



Targeting Offshore Bank Accounts

What's next?

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The IRS is actively pursuing taxpayers who have unreported offshore accounts. Should a taxpayer with such an account consider making a voluntary disclosure before the taxpayer's name is known to the IRS?

IRS' and Congress' Aggressive Pursuit of Offshore Accounts

The IRS is aggressively pursuing taxpayers who may be using offshore bank accounts to evade federal income taxes and to hide assets. IRS Commissioner Doug Shulman said that he was "committed to bringing to bear the full arsenal of IRS resources to pursue egregious offshore tax abuse. International tax issues are a top priority and we will continue to aggressively pursue people hiding assets offshore." Congress is also pursuing other offshore abuses. The Permanent Subcommittee on Investigations has scheduled a hearing for March 2009, which "will continue the Subcommittee's examination of financial institutions, which are located in offshore tax havens and which use practices that facilitate tax evasion and other misconduct by U.S. clients."

In February 2009, the Justice Department sought enforcement of a "John Doe summons" (any summons where the name of the taxpayer under investigation is unknown and therefore not specifically identified) served on UBS (a global financial services firm), seeking the names of U.S. taxpayers with undeclared accounts at the bank. An internal report of UBS from 2004 was appended to the petition and revealed that UBS had approximately 52,000 "account relationships" with an aggregate value of \$14.8 billion where the U.S. account holders did not submit Form W-9s.

Voluntary Disclosure Policy

If the IRS is successful in obtaining the account information from UBS sought in the John Doe summons, the disclosure could lead to thousands of U.S. taxpayers who have failed to report their UBS accounts and the income earned on the account. Shulman cautioned that these individuals should seek immediate advice of competent tax counsel. Further, as mentioned by Shulman, these individuals should consider the IRS voluntary disclosure policy, allowing them to avoid criminal prosecution by voluntarily disclosing the failure to report the UBS or other foreign account and the income before their names are known to the IRS and the IRS opens an investigation of those persons.

Policy of Voluntary Disclosure

A "voluntary disclosure" is a long-standing policy of the IRS to refrain from recommending prosecution of taxpayers for evasion or false returns as long as the taxpayer's voluntary discloses such evasion or false returns before the

government finds out about the taxpayers and begins an investigation. A voluntary disclosure will allow the taxpayer to avoid criminal prosecution in exchange for the taxpayer's cooperation with the IRS in determining the correct amount of tax, interest and penalty for the open years. Since the statute of limitations for most tax crimes is six years, the taxpayer generally will have to make a voluntary disclosure for the prior six years, if applicable.

Requirements: Truthful, Timely and Complete

The requirements of a voluntary disclosure, set forth in the Internal Revenue Manual are:

1. The disclosure must be made before the taxpayer is the subject of an investigation or audit or the IRS has received information from a third party regarding the taxpayer's noncompliance;
2. The income is not illegal source income;
3. The disclosure must be complete and truthful; and
4. The taxpayer must make good-faith arrangements with the IRS to pay — in full — the tax, interest and penalties.

A taxpayer can make a voluntary disclosure by filing corrected amended returns and previously unfiled information returns for the open years, usually called a "quiet disclosure," or by contacting the local Criminal Investigation Division (CID) office and presenting the amended returns with payment of the tax and interest and the previously unfiled information returns with a request for a conference, usually called a "noisy disclosure." The noisy voluntary disclosure is usually in the form of a letter from the taxpayer's attorney that encloses the client's complete and accurate amended returns, which offers to pay the tax, interest and any penalties and which is timely. Amended returns need not be submitted with a voluntary disclosure, as long as the disclosure includes the types of returns involved, the tax periods, a brief description of all omitted income, the tax scheme used by the taxpayer and the dollar amount of taxes and interest owed as a result of the omission. If the disclosure does not meet the IRS criteria for a voluntary disclosure, a letter will be sent to the taxpayer with the reasons the disclosure does not qualify as a voluntary disclosure.

Report of Foreign Bank and Financial Accounts (FBAR)

Every person making a voluntary disclosure with respect to an offshore account will also have to file foreign bank account reports (FBAR) for the open years with respect to those accounts. The FBAR requires U.S. taxpayers with a financial interest or authority over a foreign account, which exceeds \$10,000 at some time during the calendar year, to submit for such year an information report.

Failure to properly file the FBAR is a criminal offense, with civil penalties up to 50 percent of the account balance for each year that a report was not filed. A failure to file the FBAR for more than a year will result in penalties equal to the entire balance of the account. If a holder of a foreign account was required to file FBARs for earlier years but did not, the delinquent FBARs should be filed with the voluntary disclosure and a statement attached explaining why the reports were filed late. The Treasury has delegated the application of the FBAR penalties to the IRS, which then has the power to decide whether to impose the penalties. No penalty will be assessed if the IRS determines that the late filings were due to reasonable cause. When deciding whether to make a voluntary disclosure or not, the taxpayer will have to consider the economic consequences of the FBAR penalty, since it could exceed the account balance. As of yet, the IRS has not announced any initiatives to encourage voluntary disclosures with respect to offshore accounts.

What to Do? Matter of Judgment

The making of a voluntary disclosure is a matter of judgment. It should be kept in mind that a voluntary disclosure is not a guarantee, but a practice that creates no substantive or procedural rights (see IRM 9.5.11.9 (1) and (2)). It is merely a mitigating circumstance in the IRS' determination as to whether to recommend prosecution or not. A voluntary disclosure should be made only after it is determined that the taxpayer is not already the subject of an investigation. Under the CID policy, the IRS will "ping" (process in which a computer network tool is used to test whether a particular host is reachable across an IP network) its national database for taxpayers to determine whether a taxpayer is already under criminal investigation. Since a taxpayer's name may be discovered by the enforcement of the John Doe Summons against UBS or in the Congressional hearings, those taxpayers that have undeclared accounts with UBS or other foreign financial institutions should take immediate action by contacting a tax professional having experience with the voluntary disclosure policy and related matters. As IRS Commissioner Shulman forewarned "having the IRS find you could mean a much heavier price than coming forward on your own." In making a voluntary disclosure with respect to an undeclared foreign account a taxpayer must comply with all of the requirements to insure that the voluntary disclosure qualifies, otherwise it will constitute an admission that the taxpayer did not report the correct income and tax, as a result of the foreign account.

About the Author

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