U.S. Offshore Account Enforcement Issues

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Scott D. Michel, Zhanna A. Ziering and Young Ran Kim examine the methods of enforcement being used by the U.S. government in its efforts to bring U.S. taxpayers into compliance, to prosecute wrongdoers, and to penetrate longstanding protections for bank information.

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I. Introduction

Since 2008, the U.S. government has been aggressively moving against potentially thousands of taxpayers who may have undeclared accounts all over the world. Through a variety of mechanisms, the government has obtained information about American account holders and their assets from jurisdictions previously thought nearly impenetrable. Many of the developments are public; others are occurring in quiet conference rooms in Washington, D.C. and elsewhere and may never become fully known to the public.

The recent developments portend the eventual erosion of traditional concepts of bank secrecy and increased transparency among nations regarding financial information. In large part, a consensus has emerged that disclosure of heretofore secret bank data is now routinely warranted not just to protect against more heinous crimes such as terrorism, narcotics, money laundering and financial fraud, but more simply, to promote the tax and fiscal interests of a given nation. Indeed, there is a growing trend of multi-lateral and bilateral arrangements among various countries that may lead to the eventual transparency among taxing authorities of much of the world's personal financial account information.

This article discusses the methods of enforcement, incentives and deterrence that are being used by the U.S. government in its efforts (1) to bring U.S. taxpayers into compliance; (2) to prosecute alleged wrongdoers located both in and outside the United States; and (3) to penetrate longstanding protections for bank information maintained in many countries outside the United States.

II. Foundation Principles—Criminal and Civil Exposure in Undeclared Account Cases

There are various reporting requirements for U.S. citizens and residents, including individuals, corporations, partnerships, trusts and estates, involving foreign accounts and other foreign holdings. The willful failure to comply with these requirements can be prosecuted as criminal offenses under U.S. law and subject the persons involved to substantial civil monetary penalties (in addition to tax and interest). Even the nonwillful failure can result in the assessment of tax, interest and penalties. The statute of limitations for criminal tax offenses is six years. The statutes of limitations on civil penalties vary by the specific penalty involved, but the most serious of the civil penalties either have a six-year, or no, statute of limitations.

A. Income Tax

U.S. taxpayers are required to report and pay tax on their worldwide income. This includes the reporting of investment income earned on financial accounts located outside the United States. U.S. tax reporting also requires taxpayers to disclose the existence of any foreign accounts on the individual's U.S. tax return. Schedule B of the Form 1040, and other tax forms, require filers to check a box answering the question whether they have signature (or other) authority or a financial interest in any foreign accounts, and if so, to list the names of the countries where the account (or accounts) is held. Beginning with the 2011 tax year, taxpayers must also answer a question on Schedule B as to whether they are required to file the Report of Foreign Bank and Financial Accounts (FBAR); and if they have "specified" foreign assets, the taxpayers must also file a Form 8938 together with their income tax return.

There are criminal penalties for the willful failure to report income and the willful filing of a false return. In addition, the IRS may assess tax, interest and penalties equal to as much as 75 percent of any tax understatement for civil fraud, and lesser percentages for incorrect filings. There are also special penalties, discussed below, arising from the failure to file, or the filing of an inaccurate or incomplete, Form 8938.

B. Foreign Bank Account Reporting (FBAR)

U.S. law also requires the filing of a separate information return, Financial Crimes Enforcement Network ("FinCEN") Form 114, known as an "FBAR," by June 30 following each calendar year. The form is not filed with a tax return—it is filed electronically *via* FinCEN's Bank Secrecy Act (BSA) E-Filing System. There are no extensions to the filing deadline.

A nonwillful failure to file an FBAR can be penalized up to $10,000. But a willful failure to file an FBAR can result in a civil penalty of as much as 50 percent of the value of the foreign account, with no cap for each violation, per year.[1] Thus, a taxpayer with a substantial undeclared foreign account may face the prospect of a multi-year civil penalty for a willful failure to file the FBAR that would not just exhaust the balance of the entire account but may result in the taxpayer having to pay additional funds.

The statute of limitations on FBAR penalties is six years. The IRS has the burden of proving willfulness, and must engage in special judicial proceedings to collect the penalty if imposed. So, in ordinary times, a practitioner should be able to negotiate the penalty downward, or away altogether, especially in the case of inherited accounts or where there are other factors indicating that the taxpayer was unaware of the FBAR filing requirement or otherwise had reasonable cause for failure to file. However, as noted below, the IRS has an offshore voluntary disclosure initiative, and IRS agents have no discretion to lower penalty amounts below those set forth in the offshore voluntary disclosure program guidance.

Note also that the penalty for failing to file the FBAR can apply to anyone who violates, *or causes any violation of,* the filing requirement.[2] Recently U.S. government officials have stated that they believe the FBAR penalty can be assessed and collected against third parties who aid and assist U.S. taxpayers in their failure to declare accounts. As noted, the willfulness penalty is 50 percent of the highest account balance and can be imposed for each of the six years open under the statute of limitations. If the United States could prove a bank's participation in a series of FBAR violations for hundreds of account holders, the potential penalty exposure could be staggering.

In order to sustain and collect the substantial penalty for willful failure to file the FBAR, the IRS must carry a burden of proof in U.S. federal court in a lawsuit aimed at the account holder, and demonstrate that the account holder's failure to file the FBAR was willful. This could be a difficult burden for the government to carry in many cases, especially those involving U.S. citizens who have lived abroad for many years and whose conduct does not reflect affirmative acts of fraud or concealment.

However, in two recent decisions, federal courts have opined on the definition of willfulness in the context of the civil monetary penalty for the failure to file the FBAR, which resulted in a weakening of the standard for "willfulness" in the civil penalty context as compared to a criminal case.

In both *Williams*[3] and *McBride*,[4] the government successfully established that the taxpayer's failure to comply with the FBAR obligations was willful for purposes of the civil penalty.

In both cases, the government's burden of proof on all questions before the court, including the question of whether the taxpayer's failure to comply with the FBAR filing obligation was "willful," was held to be "a preponderance of the evidence."

Taken together, both decisions appear to have adopted a standard of "reckless disregard" or "willful blindness" as a basis to establish "willfulness" for FBAR penalty purposes. "Reckless disregard" means that an individual was aware of the failure to file an FBAR and nonetheless ignored the obligation to file the form. "Willful blindness" means that an individual deliberately took steps to avoid learning about a legal requirement, such as an FBAR filing requirement. Key factors in analyzing the willfulness issue after these recent court decisions are as follows:

- Did the taxpayer check the "foreign bank account question" box on the tax return yes or no?
- Did the taxpayer inform his return preparer that he held foreign accounts?
- Did the taxpayer sign his tax return under penalties of perjury (as required on Form 1040) even if the taxpayer did not fully read the return?
- Was the taxpayer ever put on notice that he may have failed to comply with rules regarding foreign accounts?
- Has there been a consistent pattern of failing to report foreign accounts over a multi-year period?

When combined with the lower burden of proof, *i.e.,* a preponderance of the evidence, these two court decisions establish a weaker standard for "willfulness" and elevate the exposure to potential FBAR willfulness penalties.

In an unprecedented development, on May 28, 2014, a federal jury found Carl Zwerner liable for a three-year willful FBAR penalty (*i.e.,* 150 percent of the account value).[5] The government had sought a four-year FBAR penalty. Among other issues, the defendant has argued that the multi-year FBAR penalty violates the Eighth Amendment's prohibition against excessive fines. On June 6, 2014, the case settled just prior to a court hearing on that issue for 100 percent of the account value (essentially for a two-year willful FBAR penalty).

C. Other Reporting Obligations

1. Reporting Obligations Relating to Foreign Entities

Many undeclared foreign accounts were set up through nominee entities, such as trusts or foundations (in Liechtenstein, *Stiftungs*), or companies in which the account holder or a nominee was a shareholder. A taxpayer's relationship with such entities is generally required to be reported as part of the U.S. tax filings. Foreign gifts or bequests, and distributions from and transactions with foreign trusts are reportable on a Form 3520, and one's ownership of a foreign company is generally reportable on a Form 5471.

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a. Forms 3520 and 3520-A. If a U.S. transferor of property to a foreign trust, or a U.S. recipient of a distribution from such a trust, fails to timely file a Form 3520 to report these transactions, the IRS may impose a penalty equal to 35 percent of the gross value of the property transferred to or received from the trust.

If a U.S. person fails to timely file a Form 3520 to report the receipt of a large gift or bequest from a foreign person or foreign estate, or files the form incorrectly or incompletely, such person may be subject to a penalty equal to five percent of the value of the gift or bequest received in the relevant year for each month that the failure to report continues, not to exceed 25 percent.

If a foreign grantor trust fails to timely file a Form 3520-A, or fails to furnish all of the required information, the U.S. owner may be subject to a penalty equal to five percent of the gross value of the portion of the trust's assets treated as owned by the U.S. person at the close of the tax year.

The failure to timely file a complete and correct Form 3520 or Form 3520-A may result in an additional 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. The total penalty for failure to report a trust transfer, however, cannot exceed the amount of the property transferred.

b. Form 5471. Depending on the type of foreign corporation involved, and the company's relationship to the U.S. shareholder, there are varying penalties that may be imposed on the failure to file a Form 5471. Generally, the 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.

c. Other Forms. Certain other filings are required in connection with owning interests in foreign partnerships (Form 8865) and with transfers to foreign corporations (Form 926). There are significant civil penalties for failure to file these forms as well.

2. Exceptions

These penalties generally have a "reasonable cause" exception, meaning that if the taxpayer can demonstrate that his or her failure to file the form was due to reasonable cause, the penalty can be abated in its entirety. Reasonable cause can include, for example, advice from a practitioner on which the taxpayer had relied, or a simple lack of knowledge on the taxpayer's part of the filing requirement.

However, in cases where there has been a failure to file such forms, there is no statute of limitations, so in theory, the IRS can reach back many years should it choose to impose civil penalties in these cases.

In the three previous IRS voluntary disclosure programs, the IRS generally permitted participants to disregard purely nominee entities and avoid filing these additional forms, so long as the entities were dissolved by the time the case was resolved. Under the new 2014 IRS voluntary disclosure program, in order to take advantage of this provision, the entity must be dissolved before the taxpayers file their amended tax returns.

D. Information Disclosure Regimes

The U.S. government has implemented and followed a number of procedures aimed at discovering American taxpayers with undeclared accounts and acting against them. The current and expanding information disclosure regime includes a combination of the following disclosure methods to obtain information about foreign financial accounts, whether in secrecy jurisdictions or otherwise:

- Informants and whistleblowers
- Criminal investigations of financial institutions and account holders
- Civil summons and audit processes
- Requests under tax treaties and mutual information exchange agreements
- The voluntary disclosures of thousands of Americans seeking to avoid criminal prosecution and obtain reduced civil penalties, and their continuing tax compliance
- FBAR filings
- Foreign Account Tax Compliance Act (FATCA) and related legislative and regulatory developments

These investigative tools provide the U.S. tax enforcement establishment with a template for continuing to pursue offshore accounts and making international tax compliance a major focus of its investigative push. This climate strongly suggests that any American taxpayer who has not complied with the rules regarding reporting foreign accounts should either take advantage of the IRS's voluntary disclosure policy or consider alternative methods of coming into compliance. This article discusses each information disclosure regime below.

