YEAR-END REVIEW: I.R.S. O.V.D.P.

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Tags
O.V.D.P.

The I.R.S. and the Department of Justice ("D.O.J.") continued their tenacious efforts against offshore tax evasion. Three major events took place in 2013: (i) a shift in the methodology to detect quiet disclosures; (ii) the bank voluntarily disclosure program ("B.V.D.P.") announced by the United States and Switzerland on August 29, 2013, and (iii) certain notable convictions, plea deals, and civil penalties.

We expect the I.R.S. and D.O.J.'s unwavering focus on offshore tax evasion to continue in 2014 as F.A.T.C.A begins to be implemented. Some practitioners fear that when F.A.T.C.A. information reporting begins, the O.V.D.P. may end, as the I.R.S. will have received information automatically on foreign accounts. If a U.S. taxpayer remains uncertain about declaring foreign financial accounts, now is the time to take remedial action. There is no Plan B, if time runs out.

QUIET DISCLOSURES

While the I.R.S. officially has discouraged quiet disclosures, a Government Accountability Office ("G.A.O") report, released on April 26, 2013, identified shortcomings in the I.R.S.'s ability to detect quiet disclosures.[27] According to the G.A.O. report:

> [The] G.A.O. analyzed amended returns filed for tax year 2003 through tax year 2008, matched them to other information available to IRS about taxpayers' possible offshore activities, and found many more potential quiet disclosures than IRS detected. Moreover, IRS has not researched whether sharp increases in taxpayers reporting offshore accounts for the first time is due to efforts to circumvent monies owed, thereby missing opportunities to help ensure compliance . . . Taxpayer attempts to circumvent taxes, interest, and penalties by not participating in an offshore program, but instead simply amending past returns or reporting on current returns previously unreported offshore accounts, result in lost revenues and undermine the programs' effectiveness.[28]

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27 See G.A.O. report, "Offshore Tax Evasion: I.R.S. Has Collected Billions of Dollars, but May be Missing Continued Evasion," available at: http://www.gao.gov/products/gao-13-318.

28 Id.

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In October 2013, the tax news services reported on an uptick in audits of quiet disclosures. The uptick in audits reflects an apparent change in I.R.S. methodology.[29]

Officials continue to state that the I.R.S. will be aggressive in asserting penalties for prior undisclosed foreign financial accounts that do not go through official channels. If a taxpayer with an undisclosed foreign financial account dislikes the penalty imposed on capital, he or she should enter the program and opt-out. Taking no action, however, is not an option as far as the I.R.S. is concerned. One I.R.S. agent summarized the I.R.S.'s view as follows:

> The guidance we're getting on quiet disclosures has been extremely harsh . . . Essentially those taxpayers walked past compliance three times: They didn't file correctly the first time, they didn't come in under voluntary disclosure, and now they're trying to hide it by slipping it in through an amended return. Don't expect much leniency if we have a quiet disclosure case; agents are being told to be aggressive.[30]

The increased aggressiveness is attributable, in part, to the I.R.S.'s victories in *Williams*[31] and *McBride*[32] defining the burden of proof to assert an F.B.A.R. penalty for willful failure to file. Although the facts of both cases are extremely favorable to the I.R.S., the courts stated that the burden of proof regarding the penalty for willfulness is the standard based on a preponderance of the evidence rather than clear and convincing evidence. Many practitioners believed that because the penalty was so high and the penalty is correlated with tax fraud, the burden of proof should have been the same. This view is consistent with the I.R.S.'s belief at one time.[33] However, in light of these cases, some practitioners believe that a taxpayer may be found to have acted willfully if (i) foreign financial accounts were owned, (ii) the accountant inquired into the existence of foreign financial accounts in the course of preparing the return, and (iii) the taxpayer responded that no accounts existed during that year.

Other tax practitioners express a wait-and-see approach, focusing on the difference between the behavior in the two cases and the behavior in many cases – *e.g.,* an individual who was born abroad and received an inheritance from a foreign parent – to believe that different facts will bring a different answer that is more favorable to the taxpayer.[34] However, the unfortunate taxpayer who must litigate that case will bear the costs and face possible defeat in the courts. This makes the O.V.D.P. penalty structure more attractive in the sense that the costs are fixed and the taxpayer achieves finality relatively quickly.

