

Voluntary Disclosure Key to Addressing Offshore Tax Cheats, Practitioners Say

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U.S. Justice Department and IRS investigations have taken aim at offshore tax evasion activities allegedly facilitated by giants of the banking world, such as Swiss banks UBS and Credit Suisse and London's HSBC. (For prior coverage, see *Doc 2008-25571* [[PDF](#)] or *2008 WTD 235-5* [Q](#).)

The issue has been prominent for some time, during which the DOJ and the IRS conducted investigations involving Caribbean tax havens such as the Cayman Islands. Since February their investigations have been focused on account holders in Liechtenstein and Switzerland.

But will these activities mark a watershed in the fight against international tax evasion, or will they eventually fade, leaving the system more or less intact for those willing and able to exploit it? Tax Analysts spoke with three practitioners to discuss their visions of the impact the current situation could have.

"We're at the beginning of an era when taxpayers can't look to tax havens" as a place to hide their assets, Scott Michel, member and current president of Caplin & Drysdale, Washington, told Tax Analysts December 2. Michel recently participated as guest expert in Swiss-American Chamber of Commerce workshops held in Geneva and Zurich that examined how U.S. account holders can go about declaring their foreign accounts.

Recent U.S. and EU efforts are aimed at creating transparency across the global economy, something that will go a long way in slowing offshore tax evasion activities, Michel said.

Recent responses by banks such as UBS -- for example, telling clients to close accounts or declining to accept overseas clients -- indicate a narrowing of banks' opportunities to remain active in the global economic community.

Secrecy, which had previously held an important place in a bank's quiver of marketing weapons, may now become a liability as tax authorities continue to target havens once felt to be free of foreign intrusion. Michel does not foresee the emergence of a completely transparent system, but rather views a modified system in which some degree of secrecy is balanced against some degree of transparency as the admission ticket to fully take part in the international system.

Michel also said that achieving a more transparent system will require an overarching, multilateral approach, as well as more specific, bilateral treaties such as the recent U.S. treaty with Liechtenstein.

Bruce Zagaris, partner with Berliner, Corcoran & Rowe LLP, Washington, told Tax Analysts December 1 that he sees long-term structural effects as well. Zagaris particularly addressed the role of tax intermediaries, a category on which the October 30 OECD discussion paper "Project on High-Net-Worth Individuals" focuses. (For the OECD discussion paper, see *Doc 2008-23122* [\[PDF\]](#) or *2008 WTD 214-17* [↗](#).)

Zagaris foresees an increasing focus on the actions of tax intermediaries, perhaps culminating in the longer term in the development of a "gatekeeper initiative," under which tax intermediaries might come under the same kind of scrutiny exhibited by anti-money-laundering circles.

In the more medium term, Zagaris, like Michel, sees a deepening of international cooperation in the form of new tax information exchange agreements. Furthermore, under pressure from both the OECD and the United Nations, international treaty provisions are to a greater extent addressing tax-related issues.

Of more immediate impact than the question of how the international system will tackle this issue is the question of how the U.S. -- that is, both U.S. holders of foreign accounts and U.S. officials at the IRS, DOJ, and Treasury -- will react.

For all interested parties, voluntary disclosure is a critical factor in addressing offshore tax issues. For taxpayers, voluntary disclosure provides the opportunity to clear the record and establish a clean slate. For government officials, voluntary disclosure offers the potential to target large numbers of tax cheats without the need to expend resources tracking each and every one down.

The critical aspect of the system is the delicate balance between penalizing tax cheats to some degree without disincentivizing them from taking part, something also outlined in the OECD discussion paper. People must be willing to freely approach the IRS, understanding that voluntary disclosure is "not a guarantee," a former assistant attorney general for the DOJ's Tax Division told Tax Analysts November 25.

Many people don't realize this lack of guarantee. Voluntary disclosure "is a practice creating no substantive or procedural rights," the former official added. Sophisticated taxpayers understand this and must be incentivized more broadly.

One particular area practitioners addressed was the Report of Foreign Bank and Financial Account (FBAR), which Treasury requires taxpayers to submit every tax year by June 30. The FBAR requires a taxpayer to check a box indicating whether he holds a foreign account. Failure to properly file the FBAR is a criminal offense, and the penalties are up to 50 percent of the account balance for each year of the omission. If the taxpayer fails to file the FBAR in more than one year, the penalties will at least equal the entire account balance.

Michel called this area "ripe for negotiation," with the IRS eager to keep from scaring people away and tending toward leniency. Zagaris similarly noted the need for FBAR penalties, which he termed "too draconian" to be addressed if the IRS hopes to attract more disclosure. According to a December 3 article in *The New York Times*, high-level officials at the IRS are in fact considering new steps, possibly affecting the FBAR penalties, to address the current scandal.

At the same time, other external pressure may be mounting on tax cheats that previously huddled in a smug feeling of safe secrecy. More and more bank employees (like Heinrich Kieber, a former LGT employee who divulged to the German government a list of 1,400 Liechtenstein account holders) are walking into IRS offices and sharing information on secret account holders. "People who think they have secret accounts are wrong," Zagaris said.

Michel echoed this idea, saying that the IRS's whistle-blower program is having a great impact in all areas of taxation, including offshore accounts. Whole law firms are emerging that specialize exclusively in this area, Michel said. Again following the example of Heinrich Kieber, entrepreneurs are looking at aiding whistle-blowers as a potential new market niche.

Further, encouraging voluntary disclosure could easily lead to the emergence of additional names of UBS officials, Zagaris said. The Raoul Weil indictment alleged that Weil -- a senior executive with UBS -- worked with many levels of bank officials in carrying out the tax evasion business; as more people step forward, more people at the intermediary levels will be netted.

The only way around this would be for UBS to reach an accommodation with U.S. officials, Zagaris said, but 70 names out of a potential 17,000 to 20,000 account holders is far too few. The Swiss government seems to want it both ways -- to cooperate, but also to maintain its secrecy by limiting its cooperation to Swiss-defined cases of tax fraud.

U.S. officials could use the potential revelations from voluntary disclosures to pressure Switzerland to cooperate lest more high-level officials be brought down, Zagaris said. However, the more indictments that are unsealed, the less secrecy

remains a marketable commodity, both goals that appeal to U.S officials, especially should Congress increase pressure for more crackdowns.

Finally, Michel suggested that state governments could also play a role. The IRS will share information with state tax authorities, which could lead to separate actions in powerful states such as New York or California. Independent enforcement could well emerge from states such as these, Michel said.

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Tax Analysts Information

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