Offshore Tax Evasion: US Initiatives

Scott D. Michel, Caplin & Drysdale

This Article discusses the US reporting rules for US taxpayers with foreign accounts and assets (including FBAR and FATCA), the civil penalties for non-compliance with the US reporting rules, current US enforcement initiatives aimed at discovering US taxpayers with undeclared foreign accounts or assets, and the options for US taxpayers to address prior non-compliance with the US reporting rules.

The US government has increased its focus on international tax issues in an effort to improve information reporting, obtain more tax and penalty revenue, and enhance its enforcement efforts. In particular, the US has been aggressively pursuing US taxpayers with unreported foreign assets to increase US revenue and bring US taxpayers into compliance with the US tax laws.

Through a variety of initiatives, the US government has obtained information about US account holders and their foreign assets from jurisdictions that rarely, or never, shared this type of information with the US. Multi-lateral diplomatic and economic pressures are causing nations that previously accepted bank secrecy as a tradition and, more practically, as a mechanism to attract deposits from around the world, to move toward greater transparency and cooperation regarding financial information.

The IRS has increased its global enforcement presence, particularly through its Criminal Investigation Division, and tax authorities worldwide have engaged in cooperative efforts to discover taxpayers with unreported assets. Given the current climate, US taxpayers (both individuals and businesses) with foreign financial assets and other foreign assets should review their compliance with the US reporting requirements. If non-compliant, these taxpayers should consider the options to correct their non-compliance with minimal risk of criminal repercussions and with potentially reduced civil money penalties.

This Article generally discusses the US reporting rules for foreign accounts and assets, the civil penalties for non-compliance, current US enforcement initiatives and the options for US taxpayers to address prior non-compliance.

US REPORTING REQUIREMENTS

There are a number of US reporting requirements for foreign financial accounts and other foreign assets of US citizens and residents (including individuals, corporations, partnerships, trusts and estates). The reporting requirements include, but are not limited to:

- Income tax (see *Income Tax*).
- Foreign bank account report (FBAR) (see *FBAR*).
- Foreign Account Tax Compliance Act (FATCA) filings (see *FATCA and Bank Disclosure*).
- Other reporting rules for certain foreign entities and assets (see *Other Reporting Rules for Foreign Entities and Assets*).

Income Tax

US taxpayers must report and pay US federal income tax on their worldwide income. This includes the reporting of investment income earned on foreign financial accounts and other foreign assets.

US tax reporting also requires US taxpayers, both individual and certain business taxpayers, to disclose the existence of any foreign financial accounts on their US federal income tax return if they have a financial interest or signature authority over these types of accounts.

Schedule B of IRS Form 1040 requires US individual taxpayers to:

- List all sources of interest and dividend income, including income from foreign accounts.
- Check a box answering the question about whether they have signature authority or a financial interest in any foreign accounts, and if so, to list the names of the countries where the account or accounts are held.
- Beginning with the 2011 IRS Form 1040, answer a question about whether they are required to file an FBAR to identify their foreign accounts (see *FBAR*).

Schedule D of IRS Form 1040 requires reporting of capital gains transactions, including gains or losses incurred in foreign investment accounts.

Effective with 2011 tax filings that are due in 2012, US individual taxpayers with an interest in any "specified foreign financial assets" are now required to attach a disclosure statement to

their US federal income tax returns if the aggregate value of the reportable foreign assets is greater than $50,000 (see *IRS Form 8938*). Specified foreign financial assets include:

- Depository or custodial accounts at foreign financial institutions.
- Stocks or securities issued by foreign persons.
- Any other financial instrument or contract held for investment issued by a foreign counterparty.
- Any interest in a foreign entity.

These new reporting requirements supplement the existing FBAR and other reporting requirements (see *FBAR* and *IRC § 6038D*).

