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VOLUNTARY DISCLOSURE

Advising Clients About the 2011 Offshore Amnesty Program

Along with increased enforcement efforts to uncover offshore accounts, the IRS has announced a new voluntary disclosure initiative that is generally tougher than the prior program.

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Estate planning practitioners should familiarize themselves with a new offshore amnesty program that the IRS announced on 2/8/2011. The IRS has coined the new program, the 2011 Offshore Voluntary Disclosure Initiative (OVDI).¹

Taxpayers seeking legal advice regarding the prospect of making a voluntary disclosure to the IRS under the 2011 OVDI are probably kicking themselves for not coming forward under the 2009 Offshore Voluntary Disclosure Program (OVDP). The terms of the 2011 initiative are similar to those of the 2009 program except that the cost of participating is higher, and the new program appears to be more rigid.

Required payments

The 2011 OVDI requires taxpayers to pay:

- (1) A miscellaneous penalty of 25% on the highest aggregate account balance covering the 2003 to 2010 time period.
- (2) Back taxes, interest, and accuracy/delinquency-related penalties for the tax years ending 2003 through 2010.

Taxpayers must satisfy all of the terms of the 2011 OVDI by 8/31/2011.

Reduced penalties. In very limited circumstances, some taxpayers may be eligible for 5% or 12.5% penalties in lieu the 25% miscellaneous penalty on the highest account balance. The 5% penalty applies to cases in which the taxpayer:

- (1) Inherited the account.
- (2) Exercised minimal control over the account.
- (3) Withdrew less than \$1,000 in any applicable year covered by the disclosure.

(4) Can establish that all U.S. taxes were paid on funds deposited on or after 1/1/1991. (U.S. taxes are presumed to have been paid on deposits prior to 1/1/1991.)

Taxpayers who meet the above criteria but who have already paid a 20% penalty under the 2009 OVDP, may seek a refund of 15% from the IRS.

The 12.5% penalty is available if the highest aggregate account balance in each of the years covered by the 2011 OVDI is less than \$75,000. Taxpayers with account balances under \$75,000 who previously paid a 20% miscellaneous penalty in the 2009 OVDP may seek a refund of 7.5% excess from the IRS.

Overcoming client resistance. When advising a client who is considering a voluntary disclosure under the 2011 OVDI, it is important to understand why many taxpayers did not come forward under the 2009 OVDP. Two of the main reasons are:

- (1) The belief that the terms of the 2009 OVDP were too harsh.
- (2) The belief that their account was unlikely to be detected.

Rest assured that a client who believed that the terms of the 2009 OVDP were too harsh will most certainly believe that the terms of the 2011 OVDI are overly harsh as well. In that event, why would such a client consider making a disclosure under the 2011 OVDI? The most probable answer is that the client fears a significantly increased risk of the offshore account being exposed now than in the past. This is especially true if the client has been following the offshore enforcement news closely over the past few years.

Even so, the client will likely still object to the 2011 OVDI terms as being unfair. Rather than attempting to convince a client that the 2011 OVDI terms are fair, the better approach is simply to advise the client that he or she may be prosecuted if the IRS gets his or her name before the client discloses the account to the IRS. The client should also be provided with the latest enforcement information available concerning any bank in which the client held undeclared offshore accounts since 1999.

UBS

The most noteworthy offshore enforcement news of the past few years has been the indictment of the Swiss bank UBS by the Department of Justice (DOJ) for its involvement in fostering offshore tax evasion by U.S. account holders. UBS entered into a deferred prosecution agreement with the DOJ on 2/18/2009.² The agreement required UBS to:

- Turn over the information related to approximately 280 account holders.
- Pay a \$780 million dollar penalty.
- Cooperate with U.S. authorities going forward.

The DOJ reserved the right to revoke the agreement and move forward with criminal prosecution if UBS failed to cooperate with the U.S. government.

