# Offshore Tax Enforcement, Voluntary Disclosure, And Undeclared Foreign Accounts

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## A. Introduction

1. For the past several years the worldwide business press has been full of stories about potentially thousands of U.S. taxpayers who may have undeclared accounts all over the world. Through a variety of mechanisms, the U.S. government has obtained information about American account holders and their assets from jurisdictions previously thought nearly impenetrable. Many 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.

2. Recent developments portend the gradual erosion of the traditional concept 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.

3. This article discusses methods of enforcement, incentives, and deterrence being used by the U.S. government to bring U.S. taxpayers into compliance, to prosecute alleged wrongdoers located both in and outside the United States, and to penetrate long-standing protections for bank information maintained in many countries outside the United States.

## B. Criminal And Civil Exposure In Undeclared Account Cases

1. A variety of reporting requirements exist 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 money penalties. Non-willful conduct 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*

i. U.S. taxpayers are required to report and pay tax on their worldwide income. This includes reporting 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 Form 1040, and other tax forms, requires filers to check a box answering whether they have signature authority or a financial interest in any foreign accounts and if so to list the names of the countries where the account(s) are held.

ii. Criminal penalties exist for willful failure to report income and 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.

b. *Foreign Bank Account Reporting*

i. U.S. law also requires filing a separate information return, a TD F 90-22.1, Report of Foreign Bank and Finance Accounts, known as an FBAR, by June 30 following each calendar year. This form is not filed with the tax return but is sent to a separate IRS service center in Detroit. There are no extensions to this deadline.

ii. A non-willful failure to file an FBAR can be penalized up to $10,000, but a willful failure to file 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. 31 U.S.C. §5321(a)(5). Thus a taxpayer with a substantial undeclared foreign account may face the prospect of a civil penalty for a multiyear, 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.

iii. 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 it downward, or away altogether, especially in the case of inherited accounts or where other factors exist indicating a taxpayer was unaware of the FBAR filing requirement or otherwise acted with reasonable cause. As noted below, the IRS has a new 2011 voluntary disclosure initiative. IRS agents have no discretion to lower penalty amounts below those set forth in program guidance.

iv. The penalty for failing to file the FBAR can apply to anyone who violates, *or causes any violation of,* the filing requirement. 31 U.S.C. §5321(a)(5). Recently U.S. government officials have stated 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. The willfulness penalty is 50 percent of the highest account balance 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.

c. *Other Reporting Obligations*

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

(1) Forms 3520 And 3520-A

(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.

(B) If a U.S. donee fails to timely file a Form 3520 to report the receipt of a large foreign gift, or files the form incorrectly or incompletely, such donee may be subject to a penalty equal to five percent, not to exceed 25 percent, of the value of the gift or bequest received in the relevant year.

(C) 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 taxable year.

(D) 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.

(2) *Form 5471.* Depending on the type of foreign corporation involved, and the company's relationship to the U.S. shareholder, varying penalties may be imposed for 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.

(A) These penalties generally have a reasonable cause exception, meaning if a 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.

(B) In cases where there has been a failure to file such forms, however, 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.

(C) In both IRS voluntary disclosure programs (discussed below), 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.

d. 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:

i. Whistleblowers and informants.

ii. Criminal investigations of financial institutions and account holders.

iii. Civil summons processes.

iv. Requests under tax treaty or mutual information exchange agreements.

v. Voluntary disclosure by thousands of Americans seeking to avoid criminal prosecution and obtain reduced civil penalties and their continuing tax compliance.

vi. Foreign Account Tax Compliance Act and related legislative and regulatory developments.

e. 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 on reporting foreign accounts should take advantage of the IRS's voluntary disclosure policy or consider alternative methods of coming into compliance.

## C. Informants And Whistleblowers

1. *Recent Developments*

   a. The United States has obtained information about a number of foreign banks and their activities involving American account holders from informants or 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 investigations of multiple foreign financial institutions and to audits or prosecution of probably hundreds of U.S. persons.

   b. 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 to U.S. authorities, unless one could show the U.S. government affirmatively participated in the unlawful conduct.