US business taxpayers are also subject to US income tax reporting rules with regard to certain ownership interests in foreign entities. US corporations, partnerships and other entities are generally required on their US federal income tax returns (for example *IRS Forms 1120* or *1065*) and on information returns included with their US federal income tax returns (for example, *IRS Forms 5471* or *8865*) to disclose controlling interests and certain specified minority interests in foreign corporations, partnerships or other foreign entities. In addition, certain US entities may eventually be required to file the IRS Form 8938 if final regulations add US entities to the list of required filers.

If a foreign corporation conducts a "trade or business" in the US or has other specified connections to the US, the foreign corporation must file an IRS Form 1120-F which requires extensive reporting of its income and assets. In addition, although a controlled foreign corporation (CFC) (generally a foreign corporation that is more than 50% owned by certain US stockholders) can defer taxation on income earned outside the US, there are a number of exceptions (generally referred to as "subpart F income"). Subpart F income includes:

- Investment income earned from stocks, bonds and similar assets.
- Income earned in certain jurisdictions through transactions with related parties outside the jurisdiction.
- Certain other items

Subpart F income must be reported by a US stockholder of the CFC on a current basis on its US federal income tax return if the US stockholder owns 10% or more of the total combined voting power of all classes of voting stock of the CFC.

FBAR

A US person with a financial interest in, or signature authority over, any foreign financial account must generally file an FBAR annually if the aggregate value of these accounts exceeds $10,000 at any time during the calendar year (see *Form TD F 90-22.1*). The rules define foreign financial account broadly to include all bank, brokerage, securities and similar accounts, and even capture cash value life insurance policies and custodial metal accounts maintained at foreign financial institutions.

The FBAR rules also include broad definitions for "financial interest" and "signature authority." A "financial interest" includes any control, direct or indirect, over a foreign financial account, and reaches US citizens or residents with a greater than 50% interest in a corporation or partnership with foreign financial assets. The FBAR rules also treat many US grantors and US beneficiaries of foreign trusts as having a reportable financial interest. With "signature authority," although there are exceptions, FBAR reporting is required from:

- US employees who hold signature authority over a company's foreign bank and other financial accounts.
- US family members who maintain powers of attorney over personal foreign accounts for their US relatives.

In 2011, there were two significant FBAR developments that broadened and expanded these requirements even further:

- The Financial Criminal Enforcement Network (FinCEN) issued new rules regarding reporting requirements for US persons with foreign financial accounts.
- The IRS issued a new FBAR form and instructions.

The new FBAR rules add to existing reporting requirements and substantially broaden FBAR filing obligations. For example:

- The new rules now require FBARs from any US citizen or resident (defined in *IRC § 7701(b)*) rather than relying on a common law residency test. This extends FBAR reporting to anyone who can "tie-break" residence to a foreign country (*Treas. Reg. § 301.7701(b)-1*).
- In many cases, the new rules require FBAR filings from US employees of US or foreign companies who have signature authority over foreign bank and other financial accounts. Although there are exceptions that attempt to mitigate the burden of these filings, FinCEN rejected proposed exemptions for custodians of employee benefit plans, and for employees of:
  - US subsidiaries of a foreign parent;
  - foreign subsidiaries of a US parent; and
  - US parent companies that can sign accounts owned by the parent's foreign subsidiary, even if these accounts are reported on the parent company's FBAR.
- Any US citizen or resident considered an owner of a foreign trust must now file the FBAR. The FBAR rules continue to impose an FBAR reporting requirement on US trust beneficiaries who are entitled to more than 50% of a trust's income or assets, but these persons can rely on an FBAR filing by a US trustee that reports the foreign account.
- The new FBAR rules make it clear that US corporations, US partnerships and other US entities must file FBARs, and those entities that might be disregarded for US tax purposes are also subject to the FBAR requirement.
- US account holders in US retirement plans are now exempt from FBAR filing to the extent these plans hold foreign accounts, but other benefit plans (for example, those maintained by foreign companies that do not qualify under

the US tax code) are not exempt. US citizens or residents with interests in these non-exempt benefit plans may also be required to file an FBAR.

