Asset Protection 2015 IRS Tax Audits and Lawsuits

Gary S. Wolfe, Esq.
Alan Jampol, Esq.
Steven Piascik, CPA/MT

Asset Protection 2015: IRS Tax Audits and Lawsuits

(2nd Edition)

By
Gary S. Wolfe, Esq.
Alan Jampol, Esq.
Steven Piascik, CPA, MT

With Special Contribution
by Landon Schwob, Esq.

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**“Knowing a great deal is not the same as being smart;
intelligence is not information alone but also judgment,
the manner in which information is collected and used.”
- Carl Sagan**

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Introduction

In Asset Protection 2015 our focus is on the two biggest risks to high net worth investors: IRS tax audits and lawsuits. In both arenas one could lose everything. Consider Kim Basinger, international movie star, who went bankrupt for failing to follow thru on an oral contract or the Estate of Michael Jackson facing a $700m IRS tax bill for failures of tax planning and no asset protection.

For this second edition of Asset Protection 2015 I have brought in two all-stars:

Alan Jampol, Esq, an internationally acclaimed trial attorney who has successfully resolved billion dollar litigation will offer an expansive insight into the myriad of issues faced by those involved in lawsuits in the US.

Steven Piascik, CPA/MT, founder/owner of Piascick, an international tax and accounting firm with clients in 50 US states and 55 countries, along with myself, will focus on the many pitfalls surrounding IRS tax audits.

Our goal as authors is simple, to be "forewarned is to be forearmed". Asset Protection planning which is done either after the audit commences or after the lawsuit is filed can lead to unexpected complications (i.e. fraudulent conveyance issues). Both have civil and criminal implications. Like life insurance, if you don’t have it by the time you need it, it’s too late.

Asset protection requires litigation expertise, income, estate and gift tax planning/compliance, and IRS tax audit expertise. It should not to be delegated to well-meaning relatives, friends or significant others who lack the necessary expertise and experience. Asset Protection planning needs to be reviewed vigilantly and implemented timely or the risk is losing everything you own.

In 2013 I wrote a book called Asset Protection: The Gathering Storm. With political and economic problems worldwide the storm is upon us. International investors and high net worth individuals are not immune to global financial catastrophe; rather, in the words of Ernest Hemingway, “bankruptcy happens gradually then suddenly. “

Asset Protection Planning protects against the following:

1. Lawsuits and claims by 3rd party creditors who may seek pre-judgment "freeze orders" i.e. writs of attachment, restraining orders and injunctions;

2. IRS tax audits, which may include pre-audit asset seizures known as jeopardy assessments;

3. Unexpected life issues: illness, death, divorce, bad investments, family trauma, natural disasters, civil strife and the world wide risk of wars, disease and riots in the streets.

4. Puerto Rico Governor Padilla announced on 6/27/15 that Puerto Rico is in a "death spiral" and cannot pay $73B in debt. Puerto Rico has more muni bond debt per capital than any US state. Puerto Rico bonds have 8 times the face value of debt of Detroit Bonds (remember what happened to Detroit).

The hidden issue is that Puerto Rico debt is widely held by individual investors in the US thru mutual funds and other investment vehicles. As a commonwealth, Puerto Rico is not entitled to file for bankruptcy. So, creditors and bondholders face an uncertain limbo (i.e. the debts cannot be repaid, the bond holders receive no income, but the creditors cannot be discharged in a bankruptcy). If you are an investor in Puerto Rico bonds, you need to "know the score."

As an investor you should contact your financial advisor and request an explanation from them as to your mutual fund or other investment fund holdings; specifically, do any funds hold Puerto Rico bonds? If so, how much of the funds assets are comprise of Puerto Rico bonds? And finally, if the Puerto Rico bonds default, how much are the projected losses (per investor)?

Lastly, Asset Protection requires constant vigilance. Investors lose money in many ways: IRS tax audits, lawsuits or bad investments. With the help of trusted professional advisors you can control your investments, your assets, and your entire net worth.

There is making it, and then there is keeping it. Time to take charge.

Chapter 1 – Life Insurance

Life insurance is known for liquidity on death, payment of estate taxes, risk protection and providing for family on death of the "breadwinner". Life Insurance may also be used for Asset Protection and Investment Tax Planning.

Life Insurance used for estate planning has significant Asset Protection and Investment Tax Planning benefits. Assets held under a life insurance policy may generate earnings not subject to IRS (or other income) tax audits, which earnings compound tax-free annually.

In addition, the cash value component of a variable life or whole policy may be held thru an irrevocable trust which accomplishes tax planning (no income, estate or gift tax on the death benefit) and provides asset protection, absent a fraudulent conveyance, the life insurance policy owned by the trust is not subject to 3rd party creditor attachment.

A life insurance policy with a cash value component (i.e. either a whole life policy or a universal life policy) has a "separate bank account" (i.e. the cash value) which is a combination of the premiums paid and the earnings on the accumulated premiums). Unlike most investments, annual earnings held under the cash value are not subject to annual income tax reporting, the earnings compound tax-free annually, and may be withdrawn tax-free as a return of basis or a policy loan.