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29 See Tax Notes Today, I.R.S. Auditors Taking Closer Look at Quiet Disclosures of Offshore Accounts, 2013 TNT 202-4 (Oct. 18, 2013).

30 See Tax Notes Today, "I.R.S. Will Soon Examine U.S. Taxpayers with Undeclared Indian Bank Accounts," 2013 TNT 219-4 (Nov. 13, 2013).

31 See *U.S. v. Williams*, 489 Fed.Appx. 655, 656 – 60 (4th Cir., July 2012).

32 See *U.S. v. Mcbride*, 988 F.Supp. 2d 1186 (D. Utah, Nov 8, 2012).

33 See I.L.M. 200603026.

34 See Tax Notes Today, "District Court Allows Second F.B.A.R. Penalty Collection to Proceed," 2012 TNT 219-3 (Nov. 9, 2012).

BANK COMPLIANCE PROGRAM

On August 29, 2013, the United States and Switzerland jointly announced the B.V.D.P., which allows participating Swiss banks to resolve their civil and criminal liability with the United States on condition that information on U.S. customers is turned over to the I.R.S. Under the program, participating Swiss banks will:

- Pay substantial penalties;
- Disclose cross-border activities;
- Provide detailed information on an account-by-account basis for accounts in which U.S. taxpayers have a direct or indirect interest;
- Cooperate in treaty requests for account information;
- Provide detailed information as to other banks that transferred funds into secret accounts or that accepted funds when secret accounts were closed; and
- Agree to close accounts of account holders who fail to come into compliance with U.S. reporting obligations.

In return, the bank will be allowed to enter a nonprosecution agreement (N.P.A.) with the D.O.J.

The B.V.D.P. contains four categories of banks:

- Category 1 banks are already under investigation and are ineligible for the program.
- Category 2 banks have reason to believe that tax-related offenses or monetary transaction offenses have been committed in connection with undeclared U.S. accounts. A letter of intent to participate should have been submitted by December 31, 2013. The deadline to comply with the terms of the program is 120 days from the date of the letter of intent, plus a sixty-day extension upon showing of good cause. According to press reports, 106 banks have agreed to enter the B.V.D.P.[35]
- Category 3 banks have not committed any tax related offenses or monetary transaction offenses in connection with undeclared U.S. accounts.
- Category 4 banks, in general, limit their activities to a local client base – *i.e.*, at least 98% of the accounts by value are held by residents of Switzerland throughout the applicable period.

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[35] "DOJ Official: 106 Intent Letters Received for Swiss Bank Nonprosectution Program," Daily Tax Report (BNA) 18 DTR K-1 (Jan. 27, 2014).

"For the time being, the bank need not provide the name of the account holder. However, the U.S. can seek the account information pursuant to an official treaty request under the existing income tax treaty framework of 1996…Switzerland stated that all requests will be processed on an 'expedited basis.'"

Under the penalty provisions applicable to Category 2 banks, those seeking a N.P.A. must agree to a penalty in an amount equal to 20% of the maximum aggregate dollar value of all non-disclosed U.S. accounts that were held by the bank on August 1, 2008. The penalty amount will increase to 30% for secret accounts that were opened after that date but before the end of February 2009 and to 50% for secret accounts opened subsequently. However, the penalty is reduced by "the dollar value of each account as to which the [bank] demonstrates . . . [it] was not an undeclared account, was disclosed by the [bank] to the I.R.S., or was disclosed to the . . . I.R.S. through the [O.V.D.P.]."[36] Thus, the program provides a significant incentive for a participating bank to encourage U.S. clients to enroll into the O.V.D.P., thereby reducing penalties for the bank.