2. *IRS Whistleblower Office*

   a. 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.

   b. The whistleblower 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 US$2 million, the IRS may pay 15–30 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.

   c. 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, Panama, and Sydney, 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 of the Criminal Investigation Division.

   d. 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. A U.S. lawyer disclosed on April 8, 2011, that his client had received the first reward paid by the whistleblower office, for US$4.5 million for exposing underreporting and underpayment of tax at a U.S. financial services company.

3. *Cooperation*

   a. In nearly every complex financial criminal investigation, U.S. prosecutors rely on cooperating witnesses to help make a case for prosecution. Where an individual is caught up in an unlawful scheme, often 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.

   b. 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 may be occurring in the 2011 arrest and indictment of various foreign bankers, including bankers at Credit Suisse in Switzerland. It is likely that other such cases are 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 higher-ups.

## D. Disclosures From Criminal Investigations Of Financial Institutions

1. Corporations doing business in America 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, a corporate entity is responsible for the conduct of its employees. Where one or more individual employees engage in unlawful conduct in connection with their employment, their actions may be deemed actions of their employer, subjecting the employer itself to criminal sanctions.

2. Thus whenever the U.S. Justice Department (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 were prosecuted.

3. Options for a company to resolve a criminal investigation include i) a non-prosecution agreement, ii) a deferred prosecution agreement, iii) a plea to a criminal charge, or iv) indictment and trial.

   a. A non-prosecution agreement 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 guilty plea. In most DPAs the government insists on an express acknowledgement of wrongdoing.

b. UBS 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.

c. 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 Justice Department, as well as production of voluminous records of their accounts.

   i. Based on this information, the Justice Department has obtained numerous guilty pleas from and indicted other UBS account holders. The Department has said that perhaps as many as 150 other UBS account holders are under criminal investigation. The number of UBS account holders who have pled to or been charged with criminal tax offenses is now approaching 30.

   ii. The Justice Department also relied on this information to charge additional Swiss bankers, financial advisers, and lawyers, alleging a conspiracy to help Americans commit tax fraud, bribery of Swiss government officials, and other offenses.

d. In January 2010 a Swiss court held this information disclosure was unlawful as a matter of Swiss law. But this ruling will not prevent the United States from using the information unless one could establish that the United States played a direct role in violating foreign law.

4. *Other Developments*

a. *Bank Leumi Requires Disclosure.* In November 2010 Bank Leumi, Israel's largest bank, began requiring U.S. clients to 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.

b. *WikiLeaks Obtains Data On Offshore Accounts.* On January 17, 2011, Rudolf Elmer, former chief of the Cayman office of Julius Baer, delivered account data of approximately 2,000 offshore accounts to WikiLeaks. WikiLeaks has not yet made the data public although it originally claimed the data could be available in a matter of weeks. Julius Baer has denied any wrongdoing. Mr. Elmer is now facing charges in Switzerland for violating bank secrecy laws. Neither of these facts, however, is likely to dissuade the United States from using this data if this information becomes available to them. Reports state that the data provided to WikiLeaks had been provided to tax authorities some months ago.

c. *HSBC-India Prosecutions.* 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 the account holder and five unnamed co-conspirators, all of whom were account managers at the international bank either in the United State or India. The indictment alleges 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, the Department of Justice has charged or obtained guilty pleas from other HSBC-India account holders.

d. *Actions Against Credit Suisse Bankers.* 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 advisers 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 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. Credit Suisse was not included in the indictment and maintains that it is fully compliant with banking regulations.

e. *Follow-Up Interviews–2009 Voluntary Disclosure Initiative.* 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 from the 2009 IRS Offshore Voluntary Disclosure Program. Criminal investigators are contacting persons who made disclosures in the 2009 program to obtained detailed information about their banks, bankers, financial advisers, 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 advisers and other third parties who appear to have had a number of U.S. clients with undeclared foreign accounts.

5. The IRS and Justice Department view the template of the UBS investigation as a path toward obtaining similar information from other financial institutions. To the extent the American 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 deferred prosecution agreement 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. At least as concerns Switzerland, the ruling on the illegality of the disclosure pursuant to the UBS DPA, and the resolution of the UBS John Doe summons case (discussed below), make unlikely another "compelled disclosure" along the lines that occurred in the UBS DPA.

