Authors
Robert G. Rinninsland
Cheryl Magat
Philip R. Hirschfeld
Galia Antebi

Tags
A.P.A.
Common Reporting Standard
C.R.S.
Economic Substance
Exchange Financial Information
F.A.T.C.A.
Foreign Tax Credit
Inversions
Israel
O.E.C.D.
Statute of Limitations
Tax Amnesty
Tax Evasion
Transfer Pricing
UBS

ISRAEL ANNOUNCES ADOPTION OF O.E.C.D.'S COMMON REPORTING STANDARD

Israel has announced that it will adopt the *Standard for Automatic Exchange of Financial Account Information: Common Reporting Standard* ("C.R.S.") issued by the O.E.C.D. in February 2013.

The C.R.S. establishes a standardized form that banks and other financial institutions would be required to use in gathering account and transaction information for submission to domestic tax authorities. The information would be provided to domestic authorities on an annual basis for automatic exchange with other participating jurisdictions. The C.R.S. will focus on accounts and transactions of residents of a specific country, regardless of nationality. The C.R.S. also contains the due diligence and reporting procedures to be followed by financial institutions based on a Model 1 F.A.T.C.A. intergovernmental agreement ("I.G.A.").

At the conclusion of the October 28-29 O.E.C.D. Forum on Transparency and Exchange of Information for Tax Purposes, about 50 jurisdictions had signed the document. The U.S. was notably absent as a signatory to the agreement. In addition to the C.R.S., the signed agreement contains a model competent authority agreement for jurisdictions that would like to participate at a later stage.

A large group of the countries that signed the C.R.S., the so-called early adopters, are aiming to implement the C.R.S. as early as January 1, 2016. The initial information is expected to be automatically exchanged with the early adopters beginning in September 2017. The other signees are expected to follow a year later.

The Israeli Finance Ministry said that the C.R.S.'s advantage lies in its "simplification of procedures, greater effectiveness, and reduction of costs." However, Israel's participation will still require legislative changes and extensive preparations. Financial institutions will need to collect declarations of residency from their account holders and to make their own independent inquiries to verify those declarations' reliability. Israel has already signed an I.G.A. with the U.S. for the exchange of information under F.A.T.C.A. Israel, along with other F.A.C.T.A. compliant jurisdictions, anticipates that compliance with the C.R.S. can be leveraged off of F.A.C.T.A. procedures put in place. Israel is now expected to adopt the C.R.S. in 2018.

While the C.R.S. has no direct legal force, it is expected that jurisdictions will follow it closely when implementing bilateral agreements.

WEIL'S ACQUITTAL: U.S. LACKED HARD PROOF IN OFFSHORE TAX EVASION TRIAL

Raoul Weil, a former top UBS AG official accused of helping Americans evade U.S. taxes, was acquitted of tax conspiracy charges on November 3 by a Florida jury that found insufficient hard evidence had been presented to link him to helping wealthy Americans hide $20 billion in secret Swiss accounts. This decision was a major setback to the government's efforts to prosecute other high-level executives for criminal conduct.

"Reliance on the testimony of co-conspirators benefitting from plea bargains is a slippery approach when hard evidence is missing. A smoking gun is required for a successful prosecution."

Former UBS bankers who worked under Mr. Weil testified against him in exchange for leniency, but prosecutors failed to introduce hard evidence showing that Mr. Weil was at the physical location of meetings with taxpayers. The jurors were skeptical of the testimony and considered the documentary evidence, such as e-mails, insufficient to tie him to the conspiracy.

The credibility and truthfulness of the testimony were called into question. One banker, Hansruedi Schumacher, admitted under questioning from defense lawyer Matthew Menchel that Weil had nothing to do with a plan to distort legal advice against promoting certain offshore structures to American clients, according to a transcript of the trial.

The Department of Justice based its case on the confluence of Mr. Weil's leadership position at UBS and the bank's admission that it helped thousands of U.S. individuals avoid payment of U.S. taxes. This reasoning reflects current Congressional sentiments that senior executives must bear responsibility for the acts of their subordinates. While the move may be politically advantageous, it is not sufficient grounds, by itself, to warrant conviction. The prosecutors should have placed less attention on political rhetoric and instead should have focused on linking the defendant to the crime through evidence that he both knew about and participated in the illegal conduct.

Similar approaches exist in civil cases where attorneys for the I.R.S. and Department of Justice have raised pejorative arguments, alleging lack of economic substance without addressing the actual facts or justifying the appropriateness of their view of substance. It is one thing to explain why a transaction is a sham. It is another thing entirely to accept the facts as presented and contend that the economic reality is something else.