III. Informants and Whistleblowers

The United States has obtained information about a number of foreign banks and their activity involving American account holders from informants and whistleblowers. Details of the information reported by Igor Olenicoff, Bradley Birkenfeld, Heinrich Kieber, Rudolf Elmer and other unidentified cooperators, informants, and whistleblowers have been reported at length in the press. This information has led to investigation of multiple foreign financial institutions and to the audits or prosecution of probably hundreds of U.S. persons. In some of these cases, the individual providing the secret information to the authorities has broken one or more laws of their home country, but that is not an obstacle preventing use of the information and investigation of the leads provided by U.S. authorities, unless one could show that the U.S. government affirmatively participated in the unlawful conduct.

A. IRS Whistleblower Office

For many years, the IRS had a somewhat informal program of encouraging informants and paying rewards, but the system was cumbersome and not productive. In 2006, the U.S. Congress passed legislation creating within the IRS a Whistleblower Office whose mission is to solicit information from informants and supervise the process of paying rewards for valuable data.

The Office is authorized to pay significant rewards for specific information leading to a determination that another party has an unpaid tax liability. The law provides for two types of awards. For cases where the amounts involved exceed $2 million, the IRS may pay 15 to 30 percent of amounts collected. In other cases, rewards may equal 15 percent of such amounts. Informants who disagree with their reward amount may appeal to the U.S. Tax Court for more money.

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 and attaches worldwide. It is not a coincidence that in the IRS National Office building in Washington, D.C., the Whistleblower Office is right next door to the offices of the Chief, Criminal Investigation Division.

A legal industry has emerged in the United States to encourage informants to come forward, with practitioners entering into contingent fee agreements with their clients to share in reward amounts.

In June 2012, in response to congressional criticism about the slow pace of paying whistleblower rewards, IRS Deputy Commissioner issued a Field Directive that announced that a comprehensive review of Whistleblower Office procedures was underway. The memorandum also requested that the Office adhere to a series of timelines aimed at promoting more expedited processing of whistleblower claims and the payment of appropriate rewards.

In September 2012, lawyers for Bradley Birkenfeld, the UBS banker who helped the U.S. government break open Swiss bank secrecy, but then served prison time for falsifying his own role in the matter, announced that the Whistleblower Office had paid him a reward of $104 million. This extraordinary development will likely encourage further whistleblowers to come forward and disclose information regarding Americans with unreported accounts overseas and foreign banks that encourage such practices or fail otherwise to comply with U.S. tax laws.

New regulations, recently issued by the Whistleblower Office with an effective date of August 12, 2014, clarify that rewards remain available even if a whistleblower was involved in the illegal conduct at issue, so long as he or she was not primarily responsible for planning or initiating the illegal conduct. The regulations also cover a number of technical issues, such as defining the "collected proceeds" on which the reward will be based.

B. Cooperation

In nearly every complex financial criminal investigation, the U.S. prosecutors rely on cooperating witnesses to help make a case for prosecution. Where an individual is caught up in an unlawful scheme, oftentimes the only way such a person can obtain lenient treatment from prosecutors and under federal sentencing guidelines is to cooperate against those around, and above, him or her in a corporate hierarchy.

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Thus, in the arena of foreign bank-related cases, the standard playbook for U.S. prosecutors is to pursue lower-level employees at financial institutions and obtain their cooperation in exchange for no, or reduced, criminal charges and lenience in sentencing. This appears to have occurred in the 2011 arrest and indictment of various foreign bankers, including bankers at Credit Suisse in Switzerland, and in the indictment of Wegelin Bank in 2012, and it is likely that there are other such cases moving behind the scenes. Anytime there is publicity about an arrest or indictment of one bank employee, one can expect that the lawyer for that person will advise his or her client about the benefits of cooperating against the employee's higher-ups.

As noted below, it is clear from developments in 2012 that a number of banks and possibly others are cooperating with U.S. enforcement authorities in a wide variety of ongoing investigations.

IV. Criminal Investigations of Financial Institutions and Account Holders

A. Disclosures Arising from Criminal Investigations of Financial Institutions

Corporations doing business in the United States are treated as artificial persons. They can sue and be sued, and they can be indicted, as an entity, for criminal offenses. Under principles of *respondeat superior*, the 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 may be deemed actions of their employer, subjecting the employer itself to criminal sanctions.

Thus, whenever the U.S. Department of Justice (DOJ) obtains evidence of wrongdoing by one or more bankers or other employees at a corporate entity, if that conduct occurred in the scope of employment, the U.S. government has a technical and legal basis to lodge criminal charges against the entity itself. This gives the United States tremendous leverage over any bank operating in the United States, where an indictment could result in significant damage to the bank's brand and reputation as well as possible regulatory consequences, including loss of licenses to operate. U.S. prosecutors make decisions about whether to indict corporate entities based on a list of public criteria, including the nature, extent and pervasiveness of the conduct; the existence of an effective compliance program; the company's cooperation with authorities in the investigation; and potential collateral damage to innocent parties that might occur if the entity was prosecuted.

Options for a company to resolve a criminal investigation include a (1) non-prosecution agreement, (2) a deferred prosecution agreement, (3) a plea to a criminal charge, or (4) indictment and trial. A Non-Prosecution Agreement (NPA) is a contract between the United States and the involved entity whereby the United States agrees not to pursue criminal charges in exchange for certain actions by the entity. A Deferred Prosecution Agreement (DPA), is similar, but the U.S. government files a specific criminal charge against the entity; prosecution on that charge is "deferred," and will ultimately be dismissed, pending the entity's performance of certain conditions. A DPA permits resolution without the government having to proceed to trial against the company, or without the company having to formally enter a plea of guilty. Having said that, in most DPAs, the government insists upon an express acknowledgement of wrongdoing.

B. Criminal Investigations of UBS

UBS, of course, entered into a DPA in 2009, whereby the bank agreed to pay the United States in excess of $750 million to resolve all criminal, and most civil, issues arising from the bank's role in facilitating U.S. tax evasion. The U.S. government views cooperation as an essential component of any DPA. Terms of the UBS DPA included the extraordinary disclosure of the identities of approximately 250–300 account holders to the DOJ, as well as production of voluminous records relating to their accounts. Based on this information, the Justice Department has obtained numerous guilty pleas from and indicted other UBS account holders. The DOJ has also relied on this information to charge additional Swiss bankers, financial advisors, and lawyers, alleging, among other things, a conspiracy to help Americans commit tax fraud, bribery of Swiss government officials, and other offenses. In January 2010, a Swiss court held that this information disclosure was unlawful as a matter of Swiss law, but in 2011, this ruling was overturned by the Supreme Court in Switzerland.

In an attempt to avoid criminal prosecution, many Swiss banks have disclosed the names and personal information of thousands of their employees to the U.S. government. Many of the employees were not notified that their names were being turned over, nor were they allowed to review the data. Some employees have filed suit against the Swiss banks, claiming that the disclosures violate Swiss privacy laws.

C. Follow-up Interviews and Enforcement Actions from 2009, 2011 and 2012 Voluntary Disclosure Initiatives and Other Investigations

The IRS Criminal Investigation Division, in some cases working with U.S. Attorney's Offices or the DOJ Tax Division, has been engaged in significant follow-up activity regarding information obtained in the 2009, 2011 and 2012 IRS Offshore Voluntary Disclosure Programs (OVDP). Additional interviews are being conducted by agents from the IRS Large Business and International Division. Agents and investigators are contacting persons who made disclosures in the OVDP to obtain detailed information about their banks, bankers, financial advisors, foreign lawyers, and any other persons who may have facilitated their use of an undeclared foreign account. A number of well-known foreign financial institutions appear to be the subject of these inquiries, as well as certain advisors and other third parties who appear to have had a number of U.S. clients with undeclared foreign accounts.

The government is also obtaining cooperation from individuals who have previously pled guilty to tax offenses arising from undeclared UBS accounts. This cooperation has, from appearances, led to multiple indictments of Swiss bankers, including bankers from Credit Suisse, and Swiss financial advisors, including Beda Singenberger, Hans Thomann and Josef Beck.

D. Criminal Investigations of Other Financial Institutions

1. Israeli Banks

In November of 2010, Bank Leumi, Israel's largest bank, began requiring U.S. clients to either declare accounts to the IRS or close their accounts. The move was used to highlight the bank's desire to comply with all legal regulatory guidelines as the United States continues to focus on prosecuting individuals and entities that promote tax evasion to U.S. taxpayers.

In June 2012, a grand jury in the Central District of California (which covers Los Angeles and its vicinity) indicted three U.S. return preparers, David Kalai, Nadav Kalai and David Almog, in connection what with appears to be an allegedly vast scheme to assist U.S. taxpayers in hiding money in Israeli banks. Two major unnamed Israeli banks are referenced in the indictment. There have been reports that the U.S. Attorney in Los Angeles is investigating Mizrahi Bank, Bank Hapoalim and Bank Leumi for violations similar to those that have ensnared UBS and other Swiss banks. Subsequently, in 2013 and 2014, six individuals plead guilty in the Central District of California in connection with maintaining undeclared accounts with Israeli banks. A common fact patter emerging in these cases is a presence of back-to-back loans where a U.S. branch of the Israeli bank would lend money to the taxpayer in U.S. and secure or collateralize such loan with the taxpayer's secret accounts held with the bank in Israel. At least one of the six individuals, Alexei Iazlovsky , was identified as a client of Nadav Kalai.

2. HSBC-India Prosecutions and Aftermath

On January 26, 2011, U.S. prosecutors indicted a naturalized U.S. citizen from India on charges arising from his account relationship with an international bank, which several published reports state is HSBC Holdings PLC, from 2001 until around 2010. The indictment describes in detail the alleged activities between account holder and five unnamed co-conspirators, all who were account managers at the international bank either in the United State or India. The indictment alleges that the bank managers helped the account holder conceal assets through foreign corporations, discouraged him from repatriating funds, offered to assist him in moving his money, and that the managers tailored this scheme specifically to U.S. citizens of Indian descent. Since January 2011, the Department of Justice has charged and/or obtained guilty pleas from other HSBC-India account holders.

In July 2011, HSBC announced that it will no longer offer wealth-management services to U.S. resident private clients from locations outside the United States, and that American clients "will be better served" by private banking teams located in the United States. The bank has started to close accounts maintained by Americans in its non-U.S. branches.

On August 29, 2012, Dr. Arvind Ahuja, a Milwaukee neurosurgeon, was convicted by a jury in the Eastern District of Wisconsin of one count of willfully filing a false 2009 income tax return and one count of willfully failing to file an FBAR disclosing that he had a financial interest in, and signature authority over, bank accounts at HSBC located in India and Jersey. Out of the seven counts that went to a jury, Dr. Ahuja was convicted of two. According to the DOJ, Dr. Ahuja had over $8 million in undisclosed offshore bank accounts. He managed these accounts with the assistance of bankers who worked at an HSBC subsidiary in New York. In February 2013, Dr. Ahuja was sentenced to three years probation and ordered to pay $350,000 in fines.

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3. Credit Suisse

After the arrest of one former UBS banker now working at Credit Suisse, and the indictment of an alleged co-conspirator, U.S. prosecutors in Alexandria, Virginia, charged four other Credit Suisse bankers with aiding and abetting U.S. citizens in evading taxes. The four bankers, all current or prior wealth advisors with Credit Suisse, are alleged to have assisted in the creation of thousands of offshore accounts with a combined value of $3 billion. The indictment also alleges that the bankers encouraged Americans to transfer assets to smaller banks in Hong Kong and Tel Aviv and to avoid participation in the 2009 voluntary disclosure initiative.