6. Various state governments are also conducting criminal investigations of their taxpayers arising from undeclared foreign accounts. The Manhattan District Attorney in New York has been active and has obtained guilty pleas and civil settlements. Other states appear to be pursuing persons who have allegedly evaded state taxes through the use of undeclared foreign accounts.

## E. Civil Summons And Audit Processes

1. 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 (IRC) seeking information on noncompliant U.S. taxpayers. If the IRS can identify an individual target, it 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.

2. *John Doe Summons*

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

    b. The IRS has often used the John Doe summons method to obtain offshore account information.

        i. In 2000 the IRS issued John Doe summonses to obtain from MasterCard and American Express records of customers using bank accounts and debit cards in certain tax haven jurisdictions.

        ii. In 2002 a similar case was filed for records maintained by VISA International. In August 2002 authorization was sought for more than 40 John Doe summonses to various vendors who had transactions with persons holding foreign accounts.

        iii. In 2008 the IRS served a John Doe summons on UBS AG and obtained an enforcement order in Florida federal court (discussed below).

        iv. 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.

v. In April 2011 a U.S. court authorized the IRS to serve a John Doe summons on HSBC Bank 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. As of the writing of this article, it was unclear whether HSBC would contest the summons, but court papers implied the bank was cooperating with the IRS.

3. *Summonses And Bank Secrecy*

a. Many foreign jurisdictions—particularly tax havens—have civil or criminal statutes that prohibit the disclosure of bank records and other confidential financial information without the consent of the depositor. When 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 terms of the foreign law. Unsurprisingly, the United States almost always wins such cases.

b. 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 court findings of civil contempt 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.

4. *The UBS John Doe Summons Case*

a. In July 2008 a U.S. court authorized the IRS to serve a John Doe administrative summons on UBS seeking production of records of all accounts that it maintained during the 2002-2007 period 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 when U.S. securities were held in the account.

b. 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 Justice Department and the IRS vigorously disputed this, arguing the treaty was a nonexclusive remedy and because UBS had a presence in the United States it was subject to a summons and could be compelled to produce documents notwithstanding conflicting provisions of foreign law.

c. 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 to identify certain types of accounts that would be disclosed. The treaty request specified two types of accounts for disclosure: accounts held in corporate or trust structures, and certain larger accounts. The parties agreed that at least 4,450 accounts would be so identified, and account holders began to receive notice.

d. In January 2010, however, a Swiss federal administrative court ruled that the treaty request at issue violated Swiss bank secrecy law because in particular 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 in 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. By March 2011 the production of this information is apparently complete.

e. The settlement of the UBS John Doe summons case may provide a template for future such disputes.

i. 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.

ii. The United States obtained something of value as well. In addition to a commitment by the Swiss to produce data on 4,450 UBS accounts, 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.*

5. *Required Records Summonses To Account Holders*

a. Recently the U.S. Justice Department 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.

b. Ordinarily, in certain circumstances an account holder would likely have the lawful right 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 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.

c. There is, however, a long-standing exception to the Fifth Amendment in the case of records required to be kept by U.S. law. The Justice Department has now argued successfully in two cases that records of foreign bank accounts are required to be maintained under 31 U.S.C. §5314 and related regulations, depriving an account holder of his or her Fifth Amendment privilege as it relates to the production of such records in response to a subpoena. *See, e.g., In re Grand Jury Investigation (John Doe),* Case No. 10gj200 (S.D.Cal. February 17, 2011).

6. *Civil Penalty Examinations*. IRS agents are trained to assess applicable penalties in appropriate cases. The *Internal Revenue Manual* provides guidance to auditors on the identification of relevant penalties and fraudulent conduct. Agents are trained to look for indications of fraud for potential referral to the IRS Criminal Investigation Division.

7. *High Net Worth Initiative*. In October 2009 the IRS announced the creation of a new High Net Worth Industry Group. The purpose of this 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 advisers. Part of this group's aim is to uncover unreported foreign assets.

## F. Treaties And Mutual Information Exchange Agreements

1. International pressure is growing for greater transparency concerning foreign account financial information.

   a. Throughout the past two or more years, the Organization for Economic Cooperation and Development (OECD) and the European Union have been pressuring a number of countries to be more transparent and to adopt broader information exchange provisions according to the OECD standard. The OECD model agreement contains broad-based provisions allowing for information exchange.

   b. 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 state 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.