Mr. Weil is the highest-ranking executive at a major bank to face criminal charges for assisting U.S. taxpayers in accessing hidden foreign accounts. Mr. Weil resigned from UBS after the indictment was handed down in 2008. The prosecutors had strong evidence against UBS bankers, but the evidence against Mr. Weil himself, beyond his position at the bank, was tenuous.

The Weil prosecutors forgot a basic element of their craft: reliance on the testimony of co-conspirators benefitting from plea bargains is a slippery approach when hard evidence is missing. A smoking gun is required for a successful prosecution.

BANK LEUMI REJECTS $300 MILLION DEMAND IN N.Y. SETTLEMENT BUT MAY FACE MORE

According to an October 29 report by Reuters Jerusalem, Bank Leumi rejected offhand a $300 million settlement offer as not being grounded in any documents or calculations. The controversy stems from an investigation into whether Bank Leumi Le-Israel BM helped U.S. citizens evade taxes. The $300 million exceeds the $254 million reserve already recorded by the bank in its financial accounts, but some estimates anticipate an amount as much as $600 million.

As we noted earlier in the year, U.S. Justice Department efforts to address foreign banks that aid and abet U.S. tax evasion are largely concentrated on Swiss banks, but in fact, the banks in Israel have been under investigation since 2011. Bank Leumi is the first major non-Swiss bank for which a separate criminal investigation by the U.S. Justice Department and related settlement has been publicized.

REVENUE DISAGREEMENT ON TRANSACTION TAX BETWEEN E.U. NATIONS

In an attempt to discourage speculative trading, ten nations in the E.U. vowed to seek an agreement on a "progressive" tax on equities and certain derivatives by the end of 2014, with implementation to commence the following year. However, issues remain regarding how to handle the revenues from the proposed financial transactions tax, as well as how to allocate income between the nations in which the financial transactions take place and the nations in which the trading firms are based. On the latter point, Italy, currently holding the rotating E.U. Presidency, proposed three possible revenue shifting models. These models would allow the tax to be collected in the country of issuance and then allocated out to take account of other parameters such as residence. No final agreement was reached, but this initiative represents the nascent stages of another tax plan intended to closely monitor and regulate the financial industry.

VANGUARD SEEKS TO DISMISS QUI TAM ACTION BASED ON VIOLATION OF ATTORNEY-CLIENT CONFIDENTIALITY

The issue of whether an in-house counsel may bring a "whistleblower" lawsuit regarding improper corporate conduct has been raised as a part of the Vanguard Group, Inc. litigation. The improper conduct at issue relates to the company's transfer pricing practices, which the in-house counsel alleges evaded more than $1 billion in U.S. federal and $20 million in New York state income taxes. By doing so, the attorney claims that Vanguard gained an unwarranted commercial advantage and essentially operated as a tax shelter.

Vanguard has filed a motion to dismiss the whistleblower lawsuit on the grounds that the in-house counsel violated attorney-client privilege in publicizing the action. Counsel for the in-house attorney has asserted that lawyers are not prohibited from bringing whistleblower suits. From a more narrow transfer pricing perspective, the

case raises interesting issues with respect to how the transfer pricing policies within the business organization are developed and reviewed.

U.K. ISSUES PAYMENT DEMANDS TO TAX AVOIDANCE SCHEME USERS

The U.K. HM Revenue and Customs ("H.M.R.C.") has issued notices to tax avoidance scheme users demanding that they pay over $404.2 million of disputed tax under the accelerated payments regime that was implemented in 2014. This regime gives certain powers to the H.M.R.C. to receive payments immediately on tax amounts in dispute from taxpayers who have implemented particular tax avoidance schemes.

Financial Secretary to the Treasury, David Gauke, said that the H.M.R.C. is on track to deliver 43,000 notices to tax avoidance scheme users, comprising £7.1 billion ($11.5 billion) of disputed tax by the end of March 2016.

The notices give recipients 90 days to pay the demanded tax. However, some taxpayers are electing to settle their tax affairs before receiving such notices, H.M.R.C. said.

MEDTRONIC'S I.R.S. TRANSFER PRICING DISPUTES MATERIAL TO EFFECTIVE TAX RATE

As we have covered in previous issues,[61] Medtronic is currently challenging $2 billion in proposed transfer pricing adjustments for tax years 2005 and 2006. As reported in recent public documents filed by the Company, the 2005 and 2006 transfer pricing dispute with the I.R.S. extends through Medtronic's 2011 tax year. In addition, the I.R.S. is proposing income reallocations associated with Medtronic's acquisition of other medical device manufacturers where the intangible property acquired was sold in intercompany transactions within the Medtronic group.

The I.R.S. position with respect to Medtronic's transfer pricing practices is that *all* U.S. goodwill, the value of the ongoing business, and the value of the workforce should be included in the intangible or tangible asset value, and the price for the property should reflect a return on these items.

