deals are off the table. For that reason and many others, taxpayers—and that can include fiduciaries like lawyers—should act without delay. In fact, recent developments show that the stakes are going up and failures to comply with tax and disclosure rules will henceforth be harshly addressed.

Lawyers and their clients should pay attention even where their roles as signatories of foreign accounts are merely fiduciary rather than beneficial in nature. Some lawyers may think they need not be concerned if their role was solely as a signatory on a trust or other fiduciary account. In fact, there are filing obligations in that situation too.[4]

More than 34,000 taxpayers have come forward over the last few years to disclose foreign accounts.[5] The IRS knows there is a much larger number who have not done so. When U.S. citizens and permanent residents file U.S. tax returns they must include investment income anywhere, no matter how small. Each tax return also asks (on Schedule B to Form 1040) whether you have a foreign account.

If so (and if the total of all foreign accounts exceeds $10,000 at any time during the year), you must check "yes." Each tax return then refers you to a separate filing, an FBAR.[6] It must be filed each year by June 30 for the prior year. No payment is required, but this disclosure form has been the law since 1970. The FBAR contains separate sections for foreign accounts you own beneficially and for those over which you have signature authority but no ownership.

The IRS takes this very seriously. Penalties for failing to include income or disclose foreign accounts can be severe, including criminal prosecution. FBAR penalties are even worse, including a fine of up to $250,000 and up to five years in prison for each failure to file.[7] It is increasingly difficult for people to claim ignorance of these rules—some taxpayers are being indicted for failure to file FBARs apart from any tax evasion or other tax crimes.

The dollars involved are also large. In the last few years of the program, the IRS has collected $5 billion from offshore accounts.[8] For taxpayers without any beneficial ownership in foreign accounts or assets, it is still necessary to file FBARs disclosing that signature authority.[9] Fortunately, most such cases can be resolved outside of the IRS disclosure program by preparing and filing the past-due FBARs.[10] They should generally be accompanied by an explanatory letter noting that your tax returns are correct,

you just became aware of the FBAR requirements, you will commence filing FBARs annually, and you ask that no penalties be imposed.[11]

For lawyers having only fiduciary roles for foreign accounts but who failed to file FBARs, this is a very good deal—with no likely penalties attached—assuming you follow this procedure. Taxpayers whose noncompliance involved not only FBARs but also tax returns should consider the IRS's third offshore program. It is similar to the 2011 program, and although there is no deadline, its terms could change at any time. The biggest change in the current Offshore Voluntary Disclosure Program ("OVDP") is a 27.5 percent penalty (up from 25 percent in the 2011 program) on the highest aggregate balance (in foreign bank accounts or entities or on the value of foreign assets) during the eight years before disclosure.[12]

However, taxpayers whose offshore accounts or assets did not surpass $75,000 may qualify for a reduced 12.5 percent penalty.[13] In addition, taxpayers who feel the penalty is disproportionate may opt out and deal with the issue as an audit item.[14] Opting out to attempt to negotiate lower penalties can import more flexibility and a greater array of procedural rights (such as going to the IRS Appeals Office) if the case does not proceed to the taxpayer's liking.

Participants in the OVDP must file all original and amended tax returns, generally going back eight years, and include payment for back-taxes and interest as well as a twenty percent penalty.[15] They must also complete and file FBARs, usually for the last eight years.[16] However, even if the undisclosed foreign accounts and unreported income go back many more years, the scrutiny and payment obligations extend only eight years back.

One reason to consider joining this IRS program is the absence of alternatives. Regardless of penalties, remaining silent is increasingly risky. The IRS has made clear that "quiet disclosures" (in which a taxpayer prepares and files amended tax returns and FBARs without calling attention to them and without joining the program) will be dealt with strictly.[17] The IRS views such actions as lacking a true voluntary correction of the past, rather akin to trying to sneak something by them.