Importantly, the new rules contain a broad anti-avoidance provision, attributing a reportable financial interest to any US citizen or resident who causes the creation of an entity to evade the FBAR filing rules. For more information about the FBAR rules, see the FBAR page on the IRS website.

FATCA and Bank Disclosure

The Foreign Account Tax Compliance Act (FATCA), enacted in 2010, is one of the most complex and important tax laws in many years.

The provisions of FATCA are intended to promote compliance with the US laws that require US persons to report income from foreign accounts. Generally under FATCA, foreign financial institutions (FFIs) must disclose the identities of their US account holders or face a 30% withholding on "withholdable payments" (including certain payments of gross proceeds and other non-taxable amounts).

In certain circumstances, FACTA extends to "non-financial foreign entities" (NFFEs) and even to some US financial institutions. The IRS has received extensive comments from affected parties worldwide, and has issued three sets of extensive guidance directed at the highly technical and complex implementation issues triggered by FATCA (including *Proposed Treasury Regulations* and *IRS Notice 2011-53*). More guidance is forthcoming. For more general information about FATCA, see the FATCA page on the IRS website, *Practice Note, What's Market: FATCA Provisions in Loan Agreements (http://us.practicallaw.com/7-502-0730)* and *Article, Impact of FATCA on Foreign Funds (http://us.practicallaw.com/2-518-6799)*.

The FATCA provisions for FFIs and NFFEs begin to take effect in 2014. Once effective, an era of automatic information exchange will begin between nearly all worldwide financial institutions and US taxing authorities. Any semblance of bank secrecy for US account holders worldwide will disappear.

Moreover, and perhaps most important, FATCA is setting in place a regime where the IRS will be able to match information obtained annually from foreign banks with US individual taxpayer filings on IRS Form 8938 (see *Income Tax*). As a result, US individual taxpayers with foreign financial accounts will find themselves similarly situated to US individual taxpayers with US accounts who receive an IRS Form 1099. The failure to file an IRS Form 8938 or to report foreign assets could result in the same kind of computer generated IRS contact where the IRS has information that a US taxpayer has a foreign financial account or asset. This could lead to comprehensive tax audits, penalty examinations and even criminal inquiries where there has been an intentional failure to report foreign financial accounts or assets.

Other Reporting Rules for Foreign Entities and Assets

There are a number of US reporting requirements for US persons with ownership interests in certain types of foreign entities and assets, including:

- Foreign trusts (see *Foreign Trusts*).
- Controlled foreign corporations (CFCs) (see *CFCs*).
- Passive foreign investment companies (PFICs) (see *PFICs*).
- Gifts, bequests or other transfers to or from foreign persons (see *Gifts, Bequests or Other Transfers To or From Foreign Persons*).

Foreign Trusts

Many foreign financial assets are held in trusts or foundations often formed in tax haven jurisdictions. In fact, many undeclared foreign accounts were set up either through:

- Nominee entities, such as trusts or foundations (for example, Liechtenstein Stiftungs).
- Companies in which the account holder or a nominee held the shares.

A US taxpayer's relationship with these types of foreign entities is generally required to be reported on US federal income tax filings. Relationships with foreign trusts are reportable on IRS Forms 3520 and 3520-A and ownership of a foreign company is generally reportable on an IRS Form 5471. Failure to file these IRS forms can result in significant penalties, for example:

- If a US transferor of property to a foreign trust or a US recipient of a distribution from a foreign trust fails to timely file an IRS Form 3520 to report these transactions, the IRS can impose a civil penalty equal to 35% of the gross value of the property transferred to or received from the foreign trust.
- If a foreign grantor trust fails to timely file a IRS Form 3520-A or fails to provide all of the required information, a US owner can be subject to a civil penalty equal to 5% of the gross value of the portion of the foreign trust's assets treated as owned by the US person at the close of the taxable year.
- The failure to timely file a complete and correct IRS Form 3520 or IRS Form 3520-A can result in an additional civil penalty of $10,000 per 30-day period for failing to comply within 90 days of notification by the IRS that the information return has not been filed. However, the total civil penalty for failure to report a foreign trust transfer cannot exceed the amount of the property transferred.