A superseding indictment was returned on July 21, 2011, charging four additional Credit Suisse employees, including the former head of North American Offshore Banking. The allegations in this new indictment include (1) helping American account holders maintain thousands of secret accounts with as much as $3 billion in assets, (2) maintaining an unlicensed and unregistered office in New York to assist customers with undeclared accounts, (3) making false statement to banking regulators and the IRS to conceal this operation, (4) assisting U.S. clients in forming sham trusts or foundations to conceal their ownership of undeclared financial assets, (5) helping U.S. customers structure cash withdrawals to avoid currency reporting, (6) advising and assisting U.S. clients in moving funds out of Credit Suisse to other financial institutions to avoid detection, and (7) discouraging U.S. clients from entering into the IRS's Voluntary Disclosure programs.

In March 2014, Andreas Bachmann, one of the eight former employees charged in 2011, was arrested and pled guilty to his role in the scheme, becoming the first of the group to do so. While the other seven remain in Switzerland (which has been unwilling to extradite), Bachmann agreed to come to the United States and enter a plea agreement. Under the terms of the deal, Bachmann faces a maximum of five years in prison.

On May 19, 2014, the DOJ filed a one count information charging Credit Suisse with a conspiracy to violate Code Sec. 7206(2), *i.e.,* aiding and assisting American taxpayers in filing false income tax returns. Credit Suisse agreed to waive indictment, plead guilty, pay $2.6 billion in the aggregate, change certain business practices, and engage a corporate monitor for two years. Credit Suisse is also obligated to disclose to the DOJ information according to the terms of the August 29, 2013, DOJ Swiss Bank Program (*see* IV.E. below), to prevent current clients from taking steps to conceal accounts upon closure, and to close the accounts of recalcitrant account holders who, for example, refuse to sign a waiver of Swiss bank secrecy. The Statement of Facts agreed to by Credit Suisse describes a long-running pattern of business conduct aimed at helping Americans hide money at the Bank for decades, and steps taken by Credit Suisse which, in the eyes of the DOJ, reflected the absence of full cooperation in the criminal investigation.

4. Wegelin Bank

In January 2012, three bankers at Wegelin Bank, Switzerland's oldest private banking establishment, were indicted by a grand jury in the Southern District of New York on charges of conspiring to help Americans hide money at the bank. The allegations stem in part from alleged efforts to help Americans move money from UBS, during the crackdown against that bank in 2009, and into Wegelin, which had no U.S. footprint.

In February 2012, the U.S. prosecutors in New York announced the indictment of Wegelin Bank itself. The indictment alleged numerous instances of the bank's employees aiding and abetting, and conspiring with, U.S. taxpayers to hide money offshore. The indictment focused particularly on activities by Wegelin in purportedly recruiting account holders from UBS and other Swiss banks who maintained a U.S. presence (and thus were vulnerable to U.S. law enforcement and information disclosure requests); Wegelin allegedly advised such persons that since it had no presence in the United States, their identity could be protected by Swiss bank secrecy.

On January 3, 2013, Wegelin entered a guilty plea and paid $74 million to the United States to resolve this criminal case. The disposition requires Wegelin to maintain the integrity of the U.S. client documents, and practitioners expect that the IRS will serve (if it has not already) a treaty request on the Swiss Federal Tax Authority seeking production of the records of U.S. account holders.

The disposition of the case against the Bank did not, at least as a matter of public record, resolve any case involving individual Wegelin bankers or owners.

5. Bank Frey Related Conviction

In August 2013, a prominent Zurich attorney, Edgar Paltzer, pled guilty to one count of conspiring to help U.S. clients file false tax returns and evade U.S. taxes on assets held in Swiss banks. The indictment alleged that Paltzer and codefendant Stefan Buck concealed clients' assets and aided clients in avoiding reporting requirements under the IRS's qualified intermediary program. Paltzer also allegedly set up Liechtenstein foundations using "off-the-shelf" corporations registered in the British Virgin Islands and Panama. Paltzer, a citizen of both the United States and Switzerland who was licensed to practice in New York, was a partner with Zurich law firm of Niederer Kraft & Frey (NKF), but after the indictment, NKF announced that he had resigned. Shortly thereafter, Bank Frey announced they were suspending business operations.

In April 2014, U.S. prosecutors filed a forfeiture action in federal court aiming to seize $12.2 million they allege was directed by Paltzer into client accounts with two unnamed Swiss banks. According to the complaint, Paltzer created sham entities in the British Virgin Islands, Liechtenstein and Panama in order to hide the identities of the account owners—a father and son, both U.S. citizens.

6. Zurcher Kantonal Bank ("ZKB")

In December 2012, the U.S. Attorney's Office for the Southern District of New York obtained an indictment against three private bankers with ZKB in Zurich. The indictment alleges, among other things, that the bankers assisted U.S. taxpayers in moving money from UBS in order to maintain the funds in their unreported state, helped these clients access cash and other funds, and, in some cases, discouraged the clients from entering into the IRS's voluntary disclosure programs. The indictment of these individuals puts pressure on ZKB because of U.S. legal principles governing corporate criminal liability, and raises an interesting question in U.S.-Swiss relations owing to the partial ownership of ZKB by the Kanton of Zurich, a governmental entity.

7. Liechtenstein Landesbank ("LLB")

On July 30, 2013, the U.S. Attorney's Office for the Southern District of New York and the Tax Division reached a Non-Prosecution Agreement with LLB, whereby the bank agreed to pay $23.8 million to resolve all matters arising from the bank's maintenance of unreported accounts held by U.S. taxpayers. Critical to the prosecutors' decision not to file criminal charges were (1) LLB's efforts in 2008, before any investigation had begun, to uncover and address problems relating to American held accounts, (2) the Bank's support of legislative changes in Liechtenstein to enable broader information sharing between the Principality and the United States, and (3) the Bank's overall cooperation in the investigation.

8. Raoul Weil Arrest and Extradition

In October 2013, Raoul Weil, the former head of UBS's wealthy client practice indicted by the United States in 2008, was arrested while vacationing in Italy with his wife. After spending several weeks in an Italian jail, he was subsequently extradited to the United States to face trial, where he faces a maximum of five years in prison. From 2002 to 2007, Weil headed UBS's wealth management international unit, where U.S. authorities alleged he and other managers conspired to help Americans hide $20 billion.

9. Ty Warner Sentence

In October 2013, billionaire Beanie Babies creator H. Ty Warner pled guilty to tax evasion for failing to report $24.4 million in income earned from assets hidden in a Swiss bank account from 1999 to 2007. Under federal sentencing guidelines, which correlate with the amount of tax loss incurred by the government ($5.6 million in this case), Warner faced 46 to 57 months in prison.

In advance of his sentencing hearing, Warner's attorneys argued in favor of probation on the grounds that (1) most defendants in offshore cases do not receive lengthy prison terms, if any prison time at all; (2) Warner had attempted to make a voluntary disclosure but had been denied entry into the OVDP because an unnamed informant had presumably leaked his name; (3) Warner would in any event be liable for $53.5 million in civil penalties; and (4) Warner's charitable activities, including $140 million donations in cash and toys to charities, had to be weighed against the impact of his tax evasion. At his sentencing hearing in January 2014, U.S. District Judge Charles Kocoras sentenced Warner to two years' probation and 500 hours community service. Judge Kocoras, who seemed to be receptive to letters of support on Warner's behalf, concluded that "society will be best served by allowing [Warner] to continue his good works." The DOJ has since appealed the sentence.

10. Swisspartners' Non-Prosecution Agreements

On May 9, 2014, the DOJ entered into a NPA with certain affiliates of Swisspartners, a Zurich-based asset management company that, among other things, marketed insurance products. The NPA covers Swisspartners' conduct of selling such products to Americans with undeclared foreign accounts. Swisspartners had approach the U.S. authorities prior to any notion that it was targeted for investigation, and its early cooperation and disclosure efforts—which included the turnover of 110 account holder names—was the basis for the NPA.

In sum, the IRS and DOJ view the template of the UBS and related investigations as a path toward obtaining similar information from other financial institutions. To the extent the U.S. authorities can obtain leverage over these financial institutions, such that there is a risk that the bank itself could be indicted, the United States can attempt to pry open additional disclosures through a DPA or other method. A financial institution faced with potential loss of privileges to do business in the United States is likely to find some way to comply with requests for further information.

E. DOJ Swiss Bank Program

In August 2013, the U.S. and Swiss governments announced a special voluntary disclosure initiative aimed at Swiss banks other than 14 banks under criminal investigation. The initiative would enable a participating Swiss financial institution to receive either a NPA or a non-target letter upon disclosure of detailed information and the eventual payment of civil monetary penalties. The penalty amounts are determined on a sliding scale focused on when the banks opened the relevant accounts, with the DOJ plainly focused on "leavers," *i.e.,* U.S. account holders who moved their funds from one bank to another to avoid disclosure. The penalties will be reduced for accounts that have been reported to the IRS, either originally or under the OVDP.

The DOJ Tax Division received 106 letters of intent from Swiss financial institutions seeking to participate in the special program. The banks, acting under an authorization from the Swiss government, are attempting to meet the various deadlines imposed in the Program and to mitigate their penalties by persuading clients to make voluntary disclosures.

Beginning in June 2014, Swiss banks participating in the Program began to provide information to the DOJ and the IRS for the preparation of "treaty requests" under the 1996 U.S-Swiss Convention and Protocol whereby the Swiss government will be asked to provide the identity of various bank clients to the U.S. authorities. The DOJ is likely to follow up soon with multiple treaty requests to the Swiss Federal Tax Authority in order to trigger disclosure of the identity of account holders and beneficial owners.

F. Criminal Investigations by State Governments

Various state governments are also conducting criminal investigations of their resident taxpayers arising out of undeclared foreign accounts. The Manhattan District Attorney in New York has been quite active, and has obtained guilty pleas and civil settlements. In April 2014, New York opened an investigation into Credit Suisse's banking practices arising from unreported U.S. accounts. Other states appear to be pursuing persons who have allegedly evaded state taxes through the use of undeclared foreign accounts.

G. Recent Developments in the Senate

In February 2014, U.S. Senator Carl Levin held the first in a series of hearings aimed at bringing attention to efforts to recoup tax revenues on billions of dollars in hidden assets. The hearings, conducted by the Permanent Subcommittee on Investigations, were focused on Credit Suisse and on enforcement actions by the DOJ. The Committee's Report was highly critical of Credit Suisse's banking practices concerning unreported U.S. accounts, and of the DOJ for not engaging in what the Committee characterized as more aggressive enforcement measures, such as the use of "Bank of Nova Scotia" subpoenas and John Doe summons enforcement, which is discussed below.

V. Civil Summons and Audit Processes

As noted, any financial institution present in the United States may be served with civil process. Such process can include an administrative summons authorized by the Internal Revenue Code seeking information on noncompliant U.S. taxpayers. If the IRS can already identify an individual target, it simply serves a "third-party recordkeeper" summons on the financial institution seeking the individual's account information. Such summonses are routinely processed by bank compliance departments. If the IRS cannot identify a particular taxpayer, it has the option of using a "John Doe" summons.

A. John Doe Summons

A "John Doe" summons is one issued in circumstances where the IRS does not know the identity of the taxpayer(s) whose tax liability it is trying to determine. Code Sec. 7609(f) requires that the IRS establish in an *ex parte* court proceeding (1) that the "John Doe" summons relates to an ascertainable group or class of persons, (2) that a reasonable basis exists for believing that such person(s) may have failed to comply with the revenue laws, and (3) that the information sought, including the identity of the individuals responsible for the violations, is not readily available from other sources.