2. A number of developments have occurred in the area of treaty-based information exchange.

a. In 2008 the United States and Liechtenstein entered into a broad-based Information Exchange Agreement, applicable to 2009 and beyond. Liechtenstein is one of the jurisdictions where a number of foundations, or Stiftungs, holding previously undeclared foreign accounts have been sited.

b. 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.

c. The Swiss and U.S. governments signed a new treaty protocol in September 2009, whereby Switzerland would expand information disclosure under the double taxation agreement beyond the narrow concept of tax fraud under Swiss law into areas of tax evasion, or the failure to report income. Switzerland was removed from the "grey list" of potential tax havens as a result of concrete steps taken by the Swiss to become more open.

d. Singapore's Ministry of Finance endorsed the OECD's Standard for the Exchange of Information for Tax Purposes in March 2009, a prerequisite to keeping off OECD's black list of tax haven countries. As of November 2009 Singapore has been removed from the OECD grey list and placed on the white list. There were reports in March 2010 that a delegation of the Singapore government was traveling to the United States to engage in discussions on information exchange and tax agreements.

e. 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 it has signed information exchange agreements with a growing number of nations.

f. 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.

g. In February 2011 the Swiss Federal Department of Finance, 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, a mutual agreement procedure, or a diplomatic exchange of notes.

h. As of March 29, 2011, 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. All but eight (five of which–Montserrat, Nauru, Niue, Panama, and Vanuatu–are deemed tax havens) had substantially implemented procedures in furtherance of that objective.

i. 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. Like most treaty exchange situations, however, the proposed statute limits information exchange to specific cases (that is, 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.

## G. Voluntary Disclosures

1. So long as a case involves legal source income, a U.S. taxpayer can use the voluntary disclosure process to avoid criminal sanctions for failure to report the existence of, and income earned on, a foreign account on income or estate tax returns, as well as for nonfiling of the FBAR. Taxpayers who have engaged in these types of misconduct may avoid 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.

2. In March 2009 the IRS announced the Offshore Voluntary Disclosure Program (OVDP), 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 OVDP. With the success of this first program, the IRS recently announced a second program, described below.

3. In the OVDP, the Service obtained information on a number of additional foreign financial institutions, as well as specific bankers, financial advisers, 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 the first OVDP are being contacted by IRS criminal investigators seeking follow-up interviews of clients to inquire more specifically about actions of bankers, advisers, and other third parties who were affiliated in some respect with undeclared foreign accounts.

4. After a series of significant administrative problems and controversial decisions by the IRS, the cases in the first OVDP are proceeding toward resolution through civil certifications, and many have reached the stage of a closing agreement.

5. On February 8, 2011, the IRS announced a second voluntary disclosure program, the Offshore Voluntary Disclosure Initiative (OVDI). This program was available until September 9, 2011, although the IRS recently announced that extensions of 90 days would be available on written request and for good cause shown. In addition to new participants who may come into the program, its rules also apply to anyone who made a voluntary disclosure on offshore accounts after the expiration of the first program on October 15, 2009, and before the new program. Details of the program are at www.irs.gov/newsroom/article/0,,id=234900,00.html?portlet=7, including copies of IRS guidance in German, Chinese, Korean, and other languages. Important components of the initiative are as follows.

   a. The new program continues the preclearance process, so potential participants can learn if their voluntary disclosure would be considered timely under IRS rules simply by providing their name and identifying information. It also continues the optional format voluntary disclosure letters, where participants provide to the IRS Criminal Investigation Division general information about their accounts, banks, bankers, advisers, and other topics. As with the OVDP, the IRS will undoubtedly continue to mine information from this new program for leads in further investigations.

   b. Once a participant clears the IRS Criminal Investigation Division process, the initiative requires filing amended or delinquent tax returns, FBARs, and other required forms for 2003-2009, and current filings for 2010. All filings must be complete and submitted to the IRS no later than August 31, 2011 (except that taxpayers with an extension for their federal return for 2010 have until October 15, 2011). This puts tremendous pressure on participants to obtain financial information, engage professional assistance, and complete their submission quickly.