From a financial reporting perspective, Medtronic has reported unrealized tax benefits of $3 billion for its 2012 to 2014 tax years and indicated that the transfer pricing disputes could have a material adverse effect on its tax rate. The trial is scheduled to commence on the Medtronic transfer pricing issues in February 2015.

[61] See *Insights* Vol. 1 No. 8, "Current Tax Court Litigation Illustrates Intangible Property Transfer Pricing and Valuation Issues."

FOREIGN FINANCIAL INSTITUTIONS MUST APPLY U.S. LAW TO DETERMINE U.S. ACCOUNT HOLDER STATUS UNDER F.A.T.C.A.

"Both the substantial presence test and the U.S. formwork involve considerations that are beyond current 'know your client' rules which would generally apply to F.F.I.'s."

Since July 1, foreign financial institutions ("F.F.I.'s") have been responsible for opening accounts with new individual customers consistent with the directives under F.A.T.C.A. Identification of new account holders by the F.F.I.'s as U.S. taxpayers is of course key to the F.A.C.T.A. regime. The question then arises as to how a given F.F.I. will accomplish this. Instructions issued to the F.F.I.'s confirm an anticipated downside to F.A.C.T.A. compliance in that the F.F.I.'s are expected to apply U.S. tax law principles in making U.S. taxpayer determinations. This will entail the collection and analysis of information that is far more technical than what may have been intended, particularly given the "self-certification" process under which individuals provide documentation to the F.F.I. F.F.I.'s most likely will have to become proficient in the application of the U.S. tax residency "substantial presence" test.

Under the substantial presence test, an individual is a U.S. tax resident if physically present in the U.S. for at least (i) 31 days in the current year, and (ii) 183 days during the three-year period that includes the current year and the two prior years, counting all the days of the current year, one-third of the days in the first prior year, and one-sixth of the days in the second prior year. There are additional rules to determine what constitutes physical presence in any given iteration of facts and circumstances.

In addition, the technicalities of individual tax forms such as the Form W-9 Request for Taxpayer Identification and the W-8 series of international forms may have to be considered by the F.F.I.

Both the substantial presence test and the U.S. formwork involve considerations that are beyond current "know your client" ("K.Y.C.") rules which would generally apply to F.F.I.'s. Ruchelman P.L.L.C. has advised entities as to their F.F.I. status and their related F.A.C.T.A. obligations. In doing so, we have seen firsthand some of the chilling effects F.A.T.C.A. has had on U.S. individuals' ability to access foreign bank accounts.

CORPORATE INVERSIONS: PFIZER STILL CONSIDERING MOVE OUTSIDE THE U.S. WHILE ABBVIE BACKS DOWN

In contrast to the halt of many inversion deals in recent weeks, Pfizer, Inc. is still considering moving the United States' biggest drug manufacturer out of the country under the right circumstances.

Pfizer has been looking for a deal that would allow the company to cut costs, add to the drug maker's pipeline, and make it eligible for a lower corporate tax rate than it currently is in the U.S. However, Pfizer C.E.O. Ian Read also added that a tax inversion transaction isn't necessarily required. It seems from Mr. Read's comments that Pfizer is considering tax structuring one facet of the strategic financial and business goals of its overall acquisition strategy, as opposed to the

driving factor. How this will play out for the company, from both a business and public relations standpoint, remains to be seen.

On the other hand, Abbvie Inc. has decided not to buy Shire, a Dublin-based drug manufacturer, despite initially stating that they would continue with their plan.

Meanwhile, Tax Inversions Become a Lobbying Phenomenon

In general, the number of inversions is slowing due to recent administrative action by the Treasury Department.[62] The new Republican-led Congress may still legislate against inversions, and outgoing Senate Finance Committee Chairman Ron Wyden (D-Ore.) claims he will continue to push legislation to curb corporate inversions, at least until his term expires in January.

The issue under dispute is whether legislative changes should be retroactively applied to companies that have already completed inversion transactions, or if legislation should cut the U.S. corporate tax rates in such a way that they are more in line with foreign jurisdictions, as well as moving towards a more territorial system of taxation. Ruchelman P.L.L.C. has recommended the latter approach.

In the meantime, as of the close of the quarter ending September 30, 41 companies have reported that they lobbied on the issue of tax inversions. In the previous quarter, the number was at a mere 16. With the control of both the House and Senate in Republican hands, it will be interesting to see if this lobbying will reverse the recent restrictions placed on inversion transactions by the Obama Administration.

SWISS BANKS REQUEST U.S. AMEND DEMANDS IN TAX AMNESTY DEALS

Swiss banks seeking to avoid U.S. prosecution by disclosing how they helped U.S. citizens evade taxes have asked the Department of Justice to rescind demands that they also cooperate with other nations. The terms of a non-prosecution agreement describes how banks can achieve amnesty through a disclosure program announced last year, but a letter to the Justice Department suggested that there were many changes to the model accord, including a requirement that banks cooperate with "any other domestic or foreign law enforcement agency" in any investigation. Lawyers for the Swiss banks argue that the requirement is not found in the program and turns a program focused on U.S. tax issues into a global agreement with no safeguards in place.