Category 2 banks must provide the following information on U.S. account holders:

- The maximum value of the account;
- The number of U.S. persons or entities affiliated with each account, and the nature of that relationship;
- Whether the account was held in the name of an individual or an entity;
- Whether the account held U.S. securities;
- The name and function of each relationship manager, client advisor, asset manager, financial advisor, trustee, fiduciary, nominee, attorney, accountant, or other individual or entity functioning in a similar capacity known by the bank to be affiliated with each U.S. account at any time during the applicable period; and
- Information concerning the transfer of funds in and out of the account.[37]

In addition, the Category 2 bank must "provide all necessary information for the United States to draft treaty requests to seek account information" and to provide "testimony of a competent witness or information as needed to enable the United States to use the information as evidence obtained pursuant to a provision of this Program or separate treaty request in any criminal or other proceedings."[38]

For the time being, the bank need not provide the name of the account holder. However, the U.S. can seek the account information pursuant to an official treaty request under the existing income tax treaty framework of 1996 ("1996 Treaty"). More importantly, when the 2009 Protocol amending the 1996 Treaty comes into full force and effect, names of U.S. persons affiliated with the account will be exchanged. Switzerland stated that all requests will be processed on an "expedited basis."

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36 See §II H. of the Program for Non-Prosecution Agreements or Non-Target Letters for Swiss Banks, available at: http://www.justice.gov/opa/pr/2013/August/13-tax-975.html.

37 *Id.* at §II D.2.

38 *Id.* at §II.D.4, F.

Under the 1996 Treaty framework, exchange of information is generally preconditioned on a standard of "tax fraud or the like," which has been interpreted to require more than mere tax evasion.[39] The 1996 Treaty's technical explanation provides a non-exhaustive list of actions that will constitute tax fraud, including falsification of a document that the taxpayer used (or intended to use). Badges of tax fraud also include forged or falsified documents, double sets of books, false invoices, incorrect balance sheets or profit and loss statements, fictitious orders, false documentary evidence, falsified tax returns, or a "Lugengebäude," which is a "scheme of lies" used to deceive the tax authorities. The 2009 Protocol has a much broader standard, specifically envisioned to circumvent the problems with the 1996 Treaty framework. Its ratification, however, is being blocked by Senator Rand Paul (R. Kentucky) for due process and privacy concerns according to news sources.[40]

Although the I.R.S. has encountered at least one legal setback in obtaining account holder information from Switzerland – the matter involved a group request for account information served to Bank Julius Baer[41] – its efforts are unrelenting and have been largely successful. The B.V.D.P. is the next phase.

RECENT NOTABLE INDICTMENTS, PLEA DEALS, AND CONVICTIONS

At the end of 2013, John Koskinen was sworn in as I.R.S. Commissioner. In his first press conference in January 2014, Commissioner Koskinen said that attention to combating offshore tax evasion was one of his key goals and in particular, the I.R.S. planned to use the information it expects to obtain under F.A.T.C.A. in identifying non-compliant U.S. persons investing abroad. The Commissioner cautioned the wealthy in the following terms, "Just because you're rich and have high-priced tax lawyers and accountants doesn't mean you can figure out a way to avoid taxes by squirreling your money away somewhere offshore."[42]

The Commissioner's attitude confirms and reinforces the views of his predecessors and heightens the need for those with ongoing unreported foreign financial accounts to take corrective action. Clearly, he anticipates that F.A.T.CA. will provide the I.R.S. with information on U.S. taxpayers automatically and completely.

The case of H. Ty Warner, the billionaire creator of Beanie Baby plush toys, is a prime example of why one must take corrective action *before* being discovered. Mr. Warner created Swiss accounts in which over $100 million was squirreled away. In

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39 See 1996 Treaty, paragraph 1.

40 See Voreacos & Rubin, "Rand Paul Seeks to Block Treaty Change on Swiss Accounts," Bloomberg (Apr. 30, 2012), available at: http://www.bloomberg.com/news/2012-04-29/rand-paul-seeks-to-block-tax-treaty-change-on-swiss-accounts.html,

41 See Bennet & Pruzin, "Julius Baer Decision Offers Little Safety For Hidden Swiss Accounts, Attorney Says," Bloomberg BNA (Jan. 16, 2014).

42 "Koskinen says Improving Compliance, Ensuring Funding are Top IRS Priorities," Daily Tax Rep. (BNA) No. 4 at G-4 (Jan. 7, 2014).