The IRS has often used the John Doe summons method to obtain offshore account information as follows:

- In 2000, the IRS issued John Doe summonses to obtain from Master Card and American Express records of customers using bank accounts and debit cards in certain tax haven jurisdictions.
- In 2002, a similar case was filed for records maintained by VISA International and, in August 2002, authorization was sought for more than 40 "John Doe" summonses to various vendors who had transactions with persons holding foreign accounts.
- In 2008, the IRS served a John Doe summons on UBS AG, and obtained an enforcement order in Florida federal court. (*See* V.C. below.)
- In 2009, a judge approved service of a John Doe summons on First Data Corporation, a payments processor, seeking information about payments made to or coming from offshore financial accounts. First Data and the IRS reached agreement and data identifying particular account holders has been produced under this summons.
- In April 2011, a U.S. court authorized the IRS to service a John Doe summons on HSBC USA, N.A., seeking records from HSBC India with regard to thousands of potentially noncompliant Indian-Americans who are U.S. taxpayers but who use banking services of HSBC India. The IRS alleged in court filings that HSBC India bankers counseled U.S.-based account holders to hide their accounts from the IRS.

B. Summonses and Bank Secrecy

Many foreign jurisdictions—particularly tax havens—have civil or criminal statutes which prohibit the disclosure of bank records and other confidential financial information without the consent of the depositor. Where the United States has served an administrative summons, John Doe or otherwise, on a U.S. branch of a foreign bank for records located in such a jurisdiction, the bank will often contest production on the ground that disclosure would violate foreign law. The U.S. court will then engage in a balancing test aimed at reconciling the needs of U.S. law enforcement with the terms of the foreign law. Unsurprisingly, the United States almost always wins such cases.

If a court rules in favor of the United States and, if applicable, the ruling stands on appeal, the bank must then produce the relevant documents or face the possibility of civil contempt of court findings and sanctions. Contempt sanctions are aimed at "purging" the contempt, meaning that a federal district judge might impose a daily fine, possibly substantial, on a noncompliant bank, creating a significant and increasing cost for continuing noncompliance.

C. The UBS John Doe Summons Case

In July 2008, a U.S. court authorized the IRS to serve a "John Doe" administrative summons on UBS seeking the production of the records of all accounts that it maintained during the period 2002–2007 for U.S. customers who instructed the bank not to disclose their identities to the IRS. Around the same time, the IRS served a request for assistance under the Swiss-U.S. Double Taxation Agreement (DTA) for records of certain accounts in which a "blocking entity" had been inserted between the account's beneficial owner and the account assets; such a practice was designed to evade rules on withholding where U.S. securities were held in the account.

UBS and the U.S. government engaged in contentious litigation regarding the summons. UBS, with the backing and assistance of the Swiss government, argued that the United States could not use the summons process to obtain the sought-after information, but instead was bound by what it considered an exclusive remedy arising under the Swiss-U.S. DTA. The DOJ and the IRS vigorously disputed this, arguing that the treaty was a nonexclusive remedy, and that because UBS had a presence in the United States, it was subject to summons and could be compelled to produce documents notwithstanding conflicting provisions of foreign law.

The IRS settled the John Doe summons case with UBS in August 2009, agreeing to a timetable whereby UBS would respond, through the Swiss government, to a new treaty request identifying certain types of accounts that would be disclosed. The treaty request specified two types of accounts for disclosure: (1) accounts held in corporate or trust structures, and (2) certain larger accounts. The parties agreed that at least 4,450 accounts would be so identified, and account holders began to receive notices.

However, in January 2010, a Swiss federal administrative court ruled that the treaty request at issue violated Swiss bank secrecy law because, in particularly, a request for certain larger accounts did not satisfy the requirement under the existing Swiss-U.S. treaty that information be disclosed only in cases of "tax fraud" under Swiss law. That concept generally reaches only instances where account holders have engaged in affirmative acts of deception and concealment, and not cases where they have simply failed to report income or to disclose an account. In March 2010, the Swiss government moved to elevate the settlement agreement to the status of a treaty. In June 2010, the Swiss Parliament approved the arrangement. Soon thereafter, the Swiss government began to provide names and account information to the United States, and by now, the production of this information is apparently complete.

> *International pressure is growing for greater transparency with regard to foreign account financial information.*

The settlement of the UBS John Doe summons case may provide a template for future such disputes. The Swiss obtained what they wanted—a decision by the United States to abandon the summons process in favor of a request under the information exchange provisions of the DTA. However, the United States obtained something of value as well. In addition to a commitment by the Swiss to produce data on the 4,450 accounts held at UBS, the United States received a commitment from the Swiss to process the treaty request expeditiously. Moreover, the United States now has a clear path to serve new treaty requests for financial information *even from banks that have no presence in the United States.*

D. John Doe Summons Activity—Correspondent Accounts

In January 2013, the IRS obtained authority to serve a John Doe summons on UBS's Stamford, Connecticut office, seeking records arising from that bank's status as the U.S. correspondent bank for Wegelin, a private Swiss bank that had earlier pled guilty to a tax offense in the U.S. courts. The records sought include the names and account information of any person holding an account at Wegelin who engaged in a transaction processed through the bank's U.S. correspondent account, which would have occurred in the ordinary course upon any transfer from

Wegelin to a U.S. account holder's domestic accounts. The IRS has pursued a similar summons involving First Caribbean Bank International, headquartered in Barbados, with 19 branches throughout the Caribbean.

On November 7, 2013, U.S. District Court of the Southern District of New York authorized the IRS to issue John Doe summonses to the Bank of New York (Mellon) and Citibank to produce information about U.S. taxpayers who may be evading federal taxes by holding interests in undisclosed accounts at Zurcher Kantonalbank and its affiliates. Just a few days later, on November 12, 2013, U.S. District Court of the Southern District of New York also authorized the IRS to issue John Doe summonses to the Bank of New York (Mellon), Citibank, JPMorgan Chase Bank NA, HSBC Bank USA NA and Bank of America to produce information about U.S. taxpayers with undisclosed accounts at The Bank of N.T. Butterfield & Son Limited and its affiliates in the Bahamas, Barbados, Cayman Islands, Guernsey, Hong Kong, Malta, Switzerland and the United Kingdom.

Since nearly all non-U.S. banks hold correspondent account relationships with at least one U.S.-based financial institution, and because all U.S.-based financial institutions are vulnerable to IRS service of a John Doe summons, this portends a new avenue for the IRS and the DOJ to obtain information about Americans holding accounts located at banks that themselves have no U.S. footprint. It would be unsurprising to see more future John Doe summonses of this sort.

Note that the United States is also using the John Doe process to assist other countries. In July 2013, the IRS served a series of John Doe summonses on U.S. financial institutions to aid Norwegian tax authorities in their investigation of taxpayers from that country who may hold unreported assets in the United States.

E. "Required Records" Summonses to Account Holders

Recently, the DOJ has begun to serve grand jury subpoenas on persons known or suspected to have undeclared foreign accounts. The subpoenas seek all information in the possession of the individual involved relating to his or her foreign account.

U.S. taxpayers have tried to decline to comply with the subpoena on the basis of the U.S. 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. Such admissions might include an implicit acknowledgement of the authenticity of the documents, of the existence of an account or accounts, and of the account holder's possession of the records. However, there is a longstanding exception to the Fifth Amendment in the case of records required to be kept by U.S. law.

The DOJ has argued successfully in five appellate courts that records of foreign bank accounts must be maintained under Title 31 Section 5314 of the U.S. Code thereby depriving a foreign account holder of their Fifth Amendment privilege as it relates to the production of foreign account records in response to a grand jury subpoena. The Supreme Court has denied certiorari on the issue twice. Absent an unlikely circuit split, the chances are low as of now that the Supreme Court would decide the issue.

F. Civil Penalty Examinations

IRS agents are trained to assess applicable penalties in all cases when appropriate. The Internal Revenue Manual provides guidance to auditors on the identification of relevant penalties and fraudulent conduct. Note that agents are trained to look for indications of fraud for potential referrals to the IRS Criminal Investigation Division.

The IRS appears to be continuing audits of various taxpayers in offshore account situations, in particular taxpayers who held accounts at UBS, whose information was disclosed pursuant to the John Doe summons settlement, and who were not participants in any of the IRS formal voluntary disclosure programs.

G. High Net Worth Initiative

In October 2009, the IRS announced the creation of a new High Net Worth Industry Group. The purpose of the group is 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 cadre of agents who can untangle corporate, pass through, trust and other entities used by high net worth individuals and recommended and implemented by their advisors. Part of this group's aim is to uncover unreported foreign assets.

VI. Tax Treaties and Mutual Information Exchange Agreements

A. International Standard for Transparency

International pressure is growing for greater transparency with regard to foreign account financial information.

Throughout the past two or more years, the OECD and the EU have been pressuring a number of countries to be more transparent and to adopt broader information exchange provisions in accordance with the OECD standard. The OECD Model Agreement contains broad-based provisions allowing for information exchange.

Very generally, the model agreement provides for exchange of information "without regard to whether the conduct being investigated would constitute a crime under the laws of the requested Party if such conduct occurred in the requested Party." The model agreement also allows for tax examiners from the requesting country to travel to the requested party to conduct a tax examination, interview witnesses and review documents therein. On April 6, 2010, the OECD announced a modification of this agreement through a protocol that would greatly expand cooperation among nations in tax examinations and related processes.

On July 21, 2014, the OECD released a report, "The Standard for Automatic Exchange of Financial Account Information in Tax Matters ("The Standard")," as an important step towards greater transparency and putting an end to banking secrecy in tax matters. The Standard calls on governments to obtain detailed account information from their financial institutions and exchange that information automatically with other jurisdictions on an annual basis. The Standard was developed at the OECD under a mandate from the G20, endorsed by G20 Finance Ministers in February 2014, and approved by the OECD Council.

B. Recent Developments Relating to Switzerland

In March 2009, the Swiss Federal Council decided that Switzerland would adopt the OECD standard for administrative assistance in tax matters. In implementing this policy, the Council reaffirmed the prohibition against "fishing expeditions" and the requirement that requests be made in individual cases, and further provided that domestic procedural protections would remain in place.

The Swiss and U.S. governments signed a new Treaty protocol in September 2009, whereby Switzerland would expand information disclosure under the DTA beyond the narrow concept of "tax fraud" under Swiss law and into areas of "tax evasion," or the mere failure to report income. Switzerland was removed from the "gray list" of potential tax havens as a result of concrete steps taken by the Swiss to become more transparent. The U.S. has yet to ratify the Protocol due to a "hold" placed on it by Senator Rand Paul of Kentucky. However, in March 2014, it was voted out of the Senate Finance Committee, so the Protocol may come to the Senate floor sometime in 2014. In early May 2014, however, Senator Paul announced that he would continue to attempt to block the protocol on "privacy" grounds.

In February 2011, the Swiss Federal Department of Finance (FDF), in response to OECD peer review comments, issued a statement that provides a basis for a requesting state to identify the subject of a request for information by means other than a name and address. Thus, if a requesting state has an account number, a social security number or some other method of identification, the Swiss government may consider this sufficient. The statement makes clear, however, that the name and address of the potential "tax cheat" is still the preferred method of identification. Some DTAs already permitted this, but for others, the new interpretation will be implemented by amendment to a DTA, by a mutual agreement procedure, or by a diplomatic exchange of notes.