   c. Participants can expect to pay i) tax on investment earnings in previously undeclared foreign accounts for 2003-2010, ii) an accuracy penalty of an additional 20 percent of the tax due, iii) interest calculated on both the tax and the 20 percent penalty, and iv) a "miscellaneous" penalty of 25 percent of the highest value of their undeclared foreign financial assets during 2003-2010. As to this latter category, importantly, the IRS insists that nonfinancial assets, such as real estate, art, or jewelry, also be included in the calculation of the 25 percent penalty if those assets have any connection or relationship to the prior tax noncompliance, for example, if they were purchased with funds from undeclared accounts.

   d. Reduced penalties of 12.5 percent are available for accounts that have been not exceeding $75,000 during 2003-2010, and of five percent for a very limited class of inherited or similar accounts where the initial account funds have been, or were not required to be, taxed under U.S. law, where the account holder used no more than $1,000 of the funds in any given year, and where there is no evidence of active management or concealment by the account holder.

e. In June 2011 the IRS issued guidance expanding the scope of a reduced penalty structure for longtime nonresident Americans with little U.S. source income. If an American has resided outside the United States during the period covered by a voluntary disclosure; has complied with tax laws in their home country, including the reporting of income on foreign accounts; and has less than $10,000 in U.S. source income, they are likely eligible for a penalty of five percent of their undeclared financial assets. This penalty does not include items such as real estate that may have been purchased with unreported income.

f. Taxpayers who reported and paid tax on all their taxable income for prior years but failed to file FBARs should file the delinquent FBARs by August 31, 2011. The IRS has stated it will not impose penalties on taxpayers who file all delinquent FBARs by August 31, 2011, if there is no unreported tax liability. FBARs for 2010 are due on June 30, 2011, and must be filed by that date.

g. Similarly the IRS has stated it will not impose penalties on taxpayers who failed to file tax information returns, such as Form 3520 for foreign trusts or Form 5471 for controlled foreign corporations, and have no unreported tax liability if the taxpayer files those delinquent forms by August 31, 2011.

h. A key difference between OVDP and OVDI is that processing of the voluntary disclosures will apparently be performed through a centralized unit as opposed to assigning individual revenue agents to each disclosure. Under OVDI the IRS will review the completed disclosure package for accuracy, completeness, and correctness and will not normally initiate a complete examination. Importantly the IRS is giving agents no discretion to reduce penalties.

i. If a participant does not believe that he or she should have to pay the 25 percent omnibus penalty, their only choice is to opt out of the program, in which case the IRS would conduct a full audit of the amended returns and propose whatever penalties it deems appropriate, including, where applicable, maximum FBAR penalties of 50 percent of the account balance per year.

ii. In June 2011 the IRS issued guidance outline procedures on 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.

iii. To sustain and collect the substantial penalty for willful failure to file an FBAR, the IRS must carry the 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 form was willful. This is 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. In 2010 a federal judge ruled that in one case the IRS had failed to carry its burden of proof and rejected the IRS's attempt to collect the maximum FBAR penalty. *United States v. Williams*, 2010-2 U.S. Tax Cas. (CCH) ¶50,623 (E.D.Va. 2010).

i. Most persons holding accounts at foreign financial institutions are invested in foreign mutual funds that, under U.S. tax law, are passive foreign investment companies (PFICs). PFICs are subject to a particularly harsh taxing regime under section 1291 et seq. of the Internal Revenue Code. Largely 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 in the 2009 OVDP. Participants now may elect whichever regime is more favorable to them. This tax regime is also available to participants in the 2011 OVDI.

j. As with the OVDP, the IRS has expressed 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.

6. *Voluntary Disclosures And Current Year Returns*

a. No legal obligation exists for a taxpayer with undeclared accounts to file amended returns. As each year passes, however, 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.

b. 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 before 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.

c. 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.

7. Many states have 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 promise that the taxpayer will not be prosecuted criminally, and most promise to waive applicable civil money penalties. These states include Connecticut, New Jersey, New York, Ohio, Pennsylvania, Virginia, and recently California. Some of these programs have expired, but states still welcome voluntary disclosures.