The Asset Protection benefits of life insurance include: minimized IRS tax audit risk (as long as the policy qualifies as life insurance), and withdrawals which if properly structured for tax purposes are exempt from taxation, audit risk, and with the appropriate asset protection strategy, exempt from 3rd party creditor attachment (absent fraudulent conveyances).

For those fortunate enough to have $10.86m in 2015, a husband and wife may capitalize an irrevocable trust with no federal gift tax on up to $10.85m contributed. If the trust is properly structured, as an intentionally defective grantor trust (e.g. the settlers retain powers to substitute trust assets, or receive trust loans without security), these "prohibited administrative powers under IRC sec. 674" make the trust a grantor trust so all income reported by the grantors and no separate income tax returns are required for the trust.

The assets in the trust (i.e. $10.86m) are not subject to estate or gift tax. Most importantly, the appreciation on the $10.86m in trust assets is not subject to 40% federal estate tax.

In addition, for asset protection, assets may be sold to the trust for a self-cancelling installment note. The assets are transferred to the trust, the income from the assets pay the note payment, the assets are now out of the taxable estate, upon the settlers' death the note is cancelled (not included in the estate and subject to estate tax). Most importantly, once the assets are in the trust, creditors of the settlers cannot attach them, absent fraudulent conveyances.

And then, $10.86m is in the trust, which if it earns 5% per year, means over $500k per year in trust income. If the $10.86m is in liquid assets (i.e.. publicly traded stocks or bonds) they may be pledged as collateral for a line of credit at favorable financing rates. For example, for high net worth investors who can borrow at LIBOR rates they may pay 1.5% interest and if they make 5.5% per cent returns, keep the 4% spread (i.e.. the difference between the interest paid and the earnings received). If the portfolio of $10.86m qualifies for a 50% margin line of credit, the investor has $5m+ in available liquid funds. If they have a 4% spread they make $200k per year net earnings, which can be used to fund a Life Insurance policy.

If the Life Insurance Policy is a NON-MEC (i.e. funded over 5 years), then $1m in net earnings (the spread between the loan payment for interest and the earnings over 5 years i.e.. $200k per year x 5 years) can purchase life insurance. So, if the $1m in premiums purchases life insurance with death benefit of $5m, then the estate is increased by $5m at death, for effectively no cost (i.e. the net earnings on the investment portfolio, in excess of the loan interest, pay the premiums). The loan of $5m is paid by the life insurance (which is effectively free i.e.. no cost), so the investor estate receives a $5m loan at no cost. Effectively, the loan of $5m is free, the insurance premiums are free.

The investment tax planning includes the following:

1. Wealth creation i.e. the estate is increased by $5m.

2. The $1m in premiums are paid into the policy, held under the policy cash value component, so the earnings (on the $1m) compound tax-free. If the policy cash value earns 8% per year, in 9 years the $1m becomes $2m. After 9 years, the investor can withdraw the premiums paid tax-free as a return of basis (i.e. $1m withdrawn tax-free), while the earnings the next $1m may be borrowed out tax-free (subject to leaving sufficient funds in the policy to pay the premiums).

The loan of $1m may be paid back by the death benefit, so if the death benefit is $5m, a $1m loan is repaid and the net death benefit is $4m. The investor may receive $1-2m back while alive, tax free, and the balance as a tax-free death benefit.

3. Life insurance has been granted an " IRS angel exception" (i.e. if it qualifies as life insurance under the funding rules it is not subject to IRS audit risk).

The life insurance held in the irrevocable is not subject to creditor attachment, absent fraudulent conveyances which may prove to be "bullet proof" asset protect for both the cash value component (i.e. premiums and earnings) and the tax-free (both income, estate and gift tax free death benefit).

In my recent June 2015 newsletter, I described this tax/financing strategy, as follows:

The Wolfe Law Group is pleased to announce a collaboration with Royal Bank Of Canada, High-Net Worth Division, lead by Tracy Pulvers and his team of advisors (RBC has the best credit rating of any bank in North America with $100B market capitalization) and PIASCIK, an international tax firm (accounting/tax, planning/tax compliance) with clients in all 50 states and in 55 countries worldwide.

The purpose of the collaboration is to offer international investors a "one-stop" service for investment portfolios and financing below market rates. In the "yen carry trade", international investors borrow at 0% interest in Japan, invest the proceeds and keep "the spread". So if they borrow at 0% and make 5% on the borrowed funds the cost of capital is $0 (finance charges) with a net yield of 5%. Effectively, investors use OPM ("other people's money") to make their investments.

In our strategy, RBC investor clients will be able to borrow at below market rates (based on the variable LIBOR rate) with current loans as low as 1%+ (if the loans are a line of credit collateralized by the investor's portfolio of investments held with RBC).

Based on RBC/Tracy Pulvers long history of successful investing for clients (nearly 50 years), Piascik's expertise in tax planning/compliance, and The Wolfe Law Group expertise in international tax planning/asset protection/ IRS audits, the client benefits may include the following:

1. Favorable financing with low interest rates;

2. Competitive investment portfolio yields;

3. Greater net after tax yields thru investment tax planning strategies (which are proprietary trade secrets held by The Wolfe Law Group)

4. Asset protection to protect investments from claims by 3rd party creditors;

5. Minimized risk of IRS tax audit (by the use of pass-thru entities, which have a lower IRS audit risk i.e.. approx. 1/2 of 1% when compared to individuals who make more than $1m per year whose audit risk is approx. 11%);

6. Greater cash flow (investment yields that pass-thru the tax planning strategy companies established have lesser income tax)

7. Immediately available liquidity for investor needs including tax payments due, business overhead or expansion, and unexpected personal needs.

