U.S. TAX UPDATE

ISSUES INVOLVING FOREIGN FINANCIAL ACCOUNTS

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ISSUES INVOLVING FOREIGN FINANCIAL ACCOUNTS

Silent Disclosures and Other Issues

Silent Disclosures

- In March 2013 the Government Accountability Office released a report on offshore tax evasion entitled "IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion."
- It stated:
  - "Some taxpayers with unreported foreign accounts may have chosen not to participate in one of IRS's offshore programs, and attempted to circumvent some taxes, interest, and penalties owed. One technique, which IRS calls a 'quiet disclosure,' is to file amended tax returns that report offshore income from prior years. Another technique is for taxpayers to declare existing offshore accounts for the first time with their current year's tax return, but not amend prior year returns. If successful, these techniques result in lost revenue for the Treasury, and undermine the offshore programs' fairness and effectiveness."

Silent Disclosures

- It continued:
  - “Quiet disclosures matter because if IRS does not identify them, it undermines the incentive to participate in the offshore programs. IRS’s offshore compliance enforcement efforts, including the offshore programs, deter taxpayers with noncompliance related to current offshore accounts, or offshore accounts that might be opened in the future. If taxpayers are able to quietly disclose and pay fewer penalties than they would have in an offshore program, the incentive for other noncompliant taxpayers to participate in a program is reduced. When quiet disclosures remain undetected, they also result in lost revenue for the government. Further, if quiet disclosures remain undetected, then IRS will not have information on the characteristics of these taxpayers and their accounts—characteristics such as bank names, country names, and promoter names—used to build cases against others.”

Silent Disclosures

- In regard to the I.R.S. methodology to detect silent disclosures, the report "tested a different methodology to identify potential quiet disclosures, and found many more than IRS detected."
- Unlike the I.R.S., the G.A.O. looked at all taxpayers who, for the tax years covered by the 2009 O.V.D.P., filed amended or late returns, <u>and</u> filed amended or late F.B.A.R.s. It then excluded O.V.D.P. participants.
- According to the Report:
  - "IRS officials from the Offshore Compliance Initiative office told us that they had no additional work planned to identify potential quiet disclosures and had not yet decided to broaden the methodologies that they had tested, but they expressed strong interest in researching our methodology to identify taxpayers attempting quiet disclosures."

Silent Disclosures

- The Report concluded the I.R.S. should amend its methodology to identify silent disclosures:
  - "Our methodology to identify potential quiet disclosures found many more potential disclosures than IRS detected. IRS may also have missed other attempts at circumvention by not researching the upward trends of taxpayers reporting offshore accounts for the first time. While there would be costs to such efforts, the amount already collected by the offshore programs suggests that considerable additional revenue gains might be possible. By identifying taxpayers attempting to circumvent some of the taxes, interest, and penalties that would otherwise be owed in its offshore programs, and taking appropriate action, IRS could potentially increase revenues, bolster the overall fairness of the program, and have a more informed basis for improving voluntary compliance."

Silent Disclosures

- October 2013
  - "Scott D. Michel of Caplin & Drysdale said that it has recently become clear that the IRS has figured out a way to detect these so-called non-program disclosures. In speaking with revenue agents, Michel said, it is clear that they are unhappy with the practice and intend to go after those taxpayers they discover have taken that approach." – 2013 TNT 202-4

Silent Disclosures

- November 2014
  - New Directive by Large Business and International
  - “The SEP team continues to examine quiet disclosures as well as cases regarding taxpayers who opted out of the IRS offshore voluntary disclosure program (OVDP), said Connors [An IRS Agent]. ‘The guidance we're getting on quiet disclosures has been extremely harsh,’ he said. ‘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.’” 2013 TNT 219-4

Silent Disclosures

- January 2014
  - “Newly confirmed Internal Revenue Service Commissioner John Koskinen said Jan. 6 that stopping offshore tax evasion is a key part of IRS's compliance and enforcement efforts.” - BNA

Silent Disclosures

- Audit
  - I.R.S. agents have less discretion.
    - Agents are told to be very aggressive in asserting penalties for quiet disclosures and anyone who opts out of the program.
    - L.B.&I. subject to new directive in November 2014:
      - Non-discretionary deadlines with respect to I.D.R. requests;
      - Must be a complete response to the I.D.R. request;
      - Maximum 49 days unless special approval by supervisor.