In July 2011, the Swiss Federal Council proposed legislation to implement Switzerland's adoption of expanded standards for information exchange, moving beyond the concept of "tax fraud" to include "tax evasion." However, like most treaty exchange situations, the proposed statute limits information exchange to specific cases, *i.e.,* no "fishing expeditions," and, as a likely reaction to the events of the past few years, makes it clear that Switzerland will not provide administrative assistance if the information request is based on data obtained in violation of Swiss law. The statute also streamlines the procedures for appeals and shortens the pertinent deadlines.

In August 2011, the Swiss government announced, subject to approval by its Parliament, that it would process information requests from the United States based on "behavioral patterns" and that it would not necessarily require the United States to provide the name and address of a specific taxpayer under investigation. This announcement appears to relax the longstanding Swiss objection to "fishing expeditions" and makes it more likely that the American government will be able to obtain names based on a showing similar to that required for service of John Doe summons.

In the fall of 2011, the IRS served a Request for Administrative Assistance on Credit Suisse seeking the production of four categories of account records. The request did not identify any particular taxpayers in issue, and reached conduct that the Swiss ordinarily would have characterized as tax evasion. The request triggered Swiss procedures requiring the bank to select account data that met the criteria cited by the United States, mandating notice to affected account holders, and triggering a review and potential judicial process involving the Swiss Federal Administrative Court and potentially the Swiss federal court system. On April 10, 2012, the Swiss federal court stopped production under this formal Request, holding that because the treaty protocols described above from 2009 and 2011 had not been ratified by the U.S. Senate (where one Senator has apparently placed a "hold" on them), the old Treaty provisions governed, and the Request made for Credit Suisse records did not meet the applicable requirements of the pre-existing treaty.

Also in April 2012, the Swiss Federal Council adopted a series of international recommendations to combat financial crime, including adding "serious tax crimes" to the list of predicate offenses for money laundering and clarifying the determination of beneficial owners in bearer share corporations and trusts. The recommendations had emerged from the Financial Action Task Force, a multilateral group aimed at combating money laundering around the world. The Council also endorsed strengthened procedures for information exchange in DTA and Tax Information Exchange Agreements.

In May 2013, the Swiss Federal Council issued an order, subject to Parliamentary approval, that would allow banks to provide nonclient information to the United States in connection with negotiations to resolve investigations and related matters that may be pending with the DOJ or the IRS. The United States could, of course, use this statistical information to make "group requests" under the prior agreement with the Swiss. As of July 2013, Swiss banks began transferring statistical data on "leaver" accounts, namely the volume and number of accounts that were closed at various institutions when the United States began to ramp up pressure on Switzerland in 2009.

In January 2013, the Swiss Federal Council announced that the new Tax Administrative Assistance Act (TAAA) would take effect February 1, 2013, without a referendum. The TAAA allows the Swiss government to now process "group requests" for information under tax information exchange provisions, without identifying the particular taxpayer(s) at issue. Such group requests must be based on behavioral patterns reflecting cases of tax evasion or fraud, and are not "admissible for information on issues which concern the period of time from when the law entered into force." Meanwhile, the revised protocols to the U.S.-Swiss tax treaty remain held up in the U.S. Senate due to objections from Senator Paul as noted.

C. Developments in Other Countries

There have been a number of developments around the world in the area of treaty-based information exchange.

In 2008, the U.S. and Liechtenstein entered into a broad-based Tax Information Exchange Agreement (TIEA), applicable for years 2009 and beyond. Liechtenstein is one of the jurisdictions where a number of foundations, or "*stiftungs*," holding previously undeclared foreign accounts have been sited.

In March 2012, the Liechtenstein Parliament amended enabling legislation that had been passed in connection with the TIEA entered into in 2009. Previously, Liechtenstein required the United States to identify the specific taxpayer as to whom a request for information was being made. The new implementing legislation however, allows for categorical requests under the TIEA, *i.e.,* requests that seek information as to a class of U.S. taxpayers who may have held accounts in Liechtenstein and failed to report them properly for U.S. tax purposes.

In May 2012, relying on this new legislation, the DOJ served a formal request under the U.S. Liechtenstein TIEA seeking account information from LLB. LLB has begun issuing letters to customers noting that their account information may be turned over to U.S. authorities and giving them the right to examine the account data and pursue remedies under Liechtenstein law. (*But see* 18 U.S.C. § 3506, discussed in VII.B.1. below.) As noted above, in July 2013, LLB resolved its own criminal investigation with U.S. authorities and is cooperating with the United States.

Singapore's Ministry of Finance endorsed the OECD's Standard for the Exchange of Information for Tax Purposes in March 2009, a prerequisite toward keeping off the OECD's "black list" of tax haven countries. As of November 2009, it has been removed from the OECD "grey list" and placed on the "white list." In July 2013, the Singapore government announced publicly that it was pursuing wider information sharing with the United States and other countries, including possibly an intergovernmental agreement for the implantation of the FATCA.

In January 2010, the Hong Kong legislature adopted a measure to permit its Inland Revenue Department to gather information from taxpayers with regard to "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 has signed information exchange agreements with a growing number of nations. Importantly, then, in July 2013, the Hong Kong Legislative Council enacted a measure to permit Hong Kong to enter into stand-alone tax information exchange agreements and a FATCA agreement with the United States. In May 2014, Hong Kong and the United States reached an agreement in principle on a FATCA Inter-Governmental Agreement (IGA).

In May 2010, the United States and other nations signed an OECD sponsored agreement that strengthened the provisions on international information exchange in tax cases.

In November 2010, the United States and Panama entered into a broad-based tax information exchange agreement, authorizing the disclosure of all information needed to enforce the tax laws, including information regarding bank accounts in Panama. The treaty authorizes the exchange of information for all tax years beginning on or after November 30, 2007. Panama entered into the treaty following its placement on the OECD's "gray list" of potential tax havens in April 2009. It was removed from the list in July 2011.

As of March 29, 2011, the OECD had concluded that *all* jurisdictions surveyed by the OECD Global Forum had committed to the international standard for exchange of information in tax matters, and all but eight (five of which—Panama, Montserrat, Nauru, Niue, and Vanuatu—are deemed "tax havens") had substantially implemented procedures in furtherance of that objective.

In August 2012, the Canadian Revenue Agency (CRA) announced that it would not assist the United States in collecting FBAR penalties. The Canada-United States Tax Convention requires Canada and the United States to assist each other in the collection of taxes, interest, and penalties. The CRA argues, however, that the U.S.-Canada tax treaty does not apply to FBAR filing obligations because the treaty only applies to taxes imposed under the Canadian Income Tax Act and the U.S. Internal Revenue Code. According to the CRA, because the FBAR filing obligation arises under the U.S. Bank Secrecy Act, 31 U.S.C. § 5311 et seq., and not the Code, Canada is not required under the Treaty to enforce penalties for FBAR violations.

VII. Voluntary Disclosures

A. Overview

So long as a case involves legal source income, a U.S. taxpayer can utilize the voluntary disclosure process to avoid criminal sanctions for the failure to report the existence of, and income earned on, a foreign account on the income or estate tax returns, as well as for the nonfiling of the FBAR. Taxpayers who have engaged in these types of misconduct may avoid such liability by initiating a disclosure before the IRS or any other U.S. government agency has information that would lead to discovery of the criminal misconduct. The manner and means of such a disclosure, and the reporting positions undertaken, must be determined with great care based on a careful analysis of all relevant facts of the particular case.

In March 2009, the IRS announced the first Offshore Voluntary Disclosure Initiative (OVDI), a settlement initiative aimed at encouraging Americans to come forward with voluntary disclosures about previously undeclared accounts. Any qualified U.S. taxpayer participating in this initiative would avoid criminal prosecution and pay civil penalties that, while substantial, would be well below what the U.S. tax authorities could, by law, otherwise seek to collect. The initiative expired on October 15, 2009. Close to 15,000 American taxpayers took advantage of the OVDI. With the success of this first program, the IRS in 2011 announced a second program, and in 2012 a third one. In 2014, the IRS substantially revised the third program, effectively commencing a fourth one on July 1, 2014. Pertinent information on the current program is described below.

In the OVDIs, the IRS obtained information on a number of additional foreign financial institutions, as well as specific bankers, financial advisors, and other persons who have aided and assisted Americans in maintaining undeclared foreign accounts. This information, assembled now in a vast database, is being used to formulate additional treaty requests and perhaps summonses to be served on other foreign governments and banks. Practitioners representing numerous individuals who participated in OVDIs are being contacted by IRS criminal investigators seeking follow up interviews of clients in order to inquire more specifically about the actions of bankers, advisors and other third parties who were affiliated in some respect with undeclared foreign accounts. These interviews appear to have led to indictments and other enforcement actions involving non-U.S. financial institutions.

B. Recent Developments in 2014

On January 23, 2012, the IRS announced a third iteration of the OVDI. Then, on June 18, 2014, the IRS announced modifications to this program, as well as new "Streamlined" Filing Compliance Procedures (SFCP), described below.

1. Modifications to the 2012 OVDP (2014 OVDP)

The 2014 changes to the OVDP focused on tailoring it to the taxpayers whose conduct was willful and, as a result, are seeking certainty in penalty exposure and relief from criminal prosecution. There are also changes to the timing and certain other administrative aspects of the Program. The highlights of the major changes are as follows.

The program continues the "preclearance" process of the earlier programs, so potential participants can learn if their voluntary disclosure would be considered timely under IRS rules by providing their name and identifying information. As of July 1, 2014, preclearance forms must identify the financial institutions involved.

Taxpayers applying to the program will be now required to provide additional information as part of their voluntary disclosure submissions. Additionally, effective July 1, 2014, the form and substance of nearly all of the documents associated with the OVDP, including the preclearance request, the Intake Letter, the Attachment(s) and other material are now different.

Under the terms of the 2012 OVDP, the IRS provided reduced penalties of five percent and 12.5 percent for certain taxpayers. Such reduced penalties are now eliminated in light of expanded SFCP for nonwillful taxpayers. As of August 4, 2014, the IRS is also increasing the offshore penalty for certain taxpayers from 27.5 percent to 50 percent. Such increase will generally apply to taxpayers who submit their request for pre-clearance only after it becomes publicly known that one of the financial institutions where the taxpayer maintained (or continues to do so) an account or another party facilitating taxpayer's offshore arrangement is under investigation by the IRS or the DOJ. All participants are required to submit all account statements; however, the IRS is now allowing such records to be submitted electronically, rather than on paper. Furthermore, OVDP participants are now required to pay the offshore penalty at the time of the OVDP submission.