Chapter 2 - Tax Planning

1. Income, Estate and Gift Tax Planning

An estate, which includes multiple assets, may entail numerous individual asset transfers. Rather than make numerous transfers (for each of the individual assets), the tax planning transforms individual assets into LLC ownership interests (membership units) which may be distributed to heirs as undivided interests in the underlying assets, for efficient distribution.

2. Estate/Gift Tax Planning

LLC membership interests have reduced marketability (less marketable than the underlying assets) creating a marketability discount (with a corresponding reduction in value of the asset owned, reducing estate and/or gift tax).

Gifts of LLC interests, (which are minority LLC interests), create valuation discounts reducing estate and gift tax (i.e., restrictions on transfer, minority interest discounts).

In 2015, the U.S. Gift Tax/Estate tax exclusion is $5,430,000 (per individual) with a top marginal tax rate of 40%, for transfers over $5,430,000.

3. Income Tax Planning

LLC business operations may reduce taxes by favorable tax deductions (vs. personal tax): Legal fees, accounting fees not disallowed (i.e., subject to the 2% “floor” for itemized deductions), No alternative minimum taxable income (i.e., versus personal tax returns), and No “compressed tax rates” re: non-grantor trusts (i.e. tax year 2015, 39.6% tax on income over $11,200).

4. Tax Year 2015 – Estimated Tax Payments

LLC net income is passed through to the owners (members) and is subject to payment of estimated income taxes (there is no income tax withholding on LLC distributions). The law provides a penalty for underpayment of estimated tax. The Taxpayer can avoid this penalty by paying the minimum installment authorized under one of the exceptions. Estimated income tax payments are due (2015): 4/15, 6/15, 9/15, (1/15/16).

No penalty for failure to pay estimated tax will apply to any individual whose tax liability for the year, after credit for withheld taxes, is less than $1,000. A U.S. Citizen or Resident need not pay estimated tax if he or she has no tax liability for the preceding tax year providing such year is a 12-month period.

Individuals who do not qualify for these exceptions may avoid the penalty for failure to pay estimated tax by:

a. Paying at least 90% of the tax shown on the current year’s return.

b. Paying 100% of the tax shown on the prior year's return.

c. Paying installments on a current basis under an annualized income tax installment method.

The required payments may be made either through withholding or payment of annual installments. The annuallization method is suitable for Taxpayers whose income is received or accrued more heavily in one part of the year (IRC §6654(d)).

An individual with adjusted gross income in excess of $150,000 can avoid the estimated tax payment by paying 110% of the amount of tax shown on the prior year's tax return, provided the prior year is a full year.

The underpayment of estimated tax by an individual results in imposition of an additional tax equal to the interest that would accrue on the underpayment for the period of underpayment (IRC Code §6654(a)).

Interest on underpayments of tax is imposed at the federal short-term rate plus three percentage points (IRC Code §6621(a)(2)). The interest rates (which are adjusted quarterly) are determined during the first month of a calendar quarter and become effective for the following quarter. Interest accrues from the date the payment is due (determined without regard to any extensions of time, until it is received by the IRS).

Interest is to be compounded daily, except for additions to tax for underpayment of estimated tax by individuals and corporations (IRC §6601).

5. Asset Protection – LLCs and Investors Tax Audits

LLCs may reduce IRS tax audit risk and offer third party creditor asset protection.

For individual taxpayers the IRS audit risk:

a. All Taxpayers (2013), .96% (1 in 104);

b. Taxpayers earning over $1m (2012), 10.85% (1 in 9);

The audit risk for LLCs is 0.4% (4/10 of 1%; i.e. 1 in 250).

6. Asset Protection – S-Corporations, LLC and Tax Planning

Both LLCs and S-Corporations are tax-reporting net income tax-paying entities. LLCs/S-Corporations pay a $800 minimum California tax, S-Corporations pay a 1.5% California corporate level tax, LLCs pay an annual "gross receipts tax", based on gross income:

Income / Tax

$0-$250,000 / $0

$250,000-$499,000 / $900

$500,000-$999,000 / $2,500

$1m – $4.99m / $6,000

$5m+ / $11,790

S-Corporations

1. May not issue preferred shares. Voting and non-voting common stock may be issued, but in all other respects, S-Corporation's shares must be identical in their rights and privileges.

2. Neither a corporation nor a non-resident alien can be an S-Corporation shareholder.

3. The inside basis of appreciated assets held by the S-Corporation (fair market value in excess of adjusted tax basis) may be adjusted to FMV upon the deceased owner's death for the successor's benefit.

4. Owners of the shares of an S-Corporation obtain no owner level basis adjustments for entry-level debt (S-Corporation debt is not allocated as an upward basis adjustment among shareholders), thereby limiting the ability of S-Corporation shareholders to claim entity level losses passed through to them.