2009, Mr. Warner's attempt to enter the O.V.D.P was rejected, as he was already known to the I.R.S.[43]

On October 2, 2013, Warner pleaded guilty to avoiding more than $5.5 million in taxes. In pleading guilty, Warner admitted to opening an account at U.B.S., the Swiss bank whose name appears in the F.A.T.C.A. legislative history as one of the principal architects of offshore accounts used to hide money from the I.R.S. He admitted to transferring $93.6 million in 2002 to a small Swiss bank. In that same year, Warner paid significant taxes on his reported $49.1 million of taxable income, but he failed to report and pay taxes on his U.B.S. income of $3.2 million. Warner also failed to file F.B.A.R.s for that year and other years in which he hid his income from the I.R.S.

In asking for leniency at the time of sentencing, his lawyers stated:

> Ty's behavior was no different legally or factually from that of tens of thousands of taxpayers who were never sentenced – or even prosecuted – because they were admitted into the I.R.S. voluntary disclosure programs.

His lawyers failed to admit one key factor. Ty tried to enter O.V.D.P. *after* the I.R.S. knew of his actions. In January 2014, Mr. Warner was sentenced to two years of probation and the performance of 500 hours of community service. Mr. Warner has paid a civil penalty of $53 million and filed amended tax returns for the years 1999 to 2008, his lawyers said. He has also paid $14 million in back taxes and interest, according to prosecutors.[44]

Government prosecutorial actions are not limited to those as well-known as Mr. Warner. On October 24, 2013, a Florida doctor was convicted in Federal court of conspiring to defraud the I.R.S. by concealing more than $35 million deposited in offshore accounts with U.B.S. Dr. Patricia Lynn Hough and her husband were found guilty of filing false income tax returns for 2005 through 2008. She is awaiting sentencing and can face a maximum potential penalty of five years in prison and a $250,000 fine for the conspiracy charge, as well as three years in prison and a $250,000 fine for each of the false income tax return charges.[45]

Many others that have dealt with U.B.S. have faced prosecution including a retired army surgeon, Michael Canale, who pleaded guilty to hiding as much as $1.5 million with U.B.S. On April 25, 2013, he was sentenced to six months in prison, fined $100,000, ordered to pay $216,407 in restitution, and required to perform 400 hours of community service.[46]

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43 "Beanie Baby Billionaire Seeks to Avoid Prison for Tax Evasion," Daily Tax Rep. (BNA) No. 2 at K-3 (Jan. 3, 2014).

44 "Beanie Baby Founder Ty Warner Avoids Jail in Tax-Evasion Case," Daily Tax Rep. (BNA) No. 10 at K-2 (Jan. 15, 2014).

45 "Florida Doctor Convicted of Concealing $35 Million in Offshore Bank Accounts," Daily Tax Rep. (BNA) No. 207 at K-6 (Oct. 25, 2013).

46 "Offshore Tax Scorecard: Bankers, Lawyers, Other Advisers See Charges Alongside Clients," Daily Tax Rep. (BNA) No. 214 at J-3 (Oct. 5, 2013).

Government actions are not limited to U.B.S. and Swiss accounts. On August 15, 2013, the Seventh Circuit Court of Appeals upheld a Federal District Court conviction of an accountant and entrepreneur, James A. Simon, for filing false income tax returns and failing to file F.B.A.R.s, as well as mail and financial fraud. Simon created a web of foreign business dealings in the Cook Islands, Gibraltar, Cyprus, and the Ukraine that were used to hide money. Mr. Simon is still awaiting sentencing.[47]

Accounts in Israel and India have received special attention. On October 18, 2013, a federal grand jury indicted two tax return preparers for willfully failing to file F.B.A.R.s for Israeli accounts over which they had signature authority. David Kalai and two others did not have a financial interest in the accounts, but had signature authority over accounts used by clients in plans recommended to hide money from the I.R.S.[48]