The terms of the 2014 OVDP apply to taxpayers who submit their Intake Letter and Attachments on or after July 1, 2014. These 2014 OVDP terms include the following provisions:

1. **Applicability.** Taxpayers who made an OVDP submission prior to July 1, 2014, may elect to have the case considered under the terms of 2014 OVDP.
2. **Eligibility.** Any taxpayer who initiated participation in the SFCP after July 1, 2014, is not eligible to participate in the OVDP. Under the 2012 OVDP FAQ 21, the IRS was expected to provide advance notice of the prospective date upon which certain groups of taxpayers would no longer be eligible for OVDP. The revised FAQ 21 removes any reference to such advance notice.
3. **Information required for preclearance.** Effective July 1, 2014, in the preclearance request to the IRS Criminal Investigation, in addition to the identifying information currently provided on the preclearance request (names, SSNs, addresses, dates of birth and telephone numbers), the taxpayers will now be required to identify all the financial institutions that held their offshore accounts that are subject to disclosure and all the offshore and domestic entities through which such accounts were held. (*See* FAQ 23.)
4. **Modified Intake Letter and Attachments.** The IRS again significantly revamped the forms for the Intake Letter and Attachments.
5. **Domestic OVDP.** The new provisions clarify that if a taxpayer also has unreported income from a domestic source, the OVDP penalty structure will only apply to offshore noncompliance. Domestic portions of a voluntary disclosure will be subject to an examination (*See* FAQs 7.1, 24).
6. **Penalties.**

i. Amount of Penalty:

- Generally, taxpayers will be subject to a miscellaneous offshore penalty of 27.5 percent imposed on the highest aggregate value of their undisclosed offshore assets. Reduced penalties of five percent and 12.5 percent are no longer available under 2014 OVDP. The offshore penalty will continue to apply to nonfinancial assets connected to tax noncompliance, as detailed below.
- As of August 4, 2014, the miscellaneous offshore penalty was increased to 50 percent for taxpayers who have or had an undisclosed offshore account with financial institution (or if the account was established by a facilitator), if *at the time of submitting preclearance request* (a) such institution or facilitator had been publicly identified as being under investigation by the IRS or the Department of Justice; (b) such institution or facilitator is cooperating with the IRS or the Department of Justice in connection with accounts that are beneficially owned by a U.S. person; or (c) the institution or facilitator were issued "John Doe" summonses. (*See* FAQ 7.2.) Once triggered, the 50-percent penalty will be imposed on all of the taxpayers' undisclosed assets, including assets otherwise not subject to this provision. The IRS now posts on its website a list of financial institutions and other entities to which this increased penalty will apply, but the governing event for purposes of increasing the penalty will be the *public disclosure* by the DOJ or the IRS; the list cannot be relied upon. A public disclosure, according to recent IRS comments, does not include (1) a disclosure by the bank on its financial statement that it is currently under investigation; (2) an article in the newspaper; and (3) cases against bank employees.
- As of today, the following banks are considered "50-percent penalty" institutions:
- UBS AG

- Credit Suisse AG, Credit Suisse Fides, and Clariden Leu Ltd.
- Wegelin & Co.
- Liechtensteinische Landesbank AG
- Zurcher Kantonalbank
- Swisspartners Investment Network AG, Swisspartners Wealth Management AG, Swisspartners Insurance Company SPC Ltd., and Swisspartners Versicherung AG
- CIBC FirstCaribbean International Bank Limited, its predecessors, subsidiaries, and affiliates
- Stanford International Bank, Ltd., Stanford Group Company, and Stanford Trust Company, Ltd.
- The Hong Kong and Shanghai Banking Corporation Limited in India (HSBC India)
- The Bank of N.T. Butterfield & Son Limited (also known as Butterfield Bank and Bank of Butterfield), its predecessors, subsidiaries, and affiliates

ii. Assets subject to offshore penalty:

- The IRS clarified that "tax noncompliance" that triggers an asset's inclusion in the penalty base includes failure to report gross income from the asset. (*See* FAQ 35.)
- As with the prior programs, importantly, nonfinancial assets, such as real estate, art, jewelry or other items, may also be included in the calculation of the 27.5-percent penalty if those assets have any connection or relationship to the prior tax noncompliance, *e.g.,* if they were purchased with funds from undeclared accounts.
- New FAQ 35.1 provides that the offshore penalty is applied to the taxpayer's interest in the asset without regard to valuation discounts, such as lack of marketability, minority interest, and tenants in common discount.

iii. FAQ 50 relief:

- Previously, FAQ 50 provided that under no circumstances will taxpayers be required to pay a penalty greater than what they would otherwise be liable for under the maximum penalties imposed under existing statutes. The IRS modified this provision by adding that the liability for maximum penalties will include such liability for all the years in the disclosure period (rather than years that are still open under the appropriate statutes of limitations outside of the OVDP regime). This modification renders the application of statutes of limitation for the purpose of comparing the penalties irrelevant.

7. **Modified Submission Requirements (FAQ 25).**

- General submission requirements remained the same as in the 2012 OVDP. Taxpayer's are still required to submit amended tax returns for the last eight years and file FBARs reporting the foreign accounts. Taxpayers are also required to file information returns such as Forms 3520, 3520-A, 5471 and 8938 as necessary. FAQ 25 now also clarifies that any required original or amended estate and/or gift tax return must also be included in the OVDP submission.
- *Form 14452.* In connection with the 2014 OVDP, the IRS is implementing Form 14452, Foreign Account or Asset Statement, to be used in lieu of the previous form. In substance, Form 14452 is almost identical to its predecessor.
- *Penalty Worksheet.* The IRS also introduced Form 14453, *Penalty Computation Worksheet*, to replace the spreadsheet previously used. This form eliminates taxpayer's ability to add an explanation for any of the items to the form or to visibly reduce account balance as duplicative under FAQ 37.
- *Account statements.* Taxpayers will be required to submit all the account statements regardless of the account balance. Taxpayers will also be required to submit relevant documents pertaining to other offshore assets. If a taxpayer is having difficulty obtaining offshore records, the taxpayer is now required to "carefully" document all the attempts and provide this information to the examiner handling the case. (See FAQ 30.)
- *Statement on Abandoned Entities.* For taxpayers seeking to disregard the offshore entities under FAQ 29, the IRS now introduced Form 14467, *Statement on Abandoned Entities*, which replaces the former Statement on Dissolved Entities. One notable change is that the Statement on Dissolved Entities allowed a taxpayer to take advantage of this procedure so long as the entities were dissolved prior to the execution of the Closing Agreement. Form 14467 requires the taxpayer to certify that the entities were already dissolved at the time the Form is executed.
- *FBARs.* FAQ 44 is amended to reflect the FBAR e-filing requirement.
- *Electronic submissions.* Professional firms may make OVDP submission on a CD or a flash drive. New FAQ 25.2 provides procedures that professional firms must undertake in order to be able to make electronic submissions on behalf of the taxpayers, including retaining documents containing taxpayers' signatures for the greater of: (1) two years after Form 906, Closing Agreement is executed by the IRS, or (2) the firm's standard document retention period.
- *Refund claims.* This is not a modified submission requirements, but the IRS representatives confirmed that if any taxpayer wishes to preserve the possibility

of a refund in year open when they begin the OVDP process, they must file a protective claim for refund as to that year.

- *Payment.* To ensure the proper application of payments, the IRS is requesting a submission of a separate check for each of the years in OVDP and for the offshore penalty. The payment for the offshore penalty must now be included with the OVDP submission.

8. **18 U.S.C. § 3506.**

- The Program intake material asks whether a taxpayer has filed an objection in a foreign country to disclosure of his name or account information. Section 3506 of Title 18, U.S. Code, requires any U.S. citizen or national who does so to serve a copy of their pleading upon the Attorney General of the United States, creating a "Catch 22" situation for anyone who wishes to avoid having their name turned over to the U.S. government.
- Section 3506 has no specific sanction, but IRS guidance now states in FAQ 21 that failure to comply with its provisions will render a taxpayer ineligible for the program. The intake letter, which must be signed by the taxpayer under penalties of perjury, asks whether the taxpayer objected to disclosure in a foreign country and if so, whether they complied with 18 U.S.C. §3506.

The IRS gives no discretion to the agents to reduce penalties. If a participant does not believe that he or she should have to pay the 27.5 percent omnibus penalty, their only choice is to "opt out" of the program, in which case the IRS will evaluate the file for a potential audit and imposition of appropriate penalties. The program continues the procedures announced in 2011 regarding decisions to "opt out" of the voluntary disclosure penalty structure. In such a case, IRS agents are instructed to neither punish nor reward persons who choose to opt out. Once an opt-out decision, which is irrevocable, is made, the taxpayer's representative and the IRS agent responsible for the examination each prepare written submissions regarding a proposed penalty resolution. These submissions are reviewed by a committee of senior IRS personnel, who then decide on the nature and extent of any ensuing examination. However, as noted below, there are new "Streamlined" filing compliance procedures for nonwillful cases, and the IRS is anticipating that most cases involving non-willfulness will go this route rather than the "opt out."

Most persons holding accounts at foreign financial institutions are invested in foreign mutual funds which, under U.S. tax law, are "passive foreign investment companies," also known as "PFICs." PFICs are subject to a particularly harsh taxing regime under Code Sec. 1291 *et seq*. Through the efforts of Caplin & Drysdale international tax attorneys working with IRS senior personnel, the IRS agreed in 2010 to an abbreviated "mark to market" taxing regime for PFIC reporting. The modified regime remains available in the current iteration of the offshore voluntary disclosure program.

The IRS continues to express negative views on the practice of a "quiet disclosure," a term used for the process of filing delinquent or amended tax returns, FBARs, and other forms without going through the formal clearance process beginning with the IRS Criminal Investigation Division. IRS guidance indicates it will be on the lookout for "quiet disclosures" for audit and, if they do not qualify for the IRS's voluntary disclosure policy, even for potential criminal prosecution. Nonetheless, quiet disclosures remain an option for certain taxpayers, especially U.S. persons who have lived outside the country for many years, who are in compliance with home country tax laws, and whose cases exhibit no evidence of criminal or fraudulent activity.

2. Expanded Streamlined Filing Compliance Procedures ("SFCP") for Non-Willful U.S. Taxpayers

a. Overview. One of the major changes to the offshore compliance initiative was the IRS's expansion of the SFCP. Previously, SFCP was only available to taxpayers residing outside of the United States since at least January 1, 2009, and who had not filed a U.S. tax return since that time. On June 18, 2014, the IRS announced one of the main changes to SFCP to be (1) an expansion of the terms of SFCP to cover a broader spectrum of U.S. taxpayers residing abroad, as to whom no penalty would be assessed, and (2) an extension of the procedures to U.S. taxpayers residing in the United States, with an application of a five-percent penalty imposed on such taxpayers' unreported foreign financial assets. The SFCP entails, in essence, the filing of qualified amended returns (QAR) with the addition of a certification of nonwillfulness and the additional penalty imposed on U.S. residents. At the same time, the IRS placed important conditions on such filings.

While, the original SFCP applied to nonfilers only, the amended returns are now accepted under the terms of the new program. Under the original terms of SFCP, a nonresident taxpayer with a U.S. tax liability of $1,500 or more was disqualified from the SFCP "safe harbor" for "low risk" and, as a result, had a potential (and unquantifiable at the outset) penalty exposure. This income threshold requirement is eliminated under the terms of the expanded SFCP.

In addition, as part of the SFCP submission, a taxpayer was previously required to complete a "risk" questionnaire. This requirement is now eliminated. Thus, the taxpayer no longer has to answer questions about whether there were accounts outside their home country, complex corporate or trust structures, or the like.

As part of the SFCP submission, taxpayers will now be required to certify under penalty of perjury that previous failures to comply with U.S. tax and reporting requirements were due to nonwillful conduct. For eligible nonresident U.S. taxpayers all penalties will be waived. SFCP was previously available only to nonresident U.S. taxpayers. Under the expanded program, eligible U.S. taxpayers residing in the United States may also take advantage of the SFCP. Such taxpayers will be subject to a miscellaneous five-percent offshore penalty imposed on the unreported foreign financial assets.

There is no preclearance process, no protection against criminal prosecution, and no cap on the offshore penalties if the IRS decides to assess willfulness-based penalties. However, if a person is denied SFCP treatment, the IRS will nonetheless refrain from accuracy related and late filing/payment penalties as the returns will be treated similar to QARs.