5. Distributions in kind of appreciated property from an S-Corporation to its shareholders is subject to a "deemed" sale treatment with gain recognition and taxation.

6. Contributions of appreciated property to an S-Corporation will result in recognition of gain to a shareholder.

7. A U.S. based S-Corporation, with outbound investment objectives may not establish and hold an 80% or more owned subsidiary to conduct operations abroad.

Limited Liability Companies

1. Various classes of interests in a LLC may be created without risk to the income tax classification of the LLC as a pass-through (one level of tax) entity (unlike S-Corporations).

2. The inside basis of appreciated property held by the LLC may be adjusted to FMV upon the death of the deceased owner.

3. LLC owners obtain owner basis adjustments for entity level debt, allowing them to claim entity losses passed through to them (unlike S-Corporations).

4. Distributions in kind of appreciated property from a LLC to its members do not trigger "deemed sale" tax treatment (i.e. gain recognition and taxation) (unlike a S-Corporation).

5. Contribution of appreciated assets to a LLC will not result in gain recognition.

6. Unlike an LLC, a limited partnership must have at least one general partner, subject to unlimited liability. In a LLC, all members will be directly protected against liabilities arising at the entity level under state law.

7. All LLC members can participate in management without losing liability protection (not just general partners in the case of a limited partnership).

8. For cross-border transactions, unlike an S-Corporation, foreign non-resident alien investors may directly join with U.S. co-ventures in a single entity to conduct a U.S. business with pass-through tax treatment for both.

9. U.S. based investors may use a LLC to conduct a foreign business and have limited liability protection and one level of pass-through taxation.

When combined, (i.e. an S-corporation) as the Manager and Owner of the LLC:

1. There is no self-employment tax (Social Security/Medicare) on net earnings distributed ultimately through an S-Corporation. In 2014 the tax savings is $17,901 (15.3% on $117,000, taxable wage base maximum).

2. The LLC may provide a single entity for inbound joint ventures between a U.S. and foreign person.

3. The LLC may hold outbound investment of U.S. based person with limited liability.

Asset Protection – LLCs and Tax Planning 2015

In 2015, self-employment tax (i.e. a tax on net earnings from self-employment) which consists of Social Security Tax (FICA) and Medicare taxes are imposed on LLC members, but not on S-Corporation shareholders. As a tax-planning strategy, an LLC may be wholly owned by an S-Corporation. LLC earnings are distributed to the LLC member, S-Corporation. There is no self-employment tax on the S-Corporation/LLC distribution (a 2015 tax savings of $17,396).

In 2015, high earners face increased FICA/Medicare Taxes (Employer/Employee Share).

1. Social Security (FICA Tax), 12.4% tax on net earnings up to $117,000 ($14,508 annual tax);

2. Medicare Tax (Self-Employment Tax), 2.9% Medicare tax on unlimited net self-employment earnings: $117,000 earnings ($3,393 annual tax), plus 2.9% tax on excess earnings.

In addition, in 2013 high earners face additional increased taxes:

1. Medicare Tax (Net Investment Income), 3.8% tax for taxpayers with income over $200,000 (individual), $250,000 (husband and wife) on lesser of net investment income or modified adjusted gross income;

2. Medicare Tax (Earned Income), 0.9% tax on earned income (wages over $200,000 individual, $250,000 husband and wife). This tax is imposed on employee's share of Medicare tax, and is disclosed on Form 1040.

3. Phase-out in itemized deductions, adds up to 1.19% to marginal tax rates.

Itemized deductions are reduced by 3% of adjusted gross income (AGI) over $250,000 for singles, $300,000 for couples, not to exceed 80% of total itemizations (medical expenses, investment interest deductions, casualty losses are all exempt). The phase-out is based on the amount of AGI and net taxable income (i.e. what is left after itemized deductions).

4. Personal Exemption, loss of exemption adds as much as 1.05% per exemption. Personal exemptions are reduced by 2% for each $2,500 of AGI over the $250,000/$300,000 thresholds, and disappear once AGI exceeds $372,500 (singles), $422,500 (couples).

As a tax-planning strategy, investment income may be lessened by "net-income" taxation. Tier #1, the LLC receives investment income, distributes net income (i.e. income less expenses) to the S-Corporation (member/manager), which in turn distributes their net income to the S-Corporation shareholders. The #2 tier distribution to the S-Corporation shareholder is subject to a lesser risk of an IRS tax audit (than an individual taxpayer) and with proper tax planning less additional tax due to the phase-out of the itemized deductions and personal exemptions.

Chapter 3 - Creditors Liability

The justification for allowing a person to "protect" assets is to permit a person to control the timing and disposition of property, and to ensure that the use the person wants his or her property to go to, it does.

A person is not obligated to make his or her assets available to creditors. The creditors have no countervailing interest to a person's freedom to freely alienate property.

The settlor's intention will not control if the actions prove to be invalid because it violates public policy, is fraudulent (hinders, defrauds or delays a creditor), or requires the performance of an illegal act.

Present and Future Foreseeable Creditors

A transfer is fraudulent as to both present and future foreseeable creditors if the debtor did not receive reasonably equivalent value for the transfer and either:

The debtor was engaged or was about to engage in a business or transaction for which the remaining assets of the debtor were unreasonably small, or the debtor intended to incur or believed or reasonably should have believed, that he or she would incur debts beyond his or her ability to pay as they became due. (Cal. Civil Code §3439.04(b)).