## H. New FBAR Filing Regulations

1. In early 2011 the U.S. government, acting through the Financial Criminal Enforcement Network (FinCEN), issued new rules (see 76 Fed. Reg 10,234 (Feb. 24, 2011) on reporting requirements for U.S. persons with foreign financial accounts. In November 2011, the IRS issued a new FBAR form and instructions.

   a. The new rules for the first time link the concept of U.S. resident to the tax code's definition in IRC §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. *See* Treas.Reg. §301.7701(b)-1 (providing that such a dual resident is nonetheless considered a U.S. tax resident for all other tax purposes).

   b. 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.

   c. 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 certain provisions attempt to mitigate the burden of such filings. FinCEN rejected proposed exemptions for custodians of employee benefit plans and for employees of: i) U.S. subsidiaries of foreign parent companies; ii) foreign subsidiaries of U.S. parent companies; and iii) 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.

   d. Anyone considered an owner of a foreign trust must now file an 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.

   e. 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 FBAR filing rules.

f. 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.

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

h. 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, that is, those maintained by non–U.S. companies that do not qualify under the U.S. tax code, are not exempt. U.S. persons with interests in such accounts must file an FBAR.

i. On March 30, 2011, the IRS issued Notice 2011-31, 2011-1 C.B. 724, 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.

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

## I. Congressional Action

1. 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 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 some guidance on FATCA, and more is undoubtedly forthcoming. Important components of the legislation are set forth below.

a. *Principal Provisions Of FATCA*

i. FATCA includes two principal operative provisions, one applying to foreign financial institutions (FFIs) and the other to all other foreign entities receiving payments from U.S. sources, either on their own behalf or acting as an intermediary. Foreign financial institutions are defined to include any entity not resident in a U.S. state or possession that:

ii. Accepts deposits in the ordinary course of a banking or similar business;

iii. Engages in the business of holding financial assets for the account of others; or

iv. Engages primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interests in securities, partnerships, or commodities.

b. *Foreign Financial Institutions*

i. Any withholdable payment by a U.S. withholding agent to any FFI would be subject to 30 percent withholding unless the FFI has entered into an agreement with the IRS under which it would face several reporting obligations. Withholdable payments include not only U.S.-source investment income but also any U.S.-source proceeds from the sale of any property "of a type which can produce interest or dividends." Thus, while gains from the sale of property are generally not includable in U.S. income in the hands of nonresidents, FATCA would subject such amounts to withholding solely to incentivize compliance with reporting requirements.

ii. To avoid withholding, FFIs would be required to enter into an agreement with the IRS under which they would be required to:

(1) Obtain information regarding each holder of each account maintained by the FFI as is necessary to determine which accounts are U.S. accounts and comply with IRS's verification and due diligence procedures;

(2) Annually report information with respect to any U.S. account held at the FFI;

(3) Deduct and withhold 30 percent of any pass through payment to a recalcitrant account holder or FFI not subject to an agreement (or elect to be withheld upon);

(4) Comply with IRS information requests; and

(5) 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.

iii. Pass through payments include all withholdable payments or any payment attributable to a withholdable payment. A recalcitrant account holder is any account holder, whether or not a U.S. resident, who either fails to comply with reasonable requests for information required by the FFI agreement or who fails to provide a waiver of a foreign law prohibition of disclosure of account holder information. The statute does not spell out further procedures for identifying recalcitrant account holders or for subjecting their accounts to closure.

iv. FFIs subject to an agreement will be required to report the name, address, and tax identification number (TIN) of any specified U.S. person named on the account or any substantial U.S. owner of any account holder. A specified U.S. person is any U.S. resident with the exception of, among others, publicly traded corporations, banks as defined in section 581 of the Internal Revenue Code, REITs, and RICs. A substantial U.S. owner is any person owning more than a 10 percent interest in any entity. Or, in the case of payees primarily in the business of trading, a substantial U.S. owner is anyone who owns any interest in the entity, including a profits-only interest.

v. The Secretary of the Treasury has wide-ranging authority to exempt FFIs from the requirement for an agreement in the case of payments to beneficial owners of a "class of persons . . . posing a low risk of tax evasion."

c. *Payments To Non–Foreign Financial Institutions*

i. Withholding agents making payments to non-FFIs would face a similar withholding requirement, except that the payee would not be required or permitted to enter into an agreement with the IRS.