The amended SFCP is only available to taxpayers who are currently not under audit or criminal investigation by the IRS. Taxpayers who participate in the SFCP are not eligible to participate in OVDP. Furthermore, taxpayers who submit an OVDP Intake Letter on or after July 1, 2014, are not eligible to participate in SFCP. However, the IRS released Transitional Rule, for taxpayers who submitted their Intake Letters prior to July 1, 2014, but do not yet have an executed Closing Agreement under which eligible and qualifying taxpayers participating in OVDP may request treatment under the applicable SFCP penalty regime.

Taxpayers who submitted preclearance request to or have been precleared by IRS Criminal Investigation Division prior to July 1, 2014, but have not yet submitted Intake Letter and Attachments, may abandon OVDP and pursue SFCP. No formal withdrawal is necessary, and there is no imminent decision deadline. The IRS does not consider preclearance request as a "voluntary disclosure," because no substantive disclosure has yet occurred.

Taxpayers who previously filed a "quiet" disclosure are eligible to participate in the expanded SFCP by submitting a certification and, if applicable, a payment of five-percent penalty. These taxpayers will not receive a negative treatment because of their prior attempt to submit a "quiet" disclosure.

Taxpayers who had made a submission under the prior SFCP guidance will now be subject to the new SFCP provisions. Therefore, the IRS will not perform the low/high risk assessment in connection with these cases.

The IRS will not provide retroactive relief and refund offshore penalty to taxpayers who would have qualified under the expanded SFCP, but who finalized their Closing Agreements with the IRS prior to July 1, 2014.

b. Streamlined Foreign Offshore Procedures (SFOP).

1. Eligibility. Under SFOP, the following nonresident individuals are eligible to participate:

1. Nonresident individuals who are U.S. citizens or "green card holders" are eligible for SFOP (as are their estates) if during any one or more of the most recent three years (for which the due date for the return has passed), the taxpayer did not have a U.S. abode *and* was physically outside of the United States for at least 330 full days. The conjunctive here is important; failure to meet either one if these requirements would disqualify a taxpayer from participating in the SFOP. However, the test must only be met in one out of the three test years. The consequences of failing to meet this test may be very costly. If a noneligible taxpayer previously filed his tax returns, then the taxpayer may take advantage of the SFCP for U.S. residents (discussed below) and pay the five-percent penalty. While a less favorable outcome than under the SFOP, it still provides an avenue for taxpayers to come into compliance at somewhat favorable cost. The real problem exists for taxpayers who had not previously filed U.S. tax returns. As discussed in greater detail below, SFCP is not available to non-filer U.S. residents. Therefore, the only IRS sanctioned avenue for such taxpayers would be by going through OVDP and paying 27.5-percent (or 50-percent) penalty. As a result of this onerous nonresidency requirement, our colleagues in Canada and Europe tend to find SFOP narrower than its previous iteration.
2. Individuals who are not U.S. Citizens or "green card holders" are eligible for SFOP (as are their estates) if in any one of the last three years (for which the due date for tax return has passed), the individual did not meet the "substantial presence test." It is not necessary to meet this requirement for all three years. An interesting question arises as to which test should be applied to determine taxpayer's eligibility for SFOP, if the taxpayer expatriated during the three-year period.
3. PFIC "mark to market" treatment discussed above that is available under the OVDP guidelines is not allowed in SFCP. Therefore, taxpayers who held PFIC items in their offshore accounts and who are choosing the SFCP approach will be subject to the harsh taxing regime under Code Sec. 1291 *et seq*.

2. Submission requirements. The following items are required to be submitted under the SFOP guidelines.

- Tax Returns: Taxpayers will be required to submit three years of past tax returns. The taxpayers are now permitted to submit amended tax returns under the terms of SFOP.
- Income Deferred Plans: Retroactive relief will be provided for failure to elect income deferral on certain retirement and savings plans if such deferral is permitted under the applicable treaty.
- FBARs: Taxpayers will be required to submit six years of past FBARs electronically and identify that the submission is being made under SFCP.
- Payment: The full amount of tax and interest must be included with the submission.
- Certification: Taxpayers will be required to certify under penalty of perjury that failure to report offshore accounts was due to nonwillful conduct. The IRS is defining nonwillful conduct as conduct that is "due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of law." As part of the certification, taxpayers will be required to (i) submit reasons for failure to report income, (ii) pay all tax and interest due, and (iii) file all the information returns including FBARs.

3. Penalties. For U.S. taxpayers eligible and qualifying for SFOP, all penalties will be waived.

4. Risk Assessment. All submissions will be subject to existing audit selection criteria. Under SFOP, taxpayers will not receive protection from criminal prosecution, nor any cap on civil penalties if the IRS disagrees on the willfulness issue and pursues the matter. However, if the return is picked up on an audit, unless the IRS finds willfulness, the penalty waiver will be in place for all penalties, including penalties for failure to file information returns. This waiver will only apply to items reported on the return. If the IRS determines an additional tax deficiency, it may assert penalties on such deficiency.

c. Streamlined Domestic Offshore Procedures (SDOP).

1. Eligibility. U.S. resident taxpayers (and their estates) are eligible for the SDOP if they (1) are not eligible for treatment as a nonresident U.S. person; (2) have previously filed a U.S. tax return for each of the most recent three years for which the U.S. tax return due date has passed; (3) have failed to report income from a foreign financial asset, pay tax on that income, and failed to file an FBAR (and other international information returns); and (4) such failure was nonwillful.

2. Submission Requirements. The following items are required to be submitted under the SDOP guidelines.

- Tax Returns: Taxpayers will be required to submit three years of amended tax returns.
- Income Deferred Plans: Retroactive relief will be provided for failure to elect income deferral on certain retirement and savings plans if such deferral is permitted under the applicable treaty.
- FBARs: Taxpayers will be required to submit six years of past FBARs electronically and identify that the submission is being made under SFCP.
- Payment: The full amount of tax, interest, and five-percent miscellaneous penalty (discussed below) must be included with the submission.
- Certification: Taxpayers will be required to certify under penalty of perjury that failure to report offshore accounts was due to nonwillful conduct. The IRS is defining nonwillful conduct as the conduct that is "due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of law." As part of the certification, on a lengthy form, taxpayers are required to list previously undisclosed foreign financial assets, which will be subject to a five-percent penalty. In addition, taxpayers are required to (i) submit reasons for failure to report income, (ii) pay all tax and interest due, and (iii) file all the information returns including FBARs.

3. Penalties. In lieu of all other penalties, taxpayers will be subject to a single five-percent miscellaneous offshore penalty imposed on the highest aggregate balance/value of the taxpayers' unreported foreign financial assets during the covered period. The IRS provided technical rules on how to calculate the penalty, but effectively, the asset is considered unreported if it was either (1) not reported on an FBAR during the six-year period, (2) not reported on Form 8938 for any of the three years for which the amended returns are filed, or (3) was reported on Form 8938 but the gross income in connection with that asset was not properly reported during any of the three years for which the returns are filed. It appears that for the purpose of calculating the SDOP penalty, any assets that are not required to be included on Form 8938 are not included in the penalty base even if there is unreported gross income relating to the asset (*e.g.,* income producing real estate that is held outright). Furthermore, for the purpose of calculating the penalty, the IRS instructs the taxpayers to use year-end account balances and asset values to determine the year with the highest aggregate value. As a result, the penalty base appears to be smaller than under the OVDP regime as it also seems to exclude personal assets, such as artwork, purchased with unreported offshore funds.

4. Risk Assessment. All submissions will be subject to existing audit selection criteria. Taxpayers do not receive protection from criminal prosecution, nor would the

27.5-percent penalty cap in OVDP apply in the event of any audit if willfulness is found. However, if the return is picked up on an audit, unless the IRS finds willfulness, the penalty waiver will be in place for all penalties, including penalties for failure to file information returns. This waiver will only apply to items reported on the return. If the IRS determines an additional tax deficiency, it may assert penalties on that deficiency.

The IRS intends to review every certification of non-willfulness submitted under SFCP and will make a determination as to whether there are any reasons for further inquiry. From time to time, the IRS will compare the information received from other sources, such as cooperating foreign banks, with the information contained in the certification.

C. Voluntary Disclosures and Current Year Returns

There is no legal obligation for a taxpayer with undeclared accounts to file amended returns. However, as each year passes, a new return comes due, which must be filed in a timely, accurate and complete manner. Similarly, the FBAR deadline of June 30 rolls around every year. A practitioner should *always* advise a client seeking advice about a potential voluntary disclosure that the client must comply with the next set of filing requirements. Any suggestion to the contrary by the practitioner could subject him or her to potential criminal liability for aiding or assisting in the failure to file a return or the filing of a false return.

This precept becomes important because many clients express a fear that a current filing may trigger scrutiny of their prior conduct, and some change their minds about making a voluntary disclosure prior to actually filing. Thus, the practitioner should always advise the client of the legal requirements for the current filing season and memorialize in the file that such advice was given.

This issue also can present problems simply by virtue of the calendar. A taxpayer whose return is on extension to October 15 of a given year may be undertaking to make a voluntary disclosure during the summer and fall of the same year. If the amended returns are not ready to be filed, the taxpayer should nonetheless report the foreign account on the current year return. The same analysis holds for FBAR filings—they should be made on a timely basis regardless of the progress of the amended returns for a voluntary disclosure filing.

D. State Governments' Program

Many states implemented amnesty programs or settlement initiatives aimed at encouraging state residents to amend tax returns to report income from foreign accounts and pay additional state tax and interest. All such programs promised that the taxpayer will not be prosecuted criminally, and most promise to waive or reduce applicable civil monetary penalties. These states include New York, Connecticut, Pennsylvania, Virginia, New Jersey, Ohio and California. Some of these programs have expired, but states will still welcome voluntary disclosures and some states are expected to reopen their programs in light of the IRS's announcement of the third program in January 2012.

VIII. FBAR

In addition to the general overview of the FBARs at Section II.B. above, this section will provide recent developments in FBARs.

A. 2011 FBAR Filing Regulations

In 2011, the U.S. government, acting through the FinCEN, issued new rules regarding reporting requirements for U.S. persons with foreign financial accounts, and in January 2012, the IRS issued a new FBAR form and instructions.

The new rules for the first time link the concept of U.S. resident to the Tax Code's definition in Code Sec. 7701(b), rather than, as in the past, relying on a common law residency test. It is not clear whether FinCEN intended this to be retroactive, but for now, anyone who is considered a resident for tax purposes has an FBAR filing requirement. This includes anyone who can "tie-break" residence to a foreign country.[6]

So, all U.S. persons with a financial interest in, or signature or other authority over, foreign accounts must file FBARs. In adopting the new rules, FinCEN ended a one year moratorium on "signature authority only" filers, who are now required to file. This includes individuals with powers of attorney or the like over accounts beneficially owned by others.

The new rules require filings from, in many cases, American employees of U.S. or foreign companies who have signature authority over corporate accounts, although there are certain provisions that attempt to mitigate the burden of such filings. FinCEN rejected proposed exemptions for custodians of employee benefit plans, and for employees of (1) U.S. subsidiaries of foreign parent companies, (2) foreign subsidiaries of U.S. parent companies, and (3) U.S. parents who can sign on accounts owned by the parent's foreign subsidiary, even if such accounts are reported on company FBARs. All such persons will now have to file FBARs.

Anyone considered an owner of a foreign trust must now file the FBAR. The rules continue to impose a reporting requirement on trust beneficiaries who are entitled to more than 50 percent of a trust's income or assets, but such persons will be able to rely on a filing by a U.S. trustee that reports the account.

Importantly, the new rules contain a broad "anti-avoidance" provision, attributing a reportable "financial interest" to anyone who causes the creation of an entity intending to evade the FBAR filing rules.