A day after UBS entered into the deferred prosecution agreement with the DOJ, the IRS served UBS with a John Doe civil summons seeking the names of 52,000 U.S. account holders. UBS asserted that it would be in violation of Swiss bank secrecy if the information were turned over. The DOJ threatened to revoke the deferred prosecution agreement if UBS failed to cooperate with the IRS. After a prolonged negotiation between

the DOJ, IRS, UBS, and the Swiss government, UBS agreed to turn over information related to 4,450 accounts by August 2010.³

Impact of settlement. The civil settlement requiring UBS to turn over account holder information to U.S. authorities was a huge blow to Swiss bank secrecy.⁴ News of the settlement prompted approximately 15,000 voluntary disclosures to be filed with the IRS under the 2009 OVDP prior to 10/15/2009. To the surprise of the IRS, many of the voluntary disclosures related to offshore accounts held at banks other than UBS.

As part of the 2009 OVDP, taxpayers were required to answer the five “W” questions—who, what, where, when, and why—relating to their offshore account. This data was collected by the IRS and DOJ for purposes of learning about the various banks and bankers that were assisting U.S. customers in evading U.S. taxes. The DOJ is now using the information collected to bring additional indictments against bankers, account holders, and most likely additional banks.

In addition to the threat presented by DOJ and IRS data mining, several large offshore banks have had account holder information compromised in some manner. UBS is the most noteworthy case, but other banks such as Credit Suisse, HSBC, Julius Baer, and Basler Kantonalbank are in the midst of dealing with problems arising out of stolen data, indicted bankers, and whistleblowers. Summaries of the problems faced by the respective banks are set forth below.

HSBC

On 4/7/2011, the DOJ filed a petition with a federal court requesting permission to serve a John Doe summons on HSBC. If approved, the John Doe summons would direct HSBC USA to produce records identifying U.S. taxpayers with accounts at HSBC India. Thus, HSBC has officially become the next bank to be targeted by the DOJ and IRS. This action is undoubtedly related to data stolen by a former bank employee.

On or about 12/9/2009, HSBC Holdings PLC had announced that an ex-employee stole client information from its Swiss private bank's headquarters in 2006 and 2007. According to HSBC, the stolen data involved fewer than ten clients. French Budget Minister Eric Woerth confirmed that a former HSBC employee had passed the stolen information to French tax authorities.

On 3/10/2010, HSBC issued a press release acknowledging that 15,000 accounts were affected by the theft.⁵ Media reports indicate that the theft also involved approximately 9,000 closed accounts. French authorities identified Herve Falciani as the former HSBC IT employee who stole the data.

On 4/14/2010, a French prosecutor, Eric de Montgolfier, told a group of reporters that 80,000 account holders have been identified from the files stolen from HSBC's Geneva branch in 2007. The French authorities have reportedly offered Falciani a new identity.

Around July 2010, the DOJ began mailing letters to certain HSBC account holders in the U.S. for purposes of advising that they are the subject of a criminal investigation. The letters state, in relevant part, that the DOJ is conducting an investigation of U.S. taxpayers who may have violated criminal laws by failing to report foreign accounts in India or Singapore.

On 4/7/2011, a spokeswoman for HSBC reportedly provided the following statement to CNBC Correspondent Eamon Javers "While we haven't seen the summons, HSBC does not condone tax evasion and fully supports the US efforts to promote appropriate payment of taxes by US taxpayers. While complying with the law in all the jurisdictions in which it operates, including India, HSBC cooperates with requests from US authorities." Unlike UBS AG, HSBC will likely cooperate with the DOJ and IRS to put this matter to rest as quickly and quietly as possible.

Credit Suisse

On 2/23/2011, the DOJ charged three current Credit Swiss bankers and one former Credit Suisse banker with Helping U.S. Taxpayers Use Secret Accounts to Evade U.S. Taxes.⁶ The indictment states that as of the fall of 2008, an "international bank" maintained thousands of secret accounts for customers in the U.S. with as much as \$3 billion in total assets under management in those accounts. Press reports indicate that the "international bank" referred to in the indictment is Credit Suisse.

After the "international bank" decided to close the secret accounts maintained by U.S. customers, it is alleged in the indictment that the defendants encouraged and assisted the customers to transfer their secret accounts to other banks in Switzerland and Hong Kong as a means of continuing to hide their assets from the IRS.