CFCs

If a US stockholder has a reportable interest in a CFC, the filing of an IRS Form 5471 may be required. Depending on the type of foreign corporation involved, and the CFC's relationship to the US stockholder, there are varying penalties that can be imposed on the failure to file an IRS Form 5471. Generally, the civil penalty is $10,000 per failure to file, but additional penalties can be imposed if the form is not filed after notice by the IRS.

PFICs

Many US taxpayers holding accounts at foreign financial institutions (whether knowingly or not) are invested in foreign mutual funds which are classified as PFICs for US tax purposes. Unlike US mutual funds, PFICs generally do not issue annual dividends and capital gains distributions and therefore the US owners of a PFIC are potentially subject to adverse US federal income tax consequences.

The general purpose of the PFIC rules is to eliminate the tax advantage to US stockholders of investing in passive assets (for example, stocks and securities) through a foreign corporation (meaning, the tax advantage of deferring US taxation of investment income until dividends are paid or shares sold). However, the PFIC rules are drafted broadly and can apply to substantial operating companies and even to foreign companies that are subject to tax in their home countries at rates greater than current US tax rates. For more general information about PFICs, see *Practice Note, Passive Foreign Investment Companies (http://us.practicallaw.com/9-501-1471)*.

Under the PFIC rules, a US stockholder that owns shares of a PFIC is subject to special rules with respect to any gain it realizes on the sale (or other disposition) of its shares and any "excess distribution" from the PFIC as well as to special US information reporting requirements (see *IRS Form 8621*). A US stockholder generally receives an excess distribution in a given taxable year to the extent that any distributions to the US stockholder (during that year) exceed 125% of the average annual distributions received by the US stockholder during the three preceding taxable years (or the US stockholder's holding period if shorter) (see *IRC Section 1291(b)*). The effect of these special PFIC rules can be quite severe and can subject a US stockholder to an extremely high tax rate and punitive interest charge on any excess distribution or gain from the sale or other disposition of PFIC stock. In certain circumstances, a US stockholder can mitigate these adverse tax consequences by making a QEF election or a mark-to-market election (for more information, see *Practice Note, Passive Foreign Investment Companies (http://us.practicallaw.com/9-501-1471)*.

During the 2009 and 2011 offshore voluntary disclosure initiatives (see *Remedies for Prior Non-compliance*), the IRS agreed to an alternative mark-to-market reporting method for PFIC reporting. The alternative reporting method greatly simplified the PFIC reporting and spared the participants the punitive interest charges that would have otherwise applied under the PFIC rules. It is not yet clear whether this alternative mark-to-market reporting method will be available in the third offshore program announced recently (see *Remedies for Prior Non-compliance*). The IRS has taken the view that the alternative reporting method does not otherwise apply, for example, in the case of civil audits of taxpayers with unreported foreign accounts.

Gifts, Bequests or Other Transfers To or From Foreign Persons

If a US donee fails to timely file an IRS Form 3520 to report the receipt of large gifts or bequests from foreign persons (generally in excess of $100,000 in a given year) or files the form incorrectly or incompletely, the US donee can be subject to a civil penalty equal to 5% to 25% of the value of the foreign gifts or bequests received in the relevant year.

Similarly, if a US taxpayer (including an individual, corporation, partnership or trust), transfers assets to a foreign corporation or partnership, these transfers generally must be reported on IRS Forms 926 or 8865, as applicable, with substantial penalties for failure to comply (especially for intentional non-compliance). US taxpayers who make gifts or bequests to foreign persons must comply with US gift and estate tax reporting rules. It is important to note that the "spousal exemption" for gifts between husbands and wives generally does not apply to gifts from a US spouse to a foreign spouse. For 2012, gifts from a US spouse to a foreign spouse in excess of $139,000 are generally subject to the US gift tax.