Moreover, the IRS is getting good information and is more and more likely to discover foreign accounts and assets and treat them harshly. The U.S. government is going after foreign banks and financial institutions and mining the data about financial advisers, trust companies, and others it received via thousands of taxpayers who have named names to the IRS. Disclosure is becoming inevitable. The massive and controversial law known as FATCA, the Foreign Account Tax Compliance Act, will soon cause financial institutions worldwide to turn over names of U.S. account holders to the U.S. government or face draconian penalties themselves.[18]

In late June 2012, the IRS released several more conditions that can spell ineligibility to participate in the OVDP. First is the Department of Justice notice requirement. When a U.S. person faces the pending disclosure of their name and details to the IRS, it is often possible for the person to hold it up in a foreign court. Many such challenges were mounted in Switzerland. But U.S. law has a trump card for such challenges. Under U.S. law, if you challenge the disclosure of your name in a foreign court you are required to notify the Justice Department of the appeal.[19] For many, that notice defeats the purpose of mounting the foreign legal challenge in the first place, so some taxpayers skip the notice.

Now, such inaction will have additional consequences. The IRS has announced that if you fail to notify the Justice Department of a foreign appeal as required, you will not be eligible for the OVDP.[20] In effect, even though there is no IRS pending investigation, you won't be allowed to join the OVDP.

Second, eligibility to participate in the OVDP could be terminated in another way, one that hardly seems to involve the taxpayer and over which the taxpayer has no control. If the foreign institution where a taxpayer has his or her account faces IRS action, the taxpayer is *also ineligible* for the OVDP. Once the U.S. government has taken action against a financial institution, any U.S. taxpayers with accounts at that institution cannot participate in the OVDP.

Both of these actions reflect a fundamental precept of voluntary disclosure. The IRS wants you to come forward *before* you must, not after. The consequences of being discovered before one voluntarily applies for amnesty can be severe.

For example, a California lawyer, Christopher M. Rusch, and two businessmen, Stephen M. Kerr and Michael Quiel, were indicted over alleged income tax and FBAR violations.[21] Similar criminal charges have been filed and more are likely on the way. In part, this is due to the treasure trove of information (including dates, names, and details) the IRS obtained via its 2009 and 2011 amnesty programs.[22]

Yet the IRS is getting still more data. The IRS has issued John Doe summonses forcing some banks to name names. The IRS has even resorted to issuing grand jury subpoenas to individuals suspected of overseas banking. The grand jury subpoena requires the suspect to produce his or her *own* bank records and details, including statements with the highest annual balances.

Unless you are within the IRS program, such information would be highly incriminating. Yet by definition if you receive such a subpoena it is too late to join the IRS program. Lawyers are used to assuming they have a right to be silent and not to incriminate themselves, but these subpoenas may be outside that protection.

Thus, it is unclear whether an individual receiving such a subpoena can refuse and successfully assert protection under the Fifth Amendment. There is an established exception for "required records" that are not covered by the protections of the Fifth Amendment.[23] The courts are only now considering whether offshore private banking falls within this exception.

The Ninth Circuit, in *In re Grand Jury Investigation M.H.*,[24] allowed prosecutors to compel an offshore account holder to produce account data even if it was self-incriminating. The taxpayer filed a petition for certiorari with the U.S. Supreme Court, but it was denied.[25] In contrast, in a similar case in Texas, *In re: Grand Jury Subpoena*,[26] the judge ruled that a taxpayer did not have to comply. The government is appealing.

All of this is occurring as criminal investigations of eleven Swiss banks continue. The banks are suspected of enabling tens of thousands of wealthy Americans to evade U.S. taxes. The banks in the crosshairs include Credit Suisse AG, HSBC Holdings plc, Basler Kantonalbank, and many others.[27]

In fact, there were massive data transfers by Swiss banks to comply with a January 30, 2012 deadline to turn over data on their offshore business. The data is said to contain thousands of pages of encrypted data, including the names of client advisers. It is unclear if the encrypted data is being used by the IRS in its current form, but the assumption is that it will be useful.[28]

Since the data is said to contain details of services to American clients, it could provide a rich vein of information for tax authorities and prosecutors to pursue. The Swiss government is attempting to prevent criminal charges being filed against the banks. Clearly, it hopes cooperation in data transfers plus the payment of fines may be enough.