On March 8, 2013, Josephine Bhasin, a resident of Huntington, NY, pleaded guilty to failing to report an account at H.S.B.C. India worth $8.3 million. On March 8, 2013, she was sentenced to two years of probation, three months of home detention, fined $30,000 and ordered to perform 150 hours of community service. Vaibhav Dahake, a New Jersey businessman, also plead guilty to hiding money with H.S.B.C. India and was sentenced, on May 22, 2013, to one year probation in light of his cooperation with the government. Sammer Gupta was not as lucky. He was sentenced July 9, 2013 to 19 months in prison and fined $2,000. He also paid an F.B.A.R. penalty of $259,045.[49]

Kathryn Keneally, Assistant Attorney General in charge of the Tax Division of the D.O.J., told the press in 2013 that the D.O.J. is looking beyond cases made public in Switzerland, Israel, and India to other countries for further actions.[50] For example, on March 1, 2013, a West Virginia doctor was sentenced to 50 months in prison for tax evasion and health care fraud. Dr. Barton Adams deposited the proceeds from their health care fraud into accounts in Canada, China, and the Philippines. In this case, the I.R.S.'s Criminal Investigation Division teamed up with the Department of Health and Human Services Office of Inspector General to act against the tax offender.[51]

The trail of government action has also extended to the advisers planning these schemes. One high profile case is that of Raoul Weil, a former head of the U.B.S. global wealth management business. Mr. Weil was indicted for conspiring from 1993 until 2010 to help clients hide assets from the I.R.S. through accounts at U.B.S. and a Swiss cantonal bank. On October 19, 2013, Mr. Weil checked into a hotel in Bologna, Italy, which triggered an alert to Italian authorities, who promptly

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47 "Conviction of Foreign Account Signatory for Tax Evasion Affirmed by Seventh Circuit," Daily Tax Rep. (BNA) No. 160 at K-7 (Aug. 19, 2013).

48 "Preparers Indicted for Stashing Millions in Israeli Accounts face New Charges," Daily Tax Rep. (BNA) No. 203 at K-4 (Oct. 21, 2013).

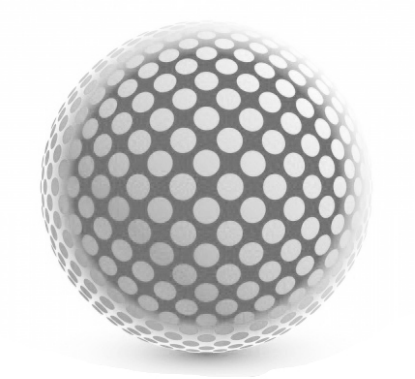
49 "Offshore Tax Scorecard: Bankers, Lawyers, Other Advisers See Charges Alongside Clients," supra note 5.

50 "Top DOJ tax Official Says Government 'Looking Everywhere' for Offshore Evasion," Daily Tax Rep. (BNA) No. 69 at G-2 (April 10, 2013).

51 "West Virginia Doctor Gets Four Years for Health Care Fraud, Tax Evasion," Daily Tax Rep. (BNA) No. 44 at K-5 (March 6, 2013).

arrested him. Four days later, Mr. Weil surrendered to U.S. authorities and now faces criminal action in the U.S.[52] On August 16, 2013, Swiss lawyer, Edgar Paltzer, pleaded guilty in New York to conspiracy for more than a decade of advising U.S. clients in committing tax fraud. He is now aiding the I.R.S. in investigations of clients who took advantage of his planning.[53]

Thus far, I.R.S. action has led to the fall of two Swiss banks. On October 18, 2013, Bank Frey & Co. announced plans to close because of the additional requirements being imposed on Swiss banks in relation to hidden offshore accounts. In 2012, Bank Wegelin also closed due to this situation, after it invited U.B.S. customers in the U.S. to open accounts upon learning of account closings by U.B.S.[54]



52 "Ex-UBS Banker surrenders to U.S. in 2011 tax Case over Secret Accounts," Daily Tax Rep. (BNA) No. 206 at K-2 (Oct. 24, 2013).

53 "Offshore Tax Scorecard: Bankers, Lawyers, Other Advisers See Charges Alongside Clients," supra note 5.

54 "Swiss Private Bank Announces Closure, Citing Tax Dispute with U.S.," Daily Tax Rep. (BNA) No. 203 at I-2 (Oct. 21, 2013).