CIVIL PENALTIES FOR NON-COMPLIANCE

The willful failure to comply with FBAR rules and the reporting rules for "specified foreign financial assets" on IRS Form 8938 can subject US persons involved to:

- Prosecutions for criminal offenses under US law (see *Criminal Investigations of Foreign Businesses and Persons*).
- Civil money penalties.

The civil money penalties for failure to report foreign assets can be substantial. For example, the civil penalty for the willful failure to file the FBAR form can be 50% of the balance in the unreported foreign financial account **per year**, over a six year statute of limitations (meaning, potentially triple the value of the account). This FBAR penalty can apply not just to the US account holder, but to anyone who causes any violation of the FBAR filing requirement (*31 U.S.C. § 5321(a)(5)*).

To sustain and collect the substantial penalty for willful failure to file the FBAR, the IRS must carry a burden of proof in US federal court in a lawsuit aimed at the US account holder and demonstrate that the US account holder's failure to file the FBAR form was willful. This is often a difficult burden for the IRS to satisfy, especially in cases involving US citizens who have lived abroad for many years and whose conduct does not reflect affirmative acts of fraud or concealment. In 2010, a US federal judge ruled in one case that the IRS had failed to carry its burden of proof and rejected the IRS's attempt to collect the maximum FBAR penalty (*United States v. Williams, 106 A.F.T.R.2d (RIA) 2010-6150 (E.D. Va. 2010)*). This case is now on appeal to the US Court of Appeals for the Fourth Circuit.

There is also a non-willfulness penalty for FBAR violations of $10,000 per infraction. The IRS interprets this to mean that even a non-willful violation where multiple foreign accounts are involved can result in a civil penalty of $10,000 per foreign account per year. However, there is a reasonable cause exception to this civil penalty.

Additionally, the failure to comply with the new requirement to report specified foreign financial assets on IRS Form 8938 (see *Income Tax*) can both:

- Increase the applicable tax penalties substantially. The failure to file a timely and complete IRS Form 8938 can result in civil penalties up to $50,000. Further, if a US individual taxpayer does not provide sufficient information to demonstrate the value of specified foreign financial assets, there is a presumption that the foreign assets exceed $50,000 for purposes of assessing the civil penalty. Similarly, there is a new "undisclosed foreign financial asset understatement" that triggers a 40% civil penalty on any tax arising from unreported foreign income sources.
- Extend the statute of limitations applicable to the IRS's review of the US taxpayer's entire US federal income tax return. The statute of limitations increases from three to six years if a US taxpayer omits from gross income on its US federal income tax return more than $5,000 of income attributable to certain foreign assets. The extended statute of limitations covers the US taxpayer's entire US federal income tax return, not just the omitted items.

There are also significant civil penalties for the failure to report:

- An ownership interest in a foreign trust, CFC or PFIC.
- Gifts, bequests or other transfers to or from foreign persons.

(See *Other Reporting Rules for Foreign Entities and Assets*.)

The statute of limitations for criminal tax offenses is six years. The statute of limitations on civil penalties varies by the specific penalty involved, but many civil penalties either have a six year statute of limitations or no statute of limitations if no tax form or return was ever filed.

US ENFORCEMENT INITIATIVES

The US government has implemented and followed a number of procedures aimed at discovering US taxpayers with undeclared foreign financial accounts and other foreign assets. The current and expanding information disclosure regime includes a combination of methods to obtain information about foreign financial accounts and other foreign assets in bank secrecy and other foreign jurisdictions. The current climate in the US strongly suggests that any US taxpayers who have not complied with the US rules requiring the reporting of foreign accounts and other foreign assets should take advantage of the IRS's current voluntary disclosure program (see *Remedies for Prior Non-compliance*) or consider alternative methods of coming into compliance (for example, by filing amended tax returns and delinquent FBARs).