Asset Protection (California) - Avoidance of Probate

Estate benefits of trusts are avoidance of probate, costs, and time-delay if the trust (i) is properly set up, and (ii) is funded.

1. Revocable Trusts - Power to Revoke

Revocable trusts are not to be considered a safe vehicle for protection of assets. California has enacted a statute, which provides that if the settlor retains absolute power to revoke, then his or her creditors can reach the trust corpus. (Cal. Prob. Code §18200).

2. Asset Protection (California Statutes)

The following are key Asset Protection Statutes in California:

California Probate Code §18200

If Settlor retains absolute power to revoke, then creditors can attach trust corpus.

Corporation Code §17302(b)

Court may order a foreclosure on the LLC membership interest, and the purchaser at the foreclosure sale obtains the rights of an assignee.

Corporations Code §17301(a)(2)

An LLC creditor-assignee obtains rights to the economic interest of the member, only, with no right to vote or participate in management.

Corporation Code §17301(a)(3)

An Assignee of an economic interest is entitled only to distributions of property (cash) and allocations of taxable income, gain, loss, deduction and credit.

3) LLC Charging Orders

An LLC offers superior asset protection from creditors, since the creditor's excusive remedy is the charging order.

a. Charging Orders - The charging order rules of Corp C §17302 provide the exclusive remedy for a judgment creditor to satisfy a judgment out of a membership or economic interest in an LLC (Corp C §17302(e)).

b. Creditor-Assignee - The secured creditor obtains rights to the economic interest of the member, only. A creditor assignee who holds only an economic interest will have no right to vote, participate in management, or exercise any other rights of a member unless the articles of organization or operating agreement grants any such rights to holders of economic interest. Corp C §17301(a)(2).

An assignee of an economic interest is entitled only to distributions of property or cash and allocations of taxable income, gain, loss, deduction, and credit. Corp C §17301(a)(3).

An assignee who becomes a member has the rights and powers and is subject to the restrictions and liabilities of a member (to the extent assigned). On becoming a member, the assignee is also liable for the obligations of the assignor to make contributions and return any prohibited distributions. Corp C §§17303(b), 17254.

The assignee is not obligated for liabilities unknown to the assignee at the time the assignee became a member and that could not be ascertained from the articles of organization or operating agreement. Corp C §17303(b).

Certain creditors may have superior rights, e.g., creditors with knowledge of the obligation who extended credit before the assignee's obligation was compromised, or creditors who may assert rights under the fraudulent conveyance laws, bankruptcy laws, or general principles of equity. Corp C §§17201(b)(2), 17201(d).

c. Lien/Foreclosure - A lien by a judgment creditor against a member's interest is created by service of a notice of motion for a charging order on the member and all other members of the LLC and continues unless the order is denied. CCP §708.320. A judgment creditor of a member may charge the “assignable” membership interest of a member without becoming a member. Corp C §17302(b).

To obtain the balance of the benefits of the economic interest, the creditor must establish a right to foreclose on the membership interest. The court may order a foreclosure on the membership interest at any time and the purchaser at the foreclosure sale obtains the rights of an “assignee.” Corp C §17302(b).

The judgment debtor and the other members of the LLC retain the right to redeem the membership interest at any time before foreclosure. Corp C §17302(c).

4. Creditors (“Phantom Income”)

LLC planning may include “creditor peril” (i.e. unexpected income tax for creditors seeking attachment of membership interests). Attaching creditors may receive income tax liability for LLC/K-1 income (debtor-member) without corresponding LLC distributions (“phantom income”).

In an LLC, an attaching creditor is not substituted as an LLC member (i.e. no voting rights, no management rights). The creditor is an “assignee” of the economic interests that the LLC membership units represent (owned by debtor-member (LLC)).

An attaching creditor, of an LLC membership interest, is taxable on the LLC member’s pro-rata share of LLC income (re: LLC member’s K-1 tax return information).

5. Secured Financing/Asset Protection

An LLC may create asset protection by third-party secured financing. The LLC may own assets (e.g., stocks or bonds) which are pledged, under a senior lien, as collateral for a third-party loan or line of credit.

Asset protection advantages include:

Third party financing (the use of “other people’s money” to finance your investment transactions, instead of your own funds). A third-party lender, loans funds to the LLC which loans funds to another company you may own (or designate as loan proceeds recipient).

By interposing a third-party lender you receive creditor protection by virtue of their senior lender lien (which is a priority lien against the assets (i.e., stocks or bonds) held under the LLC).

6. Stocks and Bonds

Bonds. The tax planning/asset protection strategy proposed may include a bond portfolio in which a sum is maintained on account, secured by a credit line which could be used at your election. The bond income would be in two forms:

a. “Discount” bond purchases (includes built-in profit in the event the bond was held to maturity).

b. Net bond interest (excess bond interest over any credit line interest charges).

Stocks. In the event you elect to invest the LLC funds in stocks not bonds, if the stocks appreciate in value, the appreciation may be “borrowed out” tax-free (until the underlying stock is sold) while you receive the income tax benefit of the tax deductions for interest paid.