The new guidance makes clear that U.S. corporations, partnerships and other entities must file FBARs, and those entities that might be disregarded for U.S. tax purposes remain subject to the FBAR requirement.

Foreign life insurance policies and annuities with accessible cash values are now considered reportable foreign accounts.

Account holders in retirement plans pursuant to various provisions of the U.S. Tax Code are now exempt from FBAR filing to the extent these plans hold foreign accounts, but other benefit plans, *i.e.*, those maintained by non-U.S. companies that do not qualify under the U.S. Tax Code, are not exempt, and U.S. persons with interests in such accounts must file and FBAR. For example, even though U.S. beneficiaries of Canadian RRSP and RRIF accounts may elect to defer U.S. tax on earned income under Article XVIII(7) of the U.S.-Canada income tax treaty by filing Form 8891, *U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Accounts,* together with their Form 1040, they may still be required to report such accounts on a timely filed FBAR.

On March 30, 2011, the IRS issued Notice 2011-31, instructing taxpayers to rely on the new regulations and instructions when filing tax forms that ask about reportable interests or authority over foreign financial accounts. It noted that the IRS would take into account the new regulations and instructions when evaluating the reasonableness of taxpayer responses on returns filed before March 28, 2011.

Subsequent to the issuance of the new regulations, the IRS has granted extensions to June 30, 2014, to certain classes of persons with signature authority over foreign financial accounts, mostly those in certain categories of the financial services industry.

B. Electronic Filing of FBARs

On July 1, 2013, IRS Form TD F 90-22.1 became obsolete and was replaced with FinCEN Form 114. While the FBAR remains materially the same, the new form must be filed electronically via FinCEN's online portal. Information on e-Filing is available on the FinCEN website at *http://bsaefiling.fincen.treas.gov/NoRegFBARFiler.html.*

FinCEN declined to extend the mailbox rule to FBARs, meaning that they must be received by June 30. Electronic filing will reduce the administrative burden on most filers. Spouses can file separate FBARs even for joint accounts.

IX. FATCA

In March 2010, President Obama signed into law the "HIRE" Act, which contained many provisions of the previously introduced Foreign Account Tax Compliance Act (FATCA). The provisions of FATCA are intended to promote compliance with U.S. law requiring the U.S. persons to report income from non-U.S. accounts. For financial institutions and many other foreign businesses and individuals, this is one of the most important tax laws in many years. It is also quite complex. The IRS has issued extensive technical guidance on FATCA, and delayed its effective date, but by mid-2014 the automatic information disclosure regime enacted by the statute should be up and running.

A. Disclosures to IRS of U.S. Account Holders

FATCA requires that "foreign financial institutions" (FFIs) and other foreign entities receiving payments from U.S. sources undertake a series of steps to identify American account holders and report information as to their accounts on an annual basis to the IRS. Failure to comply could subject the affected institution to a series of 30-percent withholdings not only on U.S.-source payment of fixed or determinable annual or periodic income ("FDAP income"), but also gross proceeds from the sale or disposition of any property that gives rise to FDAP income. Withholding on U.S. source FDAP income began on July 1, 2014. Withholding on gross proceeds will begin after December 31, 2016. These withholding provisions are designed solely to incentivize compliance with reporting requirements.

The reporting regime requires FFIs to:

- enter into an FFI agreement by registering with the IRS unless they are deemed compliant FFIs or excepted entities;
- obtain information regarding each holder of each account maintained by the FFIs as is necessary to determine which accounts are U.S. accounts and comply with IRS's verification and due diligence procedures;
- annually report information with respect to any U.S. account held at the FFIs;
- deduct and withhold 30 percent of any "pass thru payment" to a "recalcitrant account holder" or FFIs not subject to an agreement (or elect to be withheld upon);
- comply with IRS information requests; and

- if, under the FFI's domestic law, the FFI would be prohibited from reporting the required information, the FFI must either obtain a waiver of such prohibition or close the account.

B. Other FATCA Provisions

In addition to implementing the new withholding/disclosure regime, FATCA includes a number of other provisions aimed at improving tax compliance across the board on issues arising from foreign accounts.

1. Disclosure of Information with Respect to Foreign Financial Assets

Individual taxpayers with an interest in any "specified foreign financial assets" are now required to attach a disclosure statement to their income tax returns if the aggregate value of such assets is greater than $50,000. "Specified foreign financial assets" include depository or custodial accounts at FFIs, stocks or securities issued by foreign persons, any other financial instrument or contract held for investment issued by a foreign counterparty, and any interest in a foreign entity. This disclosure is made on Form 8938 and supplements the existing FBAR requirements.[7]

Civil penalties for failure to supply this information are $10,000, with additional $10,000 penalties up to a maximum of $50,000 after notice from the IRS.[8]

Further, a 40-percent penalty can now be imposed on any understatement of tax attributable to an undisclosed foreign asset, subject to the usual defenses to understatement penalties.[9]

The Form 8938, in the near future, will allow the IRS systematically to "match" information received from financial institutions and other entities required to supply data to the United States, on the one hand, and the information provided (or not provided) by taxpayers on the Form 8938 associated with their income tax filings.

2. Modified Statute of Limitations

The statute of limitations was modified for significant omission of income in connection with foreign assets. Current Code Sec. 6501(c)(8) begins the three-year period of assessment for understatements attributable to failure to report foreign accounts on the date such information is actually provided to the IRS. FATCA extends the three-year period to six years from that same date. When a taxpayer fails to report certain foreign asset information, the statute is tolled for a period including the taxpayer's noncompliance plus three years. Further, the extended statute applies to the taxpayer's entire return, not just to unreported foreign assets. This provision is effective for any year open on the date of enactment, and to returns filed after enactment.[10]

3. Foreign Trust Related Provisions

FATCA clarifies (1) that an amount is treated as accumulated for the benefit of a U.S. beneficiary of a foreign grantor trust even if the U.S. beneficiary's interests are contingent on a future event[11]; (2) that if any person, such as a trustee or "protector," has the power to add beneficiaries, the trust shall be considered to have U.S. beneficiaries unless a specific list of beneficiaries is provided and no beneficiary included on the list is a U.S. person[12]; and (3) that any agreement or understanding, such as a letter of wishes, that may result in a U.S. person benefitting from the trust will be considered a term of the trust.[13]

FATCA imposes new reporting requirements on any U.S. person treated as an owner of any portion of a foreign trust, and creates a presumption that a foreign trust has a U.S. beneficiary unless the beneficiary submits information demonstrating to the Secretary's satisfaction that no part of the income or corpus of the trust may be paid to or accumulated for the benefit of a U.S. person, and if the trust were terminated during the taxable year, no party of the income or corpus could be paid for the benefit of a U.S. person.[14]

In addition to cash and securities, that if provided or loaned to a beneficiary are considered distributions, FATCA provides that the fair market value of any use of property owned by the trust, such as real estate, is treated as a trust distribution.[15]

Trusts as compliant FFIs should demonstrate their FATCA status to withholding agents by providing withholding certificate and documentary evidence. However, in the case where a foreign grantor trust receives withholdable payment, it was not entirely clear who would be the account holder and the payee who is responsible for providing such documents. The relevant Treasury Regulations under FATCA formerly had a special rule that the grantor of a grantor trust, rather than the trust, would be treated as the account holder. This rule would have been contrary to most other information reporting and withholding rules, which treat a trust as an account holder and as the payee. Thus the new final and temporary regulations, published on March 6, 2014, removed the grantor trust rule so that the general rule for treating an entity as an account holder applies to treat a grantor trust as the account holder and the payee.

4. FFI Registration System

The IRS announced a new online registration system for financial institutions to register with the IRS to comply with FATCA requirements, available at *www.irs.gov/fatca*.[16] FFIs will receive a global intermediary identification number (GIIN) , which will be used for both reporting purposes and to identify its status to persons making withholdable payments to it (referred to as "withholding agents").All GIINs will appear on a publicly available list (the "IRS FFI list") that the IRS first posted electronically on June 2, 2014, and that it proposes to update on a monthly basis thereafter.An FFI agreement is effective as of the date when an FFI obtains a GIIN.

C. Inter-Governmental Agreements (IGAs)

One concern that has arisen is whether FFIs can provide financial information to the United States pursuant to FATCA without violating their own domestic privacy laws. The United States has announced several agreements (or "IGAs") with foreign countries, including Switzerland, to address this issue and to provide an alternative approach to the implementation of FATCA. Dozens of countries are said to be in talks with the United States, and several countries previously considered sacrosanct tax secrecy jurisdictions have reached agreements, such as the Cayman Islands and Switzerland. As of July 8, 2014, 39 countries, including major trading partners as well as tax secrecy jurisdictions, such as Bermuda, British Virgin Islands, Isle of Man, and Guernsey, have signed IGAs with the United States, 62 countries, including Brazil, India, China, Singapore and Hong Kong, have initialed IGAs, and dozens of other countries are in discussions with U.S. authorities regarding the possibility of entering into IGAs.

X. Conclusion

Through a combination of criminal and civil investigations, congressional action, and leads and data provided by informants, whistleblowers and thousands of Americans making voluntary disclosures, the U.S. government has begun to penetrate walls of bank secrecy maintained in many nations around the world. In addition, 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. And the U.S. Congress, working with the Administration, has clearly put international tax issues at the forefront of mechanisms to improve information reporting, obtain more tax and penalty revenue, and enhance enforcement efforts.

Governments are starved for revenue, and these efforts are aimed at promoting tax compliance and fairness as well as raising money for a nation's fisc. We expect such efforts to continue.

The lessons of the past five years are that practitioners around the world should prepare themselves for a regime promoting greater information disclosure. Any noncompliant American taxpayers who have yet to declare foreign accounts or other reportable assets should be mindful of these developments and aware of the increased global enforcement presence by the IRS, and particularly its Criminal Investigation Division, and the considerably enhanced cooperation among tax authorities worldwide.

It is very much in the IRS's interest to encourage taxpayers to come forward and bring funds held in undeclared accounts "back into the system," for future taxation on income and gains earned by such funds and, eventually, perhaps, through imposition of the estate tax. The voluntary disclosure policy is an important component of the IRS's overall compliance mission.

In light of the many developments occurring in the past four years in the area of undeclared accounts, and the increasing ability of the U. S. government to penetrate bank secrecy, it would still behoove financial and legal advisors worldwide to consider advising individual U.S. clients who may have undeclared accounts and institutional clients who may have assisted U.S. taxpayers to establish such accounts to come into compliance. Although the civil liabilities may be severe and the financial pain high, the ability to avoid criminal prosecution in the enhanced enforcement environment is a substantial benefit to be considered.

ENDNOTES

1 31 U.S.C. §5321(a)(5).
2 31 U.S.C. § 5321(a)(5).
3 *J.B. Williams*, CA-4, 2012 USTC ¶50,475.
4 *J. McBride*, DC-UT, 2012-2 USTC ¶50,666.
5 *Zwerner*, DC-FL, No. 1:13-cv-22082-CMA (June 11, 2013).
6 *See* Reg. §301.7701(b)-1 (providing that such a dual resident is nonetheless considered a U.S. tax resident for all other tax purposes).
7 Code Sec. 6038D.
8 Code Sec. 6038D(g).
9 Code Sec. 6662(j).
10 Code Sec. 6501(c)(8), (e).
11 Code Sec. 679(c)(10).
12 Code Sec. 679(c)(4).
13 Code Sec. 679(c)(5).
14 Code Sec. 679(d).
15 Code Sec. 643(i).
16 IR-2013-69.