Whistleblowers

The US has obtained information about a number of foreign banks and their activities involving US account holders from whistleblowers. This information has led to the investigation of multiple foreign financial institutions and to the audits or prosecution of a large number of US taxpayers.

The whistleblower trend is likely to increase, especially given the creation of a new IRS whistleblower office, whose mission is to solicit information from whistleblowers and supervise the process of paying rewards for valuable data. The whistleblower office is authorized to pay significant rewards for specific information leading to a determination that a US taxpayer has an unpaid tax liability. The law provides for two types of awards:

- For cases where the amounts involved exceed $2 million, the IRS can pay 15% to 30% of the amount collected.
- In other cases, rewards can equal 15% of the amount collected.

Whistleblowers who disagree with their reward amount can appeal to the US tax court for more money (*26 U.S.C. § 7623*).

Whistleblower claims are reviewed by specialists in the whistleblower office and, if deemed worthy of investigative work, are sent to agents in the field for further development. All information provided by whistleblowers is screened by the IRS Criminal Investigation Division, which has new offices in Beijing, Sydney and Panama, and other offices worldwide.

Criminal Investigations of Foreign Businesses and Persons

Corporations doing business in the US are treated as legal persons. They can sue and be sued, and they can be indicted, as an entity, for criminal offenses.

Under principles of *respondeat superior*, a corporate entity is responsible for the conduct of its employees. Where one or more individual employees engage in unlawful conduct in connection with their employment, their actions can be deemed actions of their employer and subject the employer to criminal sanction. Under this legal principle, the US Justice Department has pursued criminal charges against foreign financial institutions and their employees as well as foreign financial advisors and others perceived to have enabled US persons to commit US tax fraud in connection with unreported foreign assets.

The IRS Criminal Investigation Division (IRS-CI) includes approximately 2,700 special agents whose job is to investigate criminal tax offenses, including:

- The failure to report foreign accounts and other foreign assets.
- Criminal conspiracy arising out of conduct aimed at enabling or assisting US taxpayers in hiding money offshore.

IRS-CI develops referrals from civil audits, from whistleblower tips and from other sources. IRS-CI has played a prominent role in developing information obtained from:

- The more than 30,000 US taxpayers who came forward in the first two voluntary disclosure initiatives and who identified their foreign banks, bankers and other advisors who assisted them in hiding money offshore (see *Remedies for Prior Non-compliance*).
- Whistleblowers (*Whistleblowers*).
- Other sources as the basis for additional criminal investigations and US indictments.

Criminal tax prosecutions in the US usually result in significant sanctions, including incarceration, fines and restitution.

Additionally, the US has already entered into a settlement with one major foreign bank and is reportedly pursuing a "global settlement" with a number of Swiss banks. If successful, these Swiss banks could be required to turn over account information for a large number of US account holders. However, it is important to note that criminal investigations have spread beyond traditional bank secrecy jurisdictions (for example, Switzerland) to foreign financial institutions with a presence in India, Israel and parts of Asia.

Civil Summons

Any foreign financial institution or other foreign business enterprise with a US presence can be served with civil process. This civil process can include an administrative summons authorized by the Internal Revenue Code seeking information on non-compliant US taxpayers. If the IRS already identified a non-compliant US taxpayer, it can serve either a:

- Summons directly on the US taxpayer.
- Third party recordkeeper summons on any financial institution (US or foreign that has a presence in the US) seeking the US taxpayer's account information.

If the IRS cannot identify a particular US taxpayer, it has the option of using a "John Doe" summons. The IRS has used the John Doe summons method to obtain foreign account information from foreign financial institutions about non-compliant US taxpayers with foreign accounts at these institutions. The law permits the IRS to serve John Doe summons where the IRS cannot identify a specific US taxpayer, but it can demonstrate that:

- A group of US taxpayers may have committed tax violations.
- The foreign financial institution may possess evidence of tax violations.
- The IRS has no readily available alternative means of obtaining the information.