The speculation is that the DOJ and IRS may use the UBS case as a template for taking action against Credit Suisse. The IRS may issue a civil John Doe summons seeking account holder information from Credit Suisse in the coming months. Reports are already surfacing that the Swiss government is attempting to intervene to avoid another UBS debacle. The end result will likely be a compromise involving the transfer of account holder information from Credit Suisse to the U.S. Government along the lines of the UBS case, but without a protracted fight, which occurred in the UBS case.

Julius Baer

On 1/17/2011, former Swiss bank executive, Rudolf Elmer, handed WikiLeaks' Julian Assange two optical discs that contained details on more than 2,000 account holders who may have evaded income taxes by using undeclared offshore accounts.⁷ WikiLeaks has reported that much of the information contained on the discs is from Julius Baer and UBS in Switzerland. The discs are reported to contain the names of powerful individuals, politicians, and corporate businessmen. WikiLeaks has indicated that the data will be released to the public in the near future.

All indications are that U.S. authorities will review any information posted by WikiLeaks. There is no indication that Julius Baer is under investigation by the DOJ at this time, nor is there any indication that Julius Baer will be served a John Doe summons from the IRS.

Basler Kantonbank

On 12/22/2010, Renzo Gadola, pleaded guilty to conspiring to defraud the U.S.⁸ Gadola, a former UBS banker, began working in Switzerland as an independent investment advisor, doing business under the name of RG Investment Partner AG. Gadola reportedly brought over 100 former UBS clients to Basler Kantonbank in an effort to keep the accounts hidden from U.S. authorities. Godola was arrested in Miami after meeting with a client at a Miami hotel and attempting to persuade that client not to disclose his Basler

Kantonalbank account to the IRS. Unbeknownst to Gadola, the meeting was recorded by the client.

Basler Kantonalbank has officially denied that it is the target of an offshore probe by U.S. authorities. The DOJ and the IRS have not indicated what, if any, enforcement action will be taken with respect to Basler Kantonalbank.

FATCA

Even clients with foreign accounts in institutions not discussed above should be concerned with the Foreign Account Tax Compliance Act (FATCA). FATCA was enacted on 3/18/2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act. Under FATCA, U.S. taxpayers holding financial assets outside of the U.S. must report those assets to the IRS on a new form (Form 8938) attached to their tax return. Reporting is required for all assets held in tax years beginning on or after 1/1/2011.

In addition, FATCA will require foreign financial institutions to report directly to the IRS certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial interest.⁹ This reporting has been referred to as "Soft Form 1099." The new reporting regime applies with respect to payments made by foreign financial institutions to covered accounts on or after 1/1/2013.

For many offshore banks, the costs to comply with FATCA are prohibitive. Rather than absorbing these additional compliance costs, it is expected that many offshore banks will simply stop holding accounts for U.S. persons. This is particularly true for smaller banks with fewer resources.

Taxpayers with undeclared accounts at smaller banks may have a false sense of security that their account will continue to fly under the radar. These taxpayers should be warned that there may come a time after the 2011 OVDI has expired when their bank sends them a letter advising that the account must be closed. Taxpayers who are determined to stay outside the system may find another bank that will take their money, but they should not expect to find one in Switzerland. For everyone else, it is "game over."

¹

² IR-2011-14, 2/8/2011, <http://www.irs.gov/newsroom/article/0,,id=235695,00.html>.

³ U.S. Department of Justice, "UBS Enters into Deferred Prosecution Agreement," 2/18/2009, <http://www.justice.gov/opa/pr/2009/February/09-tax-136.html>.

⁴ IR-2009-75, 8/19/2009, <http://www.irs.gov/newsroom/article/0,,id=212124,00.html>.

⁵ IRS, "Excerpts from IRS Commissioner Doug Shulman's Press Remarks on UBS," 8/19/2009. <http://www.irs.gov/newsroom/article/0,,id=212203,00.html>.

⁶ HSBC Holdings plc, "HSBC Private Bank (Suisse) SA Victim of Data Theft and Apologises to Clients," 3/11/2010, <http://www.hsbcpriatebankfrance.com/english/HSBC-Private-Bank-Suisse-victim-of-data-theft-apologises-clients.asp>.

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<http://www.justice.gov/tax/txdv11225.htm>.

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YouTube, "Wikileaks press conf. Jan 17 2011," 1/17/2011.

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