As this drama plays out, additional account details and prosecutions are likely in what has become an epic battle over global transparency. Lawyers and their clients are almost certainly better off trying to get the best deal they can get and to get it soon. ■

Endnotes

1 *See* Robert W. Wood, *IRS Offshore Amnesty: Second (Last) Chance,* Forbes.com, Feb. 9, 2011, http://www.forbes.com/sites/robertwood/2011/02/09/irs-offshore-amnesty-second-last-chance/.

2 *See* I.R.S. News Release IR-2012-5, IRS Offshore Programs Produce $4.4 Billion to Date for Nation's Taxpayer's; Offshore Voluntary Disclosure Program Reopens (Jan. 9, 2012), http://www.irs.gov/uac/IRS-Offshore-Programs-Produce-$4.4-Billion-To-Date-for-Nation%E2%80%99s-Taxpayers;-Offshore-Voluntary-Disclosure-Program-Reopens.

3 *See id.*

4 *See* Instructions to IRS Form TD F 90-22.1 (Rev. Jan. 2012), *available at* http://www.irs.gov/pub/irs-pdf/f90221.pdf.

5 *See* I.R.S. News Release IR-2012-5, *supra* note 2.

6 *See* IRS Form 1040, Schedule B, Interest and Ordinary Dividends, *available at* http://www.irs.gov/pub/irs-pdf/f1040sb.pdf.

7 31 U.S.C. § 5321(a)(5)(C); *see also* 31 U.S.C. § 5322(a); 31 C.F.R. § 103.59(b).

8 *See* I.R.S. News Release IR-2012-5, *supra* note 2.

9 *See* Instructions to Form TD F 90-22.1, *supra* note 4.

10 *See* I.R.S., Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers, FAQ 17, 38 (June 26, 2012) ("I.R.S. 2012 OVDP FAQ"), *available at* http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers.

11 *See id.*

12 *See* I.R.S. News Release IR-2012-5, *supra* note 2.

13 *See id.*

14 *See id; see also* I.R.S. 2012 OVDP FAQ, *supra* note 10, at 51.1—51.3.

15 *See* I.R.S. 2012 OVDP FAQ, *supra* note 10, at 7.

16 *See id.*

17 *See* I.R.S. 2012 OVDP FAQ, *supra* note 10, at 15.

18 *See* Joint Comm. on Taxation, *Technical Explanation of the "Foreign Account Tax Compliance Act of 2009"* (JCX-42-

09), Oct. 27, 2009, *available at* https://www.jct.gov/publications.html?func=startdown&id=3596.

19 *See* 18 U.S.C. § 3506.

20 *See* I.R.S. 2012 OVDP FAQ, *supra* note 10, at 21.

21 *See* U.S. Dep't of Justice Press Release, UBS Clients and Tax Attorney Indicted in Phoenix for Hiding Assets in Secret Foreign Bank Accounts (Jan. 30, 2012), *available at* http://www.justice.gov/tax/2012/txdv12136.htm.

22 *See* U.S. Department of Justice Offshore Compliance Initiative Notice, http://www.justice.gov/tax/offshore_compliance_intiative.htm (last visited Dec. 3, 2012).

23 *See* Robert W. Wood, *IRS Makes Swiss Cheese Of Swiss Banks,* Forbes.com, Jan. 9, 2012, http://www.forbes.com/sites/robertwood/2012/01/09/irs-makes-swiss-cheese-of-swiss-banks/.

24 *M.H. v. United States* (*In re Grand Jury Investigation M.H.*), 648 F.3d 1067 (9th Cir. 2011).

25 *Id.*, *cert. denied*, 133 S. Ct. 26 (2012).

26 No. 4:11-mc-00174 (S.D. Tex. Feb. 11, 2011) (under seal).

27 *See* David Voreacos, *Swiss Banks Said Ready to Pay Billions, Disclose Customer Names*, Bloomberg.com, Oct. 24, 2011, http://www.bloomberg.com/news/2011-10-24/swiss-banks-said-ready-to-pay-billions-disclose-customer-names.html.

28 *See* Emma Thomason, *Swiss Banks Hand Over Encrypted Data in U.S. Tax Row*, Reuters, Jan. 31, 2012, *available at* http://www.reuters.com/article/2012/01/31/us-switzerland-usa-tax-idUSTRE80U10Y20120131.