Recently, the US Justice Department has started serving grand jury subpoenas on US individuals known or suspected to have undeclared foreign accounts. The grand jury subpoenas seek all information in the possession of the US taxpayer relating to its foreign account. US taxpayers have tried to decline to comply with the subpoena on the basis of the US Constitution's Fifth Amendment privilege against self-incrimination, which in this context protects one from being compelled to make implicit testimonial admissions through the production of foreign account records. However, there is a longstanding exception to the Fifth Amendment in the case of records required to be kept by US law.

The US Justice Department has argued successfully in one appellate court that records of foreign bank accounts must be maintained under Title 31 Section 5314 of the US Code and therefore has successfully deprived a foreign account holder of its Fifth Amendment privilege as it relates to the production of foreign account records in response to a grand jury subpoena (*M.H. v. United States, 648 F.3d 1067 (9th Cir. 2011)*). However, the Justice Department has not always succeeded with this argument, for example, where the court declined to extend the required records exception to foreign bank records (*In re Grand Jury Investigation, Misc. No. H-11-174 (S.D. Tex. 2011)*). Given the conflicts in the courts on this issue, this issue may head to the US Supreme Court for a final determination.

Audits

The IRS has also started auditing US taxpayers suspected of having undeclared foreign accounts and other foreign assets. In particular, the IRS has pursued a "High Net Worth Initiative," which seeks to centralize IRS expertise in the audit of high net worth individuals and their associated entities. Through a combination of recruitment and training, the IRS is developing an expert group of agents who specialize in analyzing corporate, pass-through, trust and other entities used by high net worth individuals to hide foreign assets.

Income Tax Treaties and Mutual Information Exchange Agreements

International pressure is growing for greater transparency with regard to foreign financial account information. The Organization for Economic Co-operation and Development (OECD) and the European Union (EU) have recently been pressuring a number of countries to be more transparent and to adopt broader information exchange provisions according to the OECD standard, which generally permits one nation to request information regarding conduct that would constitute a tax violation (whether or not it constitutes a tax violation in the country from which the information is sought). The OECD Model Agreement on Double Taxation, aimed at preventing double taxation of individuals and businesses in cross-border transactional or other situations, contains broad based provisions allowing for information exchange.

There have also been a number of developments in the area of income tax treaty-based information exchange:

- In 2008, the US and Liechtenstein entered into a broad based Information Exchange Agreement, applicable for years 2009 and beyond, which permits disclosure by Liechtenstein to the US of information relating to potential US tax offenses.
- In 2009, the US and Swiss governments signed a new income tax treaty protocol under which Switzerland would expand information disclosure under the Double Taxation Agreement beyond the narrow concept of "tax fraud" under Swiss law and into broader concepts of "tax evasion" or the mere failure to report income.
- In 2011, the Swiss government agreed to start processing US income tax treaty requests without requiring the identification of the US taxpayer under inquiry. Instead, requests can now be phrased to recite "behavioral patterns" across various account categories provided that certain additional criteria have been met. This is a significant expansion from prior Swiss practice, under which the Swiss would process a request

only against a named party. Now, if the IRS has information that a given bank or financial advisor has assisted a group of US taxpayers in hiding money, the tax treaty authorizes information exchange even if the IRS cannot identify the precise US taxpayers who may be involved. It is important to note that even though the Swiss Parliament has ratified and implemented this treaty protocol (as well as the one adopted in 2009), the US Senate has not yet done so. In April 2012, a Swiss federal administrative court held that the absence of US ratification required Switzerland to process certain information requests made under the US-Swiss income tax treaty under the earlier, and far narrower, disclosure regime (see *Press Release, Bundesverwaltungsgericht, A-737/2012: Decision of the Swiss Fed. Admin. Court in re Credit Suisse client v. Swiss Fed. Tax Admin. (Apr. 10, 2012)*).