Chapter 4 - Limited Liability Companies: General

LLC Advantages

Asset protection (no creditor seizure of underlying assets).

Reduced tax compliance (no income tax withholding on LLC distributions). When established and owned by a trust offers privacy and confidentiality. Limited liability companies afford members the limited liability enjoyed by corporate shareholders and pass-through tax advantages of a partnership absent the restrictions imposed on limited partnerships and subchapter S corporations.

The limited liability companies are formed by filing articles of organization with the Secretary of State under an operating agreement (not filed) which is between all the members as to the affairs of the limited liability company and the manner in which the business is to be conducted. The limited liability company allows its owners (referred to as members) limited liability, but permits the members to actively participate in the entity's management. If the members do not want to manage the activities of the limited liability company, they can appoint managers.

Neither the owners (i.e., members) nor the managers are personally liable for the company's debts and obligations. For U.S. federal income tax purposes, the limited liability company is treated as a partnership, which makes it a reporting entity, but not a taxpaying entity. All of its items of gross income, deductions, gains, losses and credits are attributable on a current basis to and reportable by its owners (Form 1065/K-1).

For superior asset protection, a Limited Liability Company ("LLC") is a tax-efficient, cost-effective alternative. As of January 1, 2000, amendments to the Beverly-Killea Limited Liability Company Act (Corp. Code §17000-17555) permit the formation of single member LLC's in California (Corp. Code §17001, 17050).

Fees

In addition to the annual tax ($800), every LLC must pay a fee based on total annual income. The LLC fee is due on or before the 15th day of the 4th month after the close of the LLC's taxable year. In addition, California imposes an additional gross receipts tax on LLC's in Revenue and Tax Code Section 17942(a)

Chapter 5 - Limited Liability Companies: Advantages

Background

In 1994, the Beverly-Killea Limited Liability Company Act (Corp C §§17000-17655) authorized the formation of California LLCs and recognized the validity of foreign LLCs registered in California. (See Corp C §§17050, 17451)

1) LLC Benefits

An LLC is a hybrid form of business entity that combines the liability shield of a corporation with the benefits of being taxed like a partnership, or, for a single-member LLC, the benefits of being ignored as a disregarded entity.

The shield protects an LLC's members from personal liability for the business's debts, and the tax classification as a partnership provides the advantages of pass-through taxation.

Eligible members of an LLC include individuals, general and limited partnerships, trusts, estates, associations, corporations, other LLCs, or other entities, whether domestic or foreign. (See Corp C §17001)

2) LLC Advantages: No Alter-Ego Liability

Under California law, no member of an LLC, solely by reason of being a member, is personally liable for any judgment of a court, or for any debt, obligation, or liability of the LLC, whether that liability or obligation arises in contract, tort, or otherwise. (Corp C §17101(a))

There are limits to the liability protection afforded by the LLCs. The Act does not protect a member from liability to third parties for the member's tortious conduct (e.g., fraud). (Corp C §17101(c))

Outside the fraud context, a member "shall be personally liable under a judgment of a court or for any debt, obligation, or liability of the LLC under the same or similar circumstances and to the same extent as a shareholder of a corporation may be personally liable for any debt, obligation, or liability of the corporation." (Corp C §17101(b)) Chapter 490 amended Corp C §17101(b) to highlight this point: "A member of a limited liability company shall be subject to liability under the common law governing alter ego liability."

Under California laws, a creditor of a partner or member is only entitled to obtain a charging order with respect to the partner or member's interest. The charging order gives the creditor the right to receive any distributions with respect to the partnership or membership interest. In all respects, the creditor is treated as a mere assignee and is not entitled to exercise any voting rights or other rights that the partner or member possessed.

Creditors have been successful in having a partnership interest subject to a charging order sold in a foreclosure sale when either the other parties consented or the court determined the sale would not unduly interfere with the partnership business. See Hellman v. Anderson, 233 Cal. App.3d 840 (1991); Crocker Nat'l. Bank v. Perroton, 208 Cal. App.3d 1(1989).

However the purchaser only acquired the partner's economic interest re: rights to distributions and not to the partnership's property or management rights in the partnership (which may result in "phantom income" and an income tax liability to the creditor).

3) Protecting Assets From Exposure To Liability

A client may own an operating business engaged in hazardous undertaking or real estate having potential liability under environmental laws. Exposing other business assets to such potential liability could be avoided by placing the hazardous business or real estate in a separate entity.

As a result of the check-the-box regulations that disregard a non-electing single-member LLC for tax purposes, a client-owned parent entity (such as another LLC, a limited partnership, or an S corporation) could own single-member LLCs holding separate parcels of real estate and separate businesses. Treas. Reg. §301.7701-3(a).

Before forming such a holding company, the client owning the hazardous assets would first transfer them to a newly formed LLC and immediately thereafter transfer the LLC interests received in exchange to the client's holding entity for interests in the holding entity. This would ensure that the client's parent entity never owned the hazardous assets outright.