Silent Disclosures

- Audit
  - If audited, the I.R.S. will initially request:
    - Up to last six years of tax returns;
    - Up to last six years of F.B.A.R.s;
    - Up to last six years of financial statements (bank accounts, credit cards, pension statements, etc.);
    - Whether the taxpayer has an interest in an entity.
  - The I.R.S. will interview the taxpayer and the original accountant who prepared the returns asking questions to demonstrate willful intent.
    - E.g. Did you know you had an obligation to file an F.B.A.R.? If no, did your accountant ask you if you had a foreign financial account? Did you file F.B.A.R.s in the past? Did you hold an interest in a foreign entity?

A Note on O.V.D.P.

- Will it end?
  - F.A.T.C.A. being implemented beginning July 2014.
  - First year of reporting is 2015.
  - Some speculate that the program will end when F.A.T.C.A. reporting begins.

Willfulness in F.B.A.R.

- If willful failure to file, subject to civil penalty of 50% penalty per account per violation per year. Thus 3x the account value potential penalties.
- What is willfulness?
  - See *McBride v. United States*, 908 F. Supp. 2d 1186 (D. UT 2012).
    - Taxpayer engaged in a scheme to avoid reporting tax by using a offshore shell companies and foreign financial accounts in the name of entities. The facts were bad:
      - Clear intent to not pay taxes;
      - Clear intent to hide accounts;
      - Knowledge of certain reporting obligations;
      - No to Schedule B Line 7a;
      - Lying to the I.R.S. about offshore activity.

Willfulness in F.B.A.R.

- What is willfulness? (continued)
  - See *McBride v. United States*, 908 F. Supp. 2d 1186 (D. UT 2012).
    - Court stated:
      - Willfulness may include reckless conduct as well as “willful blindness.”
        - Duty to inquire further after notice.
        - Reasonable to assume that a person who has foreign bank account would read the information specified by the government in tax forms, including reference on Schedule B to the F.B.A.R.
        - For an individual to have acted willfully, an individual need not have been “subjectively aware of the FBAR reporting requirement or else an individual would be able to defeat liability by deliberately avoiding learning of his or her legal duties.”

Willfulness in F.B.A.R.

- What is willfulness? (continued)
  - See *McBride v. United States*, 908 F. Supp. 2d 1186 (D. UT 2012).
  - Court applied:
    - A preponderance of the evidence standard rather than a clear and convincing evidence standard.
    - 2nd case to use preponderance of the evidence of standard. See *United States v. Williams*, No. 1:09-cv-437, 2010 WL 3473311 (E.D. Va. Sep. 1, 2010), rev'd on other grounds, *United States v. Williams*, No. 10-2230, 2012 WL 2948567 (4th Cir. Jul. 20, 2012).

Willfulness in F.B.A.R.

- What is willfulness? (continued)
  - Discussion: What does this case mean?
    - Was the holding dicta or unnecessary to reach its conclusion?
      - Some practitioners argue it may be. Penalty could have been applied using clear and convincing standard.
    - Bad facts means bad law?

Willfulness in F.B.A.R.