ii. A withholding agent would be required to withhold 30 percent of any withholdable payment to a non-FFI regardless of whether the payee is the beneficial owner of the payment. To avoid withholding, the payee would either have to certify that the beneficial owner(s) of any payment have no substantial U.S. owners or would have to provide the name, address, and TIN of each beneficial owner. The withholding agent would have to withhold if the agent has any reason to know any payee certifications or representations are false. To avoid withholding, the withholding agent also would be required to report to the IRS all information received from payees. Withholdable payment, specified U.S. person, and substantial U.S. owner are defined as above. Exceptions to the withholding requirement are provided for beneficial owners that are publicly traded, certain members of affiliated groups, residents of U.S. possessions, and, as the Secretary of the Treasury may determine, any class of payments posing a low risk of tax evasion. As with FFIs, the Secretary is given broad authority to exempt payees from withholding requirements.

d. *Guidance And Effective Dates.* Most FATCA requirements would apply to payments made after December 31, 2012, with certain exceptions. On April 8, 2011, the IRS issued a second round of extensive FATCA guidance (see Notice 2011-34, 2011-1 C.B. 765, instructing FFIs on the steps required for them to identify U.S. accounts among their existing account holders. The notice also includes a test for private bankers to attempt to find U.S. connections among account holders, includes details on the definition of pass through payments, and provides for a certification process for deemed compliant FFIs. It provides that FFIs have to report only year-end balances to the IRS and do not have to report basis on investment transactions. Yet more guidance is expected from the IRS concerning the detailed implementation of FATCA.

e. *Other FATCA Provisions.* In addition to implementing the new withholding and disclosure regime, FATCA includes a number of other provisions aimed at improving tax compliance across the board on issues arising from foreign accounts. Unless indicated, the effective dates as of the writing of this article are as of or for years beginning after enactment. These include:

i. *Disclosure Of Information With Respect To Foreign Financial Assets*

(1) 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 requirement would supplement the existing FBAR requirements. IRC §6038D(d). The IRS has issued a proposed form 8938 for such reporting.

(A) 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. IRC §6038D(g).

(B) Any understatement of tax attributable to an undisclosed foreign asset is now subject to a 40 percent penalty and the usual defenses to understatement penalties. IRC §6662(j).

ii. *Modification Of Statute of Limitations For Significant Omission Of Income In Connection With Foreign Assets*

(1) Current section 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 non-compliance plus three years. Further, the extended statute applies to the taxpayer's entire return, not just to foreign assets. This provision is effective for any year open on the date of enactment and to returns filed after enactment. IRC §§6501(c)(8), (e).

iii. *Foreign Trust Related Provisions*

(1) FATCA clarifies: i) 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, IRC §679(c)(i); ii) 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 is provided and no beneficiary is a U.S. person, IRC §679(c)(4); and iii) that any agreement or understanding, such as a letter of wishes, that results in a U.S. person benefitting from the trust will be considered a term of the trust, IRC §679(c)(5).

(2) It 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 part of the income or corpus could be paid for the benefit of a U.S. person. IRC §679(d).

(3) 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. IRC §643(i).

f. The international reaction to FATCA is mixed. Some argue that the legislation is, plain and simple, an act of U.S. imperialism. Other countries, however, are starting to look at the FATCA model as an option for their own tax enforcement. Some smaller banks are concluding that they would rather not invest in the United States than be subject to the compliance costs associated with FATCA implementation. Others are seeking to eliminate any U.S. accounts to the maximum extent possible. It is expected that most banks worldwide will comply with FATCA rather than forego investing in the United States. FATCA will provide much more information to the IRS about U.S. account holders than it has ever received. With the enhanced penalties and extended statute of limitations, FATCA can be expected to result in the eventual diminishment of bank secrecy for Americans worldwide and continued enforcement in the foreign account area for many years.

## J. Conclusion

1. 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, multilateral 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. 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.

2. 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. Such efforts are expected to continue.

3. The lesson of the past three years is 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, particularly its Criminal Investigation Division, and considerably enhanced cooperation among tax authorities worldwide.

4. 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.

5. In light of the many developments occurring in the past three 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 advisers 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 and, if appropriate, to take advantage of the voluntary disclosure policy, especially in light of new penalty caps through the conclusion of the second voluntary disclosure program. Although civil liabilities may be severe and financial pain high, the ability to avoid criminal prosecution in the enhanced enforcement environment is a substantial benefit to be considered.

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