4) Corporate Formalities

LLCs are subject to fewer formality requirements than are corporations, but members should maintain proper records, including copies of the articles or certificate, the operating agreement, a list of members, and copies of contracts and leases. The members generally should also observe the requirements and formalities set out in the company's operating agreement. Since a single-member LLC is especially vulnerable to an alter-ego claim, it is important to bolster the separateness of the owner from the entity.

The failure to observe the formalities of meetings does not establish alter-ego liability or personal liability if such formalities are not required by the LLC's articles of organization or operating agreement. (Corp C §17101(b)) This statutorily recognized ability to conduct LLC operations in an informal manner without exposing the members to alter-ego liability is a principal advantage of LLCs over corporations. Except in cases of extreme disregard of corporate formalities (e.g., commingling or diversion of assets, manipulation of assets and liabilities, holding oneself as the obligor to creditors), undercapitalization appears to be the most likely ground (other than fraud) for holding members of an LLC liable for the LLC's obligations under the alter-ego doctrine.

5) Undercapitalization

No rule of thumb determines with mathematical certainty what dollar amount adequately capitalizes an LLC. This is determined on a case-by-case basis by considering the size, nature, and reasonably expected hazards and risks of the particularly business. To prevent a creditor from successfully invoking alter-ego liability against an LLC, the LLC's members (or for a single-member LLC, the LLC's member) should respect the LLC as a separate entity by doing the following:

a. Establishing a separate bank account for the LLC;

b. Avoiding the commingling of personal assets with the LLC assets;

c. Documenting loans between members and the LLC;

d. Ensuring that the transactions between the LLC and its member(s) are conducted in an arm's length manner; and

e. Avoiding diversion of LLC funds for non-LLC purposes.

6) Advantages Of Limited Liability Companies

a. Estate Planning

Members can gift interests in family-owned businesses to children and others without losing control because the recipient does not have free transferability of interest.
At the death of a member, the remaining members can elect a stepped-up basis of the decedent's share of LLC assets.
An LLC can provide the estate planning benefits of a family limited partnership without the general partner assuming liability.

b. Compared to C Corporations:

Lower taxes – no double taxation.
No excess compensation problems.
No accumulated earnings tax.
Allows special allocations.
Wide range of management structures available.

c. Compared to Sole Proprietorships:

Limited liability-
Can take in investor(s) without giving up control.
Can give investor(s) tax benefits without liability.

d. Advantages over S Corporations:

Can have an unlimited number of owners (members).

No restrictions on who can be a member.
No built-in gains tax.
No tax on excess net passive investment income.
Can have special allocations.
LLC debt – even nonrecourse debt – is allocated to members, thus increasing basis.
Member's basis is stepped-up at a death of member.

S corporations are subject to certain restrictions on both the number and types of shareholders. There are no restrictions on who may be a member of a LLC or the number of members.

S corporations are not permitted to specially allocate income or loss. LLCs may specially allocate income or loss.

S corporations may not have more than one class of stock outstanding. LLCs can have an almost infinite variety of classes or series of interests.

S corporations are subject to certain penalty taxes for built-in gains and excess passive income. These penalty taxes do not apply to LLCs.

S corporations doing business in California are subject to a one and one-half percent net income tax. LLCs which are classified as partnerships for federal income purposes are not subject to this tax.

On the death of a shareholder or sale of stock, an S corporation does not adjust the basis of its assets. An LLC, since it is taxed as a partnership, can elect to adjust the basis of its assets on the death of a member or on the sale of a membership interest.

A shareholding of an S corporation is not entitled to basis for debts of the S corporation for purposes of using S corporation losses. However, a member of an LLC is entitled to basis for the LLC's debt under IRC section 752 even though that debt will be nonrecourse to the member.

e. Advantages over Limited Partnerships:

LLCs provide advantages over limited partnerships. These advantages include:

A limited partnership must have at least one general partner who is personally liable for the debts of the entity. An LLC does not have or need a general partner.

Limited partners who participate in the management of the limited partnership can be classified as general partners and face unlimited liability. In general, members are not liable for the debts of an LLC.

f. Advantages over General Partnerships:

Limited liability of members can participate without risking liability protection.

7) An LLC's principal advantage over a general partnership is that no member is personally liable for the debts of the partnership. Typically this restriction does not apply to professional LLCs where the members are liable for their own negligence and the negligence of subordinates. This liability protections may further be limited by judicial doctrines or piercing the corporate veil.

Chapter 6 - Limited Liability Companies: Tax Issues

Special Contribution by Ryan L. Losi, CPA, Piascik.com

Federal Tax Law

The “check the box” regulations of the federal tax laws provide that an LLC with two or more members may choose to be taxed as either a partnership or a corporation. The LLC must file an election to be taxed as a corporation or it will automatically be treated as a partnership. (Treas. Reg. §301.7701-3)

A single-member LLC may choose between tax treatment as a corporation or being disregarded for tax purposes (i.e., a disregarded entity). (Treas. Reg. §301.7701-3) A single-member LLC must file an election to be taxed as a corporation or it will be automatically treated as a disregarded entity.

In general, a domestic one-member unincorporated entity does not need to file anything in order to obtain “disregard” treatment, but an incorporated entity formed outside the United States may need to elect “disregard” treatment if it is not listed in the check-the-box regulations as a “per se” corporation. A single-member entity that is disregarded as an entity separate from its owner will be taxed as a sole proprietorship, division, or branch of its owner.