There has also been other progress in Asia:

- In 2009, Singapore's Ministry of Finance endorsed the OECD's Standard for the Exchange of Information for Tax Purposes in March 2009, a requirement to keep off the OECD's "black list" of tax haven countries. This means that Singapore is adopting the international standard for information disclosure, and would be obligated to produce information in response to a properly framed request from a treaty partner even if the alleged offense would not have violated the laws of Singapore.
- In 2010, the Hong Kong legislature adopted a measure to permit its Inland Revenue Department to gather information from taxpayers regarding "any matter that may affect any liability, responsibility or obligation of any person ... under the laws of a territory outside Hong Kong concerning any tax of that territory" under certain conditions. The Hong Kong government is also considering administrative rules to implement these provisions, and it has signed information exchange agreements with a growing number of nations, but not yet with the US.

REMEDIES FOR PRIOR NON-COMPLIANCE

The IRS voluntary disclosure policy applies to all US taxpayers, whether individual, corporate, partnership, trust or other entity. As long as a case involves legal source income (meaning, not the proceeds of non-tax crimes), both US individual and business taxpayers potentially can use the US voluntary disclosure process to avoid criminal sanctions for:

- The failure to report the existence of, and income earned on, a foreign account or asset on its US federal income or estate tax returns.
- The non-filing of the FBAR (see *FBAR*) and other information returns (for example, IRS Forms 3520, 3520A and 5471).

To qualify for US voluntary disclosure, the disclosure must be:

- Timely, meaning before the IRS has:
  - begun a civil audit or criminal investigation of the US taxpayer or notified the US taxpayer that intends to do so;
  - obtained information about the specific US taxpayer's non-compliance;
  - started an audit or investigation "directly related" to the specific US taxpayer; or
  - received information related to the US taxpayer from some kind of criminal enforcement action (for example, material produced pursuant to a grand jury subpoena served on a third party).
- Truthful and complete.
- Accompanied by payment of the relevant US tax and interest (or the making of good faith arrangements to pay).

Additionally, the US taxpayer must promise continuing cooperation in any further review or inquiry by the IRS.

In 2009 and 2011, the IRS had two special voluntary disclosure programs to encourage US taxpayers to come forward with voluntary disclosures about previously undeclared foreign accounts or assets. Any US taxpayer who began the voluntary disclosure process before the IRS learned of their tax non-compliance or opened an audit or investigation against them was eligible to make a voluntary disclosure, and participating in these initiatives likely both:

- Avoided criminal prosecution.
- Minimized civil penalties. Participants still paid civil penalties that, while substantial, were well below what the US tax authorities could, by law, otherwise seek to collect.

More than 30,000 US taxpayers participated in the 2009 and 2011 programs.

On January 10, 2012, the IRS announced a third voluntary disclosure program. This program does not have a specified deadline, although the IRS was clear that the program could be terminated at any time. In general, the program requires the submission of information first to the IRS-CI, and then the filing of eight years of tax returns, FBARs and other required tax forms. While specific guidance on this new program is expected this year, a US taxpayer generally must pay the US tax and interest on the investment income earned in the foreign accounts or on the foreign assets over the eight year period, plus two penalties:

- An accuracy, failure to file and/or failure to pay civil penalty (plus interest) of 20% or 25% of the tax due.
- An omnibus "offshore" civil penalty of 27.5% of the highest value in the unreported foreign assets during the previous eight years. This second civil penalty can be reduced in certain limited circumstances.

US taxpayers can "opt out" of the 2012 voluntary disclosure program if they believe, and can demonstrate, that their failure to report the foreign accounts or assets was not willful. Opting out enables the IRS to conduct a full audit, and if the taxpayer can satisfy the IRS that their conduct was not willful, lesser penalties might be imposed (for example, the non-willful FBAR penalty). However, opting out is an irrevocable waiver of the civil penalty cap applied in the voluntary disclosure program, so any decision to opt out must be made with great care and under the advice of a tax professional.