---

[62] See "Administrative Attack on Inversions: Notice 2014-52," in this edition of *Insights.*

STATUTE OF LIMITATIONS FOR FOREIGN TAX CREDIT STARTS COUNTING AT YEAR OF INCOME, NOT YEAR LIABILITY IS DETERMINED

"The Court's decision illustrates a trap for the unwary with respect to the interplay of the 'when' and 'how much' aspects of corporate foreign tax credit planning."

Applying the Internal Revenue Code (the "Code") §6511(d) 10-year statute of limitation rule for claim of foreign tax credit, a U.S. Court has ruled that the 10-year statute of limitations period runs from the years for which the credits would have offset income, and not the year the company settled the liability. In *Albemarle Corp. v. United States*,[63] the company realized debenture income in 1997 and 1998 which it considered not subject to Belgian tax. In fact, the income *was* subject to Belgian tax, and the amount of the liability was settled with the Belgian authorities in 2002. The Court held that Albemarle's foreign tax credit accrued in 1997 and 1998, not 2002, and therefore the 10-year statute of limitations ran from the earlier years.

Under U.S. tax law, allowable credit for foreign taxes paid is generally determined under the principles of U.S. tax law. U.S. tax law principles govern both the determination of income and the triggering of the related tax liability. Administrative procedures govern the amount of the foreign tax liability. The Court's decision illustrates a trap for the unwary with respect to the interplay of the "when" and "how much" aspects of corporate foreign tax credit planning.

CAMP PROPOSAL NOT MEANT TO CREATE A NEW DEFINITION OF INTANGIBLE PROPERTY

Rep. Dave Camp (R-Mich.), chairman of the House Ways and Means Committee, along with other committee representatives, have confirmed that his February 2014 tax overhaul proposal does not create a new definition of intangible assets. Their comments were meant to address concerns raised that his proposed new category of Subpart F income, "foreign based company intangible income," did just that. Foreign based company intangible income under Camp's proposal would be subject to a possible 15% U.S. tax, unless earned in a country that has a tax treaty with the U.S. or an effective rate of tax of at least 12.5%. Specifically, intangible property income would not be based on a "facts and circumstances" test.

COURT ORDERS I.R.S. TO MAKE WITNESS AVAILABLE FOR EATON CORP. DEPOSITION IN EATON A.P.A. CANCELLATION LITIGATION

The ebbs and flows of the Eaton litigation, as we reported on earlier this year, continue, as the U.S. Tax Court ordered the I.R.S. to make former Advance Pricing Agreement ("A.P.A.") Program team leader, Patricia Lacey, available for further

---

[63] Fed. Cl., 2014 BL 277726, No. 1:1-cv-00184, 10/19/14

deposition. The Court has also ordered both sides to agree on another witness out of the six the Company has asked to depose.

The Court appears to have agreed at least in part with Eaton's assertion that Lacey and Associate Chief Counsel (International), Steven Musher, did not provide the information that they sought with respect to their rationale for the cancellation of the A.P.A.'s. In fairness to Eaton, a more robust explanation from the government for cancellation of the A.P.A.'s is deserved, than merely that the I.R.S. believed it intentionally deviated from the terms of the A.P.A.'s. In the Court's order, Ms. Lacey and the other witness are ordered to provide "substantial knowledge" of the specific ground(s) that the I.R.S. relied on in cancelling the A.P.A.'s and the factual basis of the underlying justifications.

WEGLIN CLIENT SENTENCED TO THREE-MONTH PRISON TERM

As we noted earlier in the year, an individual client of Wegelin & Co. pled guilty to willfully failing to file Reports of Foreign Bank and Financial Accounts ("F.B.A.R.'s") with the I.R.S. with respect to funds in a secret Swiss bank account that he maintained and controlled at Wegelin & Co. The individual had opened the account when he was a Russian citizen. He emigrated to the U.S. in 1984 and obtained U.S. citizenship in 1986. No F.B.A.R.'s were ever filed for the account. He used the account as an operating and investment fund for his business in New York.

The individual, Viktor Kordash, was sentenced to a three-month prison term as well as three years of supervised release, and was ordered to pay more than $100,000 in back taxes and civil penalties.[64]

"An individual client of Wegelin & Co. pled guilty to willfully failing to file F.B.A.R.'s… [and] was sentenced to a three-month prison term as well as three years of supervised release, and was ordered to pay more than $100,000."

[64] *United States v. Kordash*, S.D.N.Y., No. 14-cr-00345.