- What is willfulness? (continued)
  - Discussion: What does this case mean?
    - One and done? Does checking the box "No" and signing your return enough? See - 2012 TNT 219-3.
      - "Kevin M. Downing of Miller & Chevalier agreed. 'As long as the accountant is asking the question, once you don't give those records, you're done. It's a great case,' said Downing, a former Department of Justice trial attorney. The civil penalty, which is up to 50 percent of the account balance for every year the offense was committed, is 'staggering,' he said." - 2012 TNT 219-3.
      - "Speaking at a separate panel of the same conference, Brian C. McManus of Latham & Watkins LLP said that while courts have so far agreed that it is permissible to impute knowledge simply by checking the box 'no' on Schedule B, those cases thus far have involved other significant facts apart from the Schedule B issue, such as lying to revenue agents or obvious concealment of the account. *McBride* involved similar bad facts. 'We'll have to wait and see whether a case comes forward where the person simply didn't know, checked the 'no' box, and there were no other significant facts to demonstrate they were willfully concealing [the account],' McManus said."

Discussion

- Why has the I.R.S. been more aggressive?
  - Successful Litigation?
  - G.A.O. Report?
  - F.A.T.C.A. nearly beginning?
  - More information from O.V.D.P. through three separate programs?
  - The feeling that taxpayers have are presumed guilty until innocent because of the widespread issues involving foreign financial account and underreporting of offshore income?

A Note on the U.S. / Swiss Program

- Background
  - On August 29, 2013 U.S. & Switzerland Issued Joint Statement regarding tax evasion.
  - Opens a Bank Voluntary Disclosure Program.
    - In theory, Swiss banks can sign on (ultimately signing a non-prosecution agreement (N.P.A.) if the terms of the Program are satisfied), turn over account information under existing treaty framework without a need to change Swiss bank secrecy laws on the account of suspicion of tax fraud by (not a fishing expedition), and get reduced penalties.
    - The Program identified four categories of banks:
      - Category 1 – banks already under investigation.
      - Category 2 – banks not under investigation but engaged in assisting tax evasion.
      - Category 3 – banks that have not engaged in such behavior.
      - Category 4 – certain local banks.

A Note on the U.S. / Swiss Bank Program

- Requirements
  - Category 2 banks must:
    - Submit a letter of intent to enter the program by January 1.
    - Prior to execution of the N.P.A.:
      - Disclose information regarding:
        - How the cross-border business for U.S. related accounts was structured, operated and supervised;
        - The names and functions of the individuals who structured, operated, or supervised the cross border business;
        - How the bank attracted and serviced clients;
        - An in-person presentation and documentation, properly translated, supporting the disclosure of the above information, as well as future cooperation as needed;
        - The total number of U.S. related accounts and the maximum dollar value, in the aggregate, of these accounts that existed on or after August 1, 2008, were opened between August 1, 2008 and February 28, 2009, and were opened after February 28, 2009.

A Note on the U.S. / Swiss Bank Program

- Requirements
  - Category 2 banks must:
    - Upon execution of N.P.A., for all U.S. related accounts that were closed after August 1, 2008, provide information including:
      - The total number of accounts closed; and
      - As to each account:
        - The maximum value;
        - The number of U.S. persons or entities affiliated or potentially affiliated with each account and the relationship of the U.S. person or entity or potential U.S. person or entity (e.g., a financial interest, beneficial interest, ownership or signatory authority);
        - How legal title was held;
        - Whether it held any U.S. securities;
        - The name and function of the relationship manager, client advisor, asset manager, financial advisor, trustee, fiduciary, nominee, attorney, accountant, or other individual or entity functioning in a similar capacity affiliated with said account on or after August 1, 2008; and
        - Information concerning the transfer of funds into and out of the account on or after August 1, 2008, on a monthly basis.

A Note on the U.S. / Swiss Bank Program

- Requirements
  - Category 2 banks must:
    - Assist in related matters upon request:
      - Provide testimony of a competent witness as needed to enable the U.S. to use the information and evidence obtained pursuant to the Program or separate treaty request in any criminal or other proceeding.
      - Translate documents at their expenses.
    - Close accounts of recalcitrant account holders.

A Note on the U.S. / Swiss Bank Program

- Discussion
  - When will my name be turned over?

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