The major differences in treatment between a single-member LLC and an LLC with more than one member is that the latter LLC must file a partnership tax return (IRS Form 1065). As a result, the members of a multi-member LLC must report their share of the LLC’s income or loss on their individual tax return (IRS Form 1040) based on the amounts reflected on the LLC’s Schedule K-1.

For a single-member LLC that is treated as a disregarded entity, there is no Schedule K-1, and therefore its member reports the LLC’s income or loss directly on his or her individual tax return. The IRS permitted the disregarding of a two-member LLC when one of the members had no economic interest. (IRS Letter Ruling 199911033)

For California tax purposes, the distinction is minimized, because, a single-member LLC that is disregarded as an entity separate from its owners must nevertheless file an LLC tax return in California (FTB Form 568), pay the $800 annual franchise tax, and pay the LLC gross receipts fee.

With respect to an LLC owner’s federal tax liability, the IRS Chief Counsel said that the IRS may not levy on the assets of a single-member LLC that is disregarded for federal tax purposes to satisfy the tax liability of the owner. (IRS Chief Counsel Advice 199930013 July 30, 1999) However, the IRS has ruled also that the owner of a single-member LLC that is disregarded for federal tax purposes is the “employer” for tax purposes and is therefore liable for nonpayment of payroll taxes. (IRS Chief Counsel Advice 199922053 June 15, 1999)

California Tax Law

Even though a single-member LLC is disregarded as an entity separate from its owners, however, it must still file an LLC tax return in California (FTB Form 568), pay the $800 annual franchise tax, and pay the LLC gross receipts fee. (Rev & T C §§23038 and 17942; FTB Notice 2000-5 May 12, 2000) (available at the Franchise Tax Board's Web site at www.ftb.ca.gov/legal).

Disregarded treatment applies only for income and franchise tax purposes. It does not apply for purposes of California sales and use, property, and documentary transfer tax laws. Documentary transfer taxes will not be imposed on a transfer between a single-member LLC and its member that changes only the method of holding title to the realty if proportional ownership interests in the realty are not changed by the transfer. (Rev & T C §11925)

Chapter 7 - Limited Liability Companies: Tax Compliance

Special Contribution by Ryan L. Losi, CPA, Piascik.com

Tax Filings

For federal tax purposes, the income and deductions of a single-member LLC owned by an individual will be reported on Schedule C of the individual's Form 1040. If the member is a corporation or partnership, the income will be reported on the member's Form 1120, 1120S, or 1065 (and ultimately, for a partnership, on the partner's own Form 1040).

To comply with California's tax reporting requirements, a single-member LLC need only complete FTB Form 568, side 1, and pay the annual LLC tax and LLC gross receipts fee. The single owner would include the various items of income, deductions, credits, and other tax attributes of the LLC on his or her tax return. Single owners should compute Schedule P to determine the LLC's credit limitation.

Avoidance of Consolidated Return Restrictions

Treatment of a one-member LLC as a disregarded entity allows corporate owners of single-member LLC's to treat them as branches or divisions, rather than as subsidiaries, for tax purposes, thus relieving them of the tax and administrative burdens imposed by the consolidated return regulations. Filing a consolidated return may defer the tax consequences of a transaction between a parent and its corporate subsidiaries, but structuring the same transaction between a parent and its single-member LLC subsidiary would avoid altogether any such tax consequences because of the single-member LLC's status as a disregarded entity.

Foreign corporations may not be included as members of an affiliated group in filing a consolidated return. (IRC §1504(b)(3)) Because single-member LLCs treated as flow-through entities are disregarded for tax purposes, however, the income and losses of foreign businesses owned by a single-member LLC may be offset against income of their U.S. parent outside of these consolidated return restrictions.

S Corporation

S corporation stock may be transferred to a single-member LLC without terminating the S Corporation election. (See IRS Letter Ruling 9739014)

Estate Planning

If real estate is held by an LLC and the LLC's operating agreement permits the interest in the LLC to pass to successors in order to prevent an inadvertent termination of the LLC, probate usually can be avoided.

Single-member LLCs have other advantages in estate planning. For example, if two or more executors are required to administer a decedent's estate, practical problems sometimes arise when an executor is unavailable. The executors could cause the estate to form a single-member LLC, with the executors serving as the LLC's officers. This structure provides the executors with some additional degree of protection from liability and (consistent with the LLC's operating agreement) allows one officer to act instead of requiring joint action by all the executors.

Reorganizations

An LLC taxed as a partnership normally may not participate in a tax-free reorganization because Subchapter C (which allows tax-free reorganizations such as mergers, divisions, and recapitalizations) applies only to corporations. (IRS letter Rulings 9409014, 9409016) No analogous set of rules permits LLCs to participate in tax-free reorganizations and mergers. However, an LLC owned solely by a corporation is treated as a branch or division of the corporate parent for tax purposes. Therefore, a single-member LLC owned solely by a corporation should be eligible to participate in tax-free reorganizations under Subchapter C.

IRC §1031 Nonrecognition Exchanges

The IRS has long taken the position that any transfer of property to or from an entity – even a wholly owned entity – simultaneously with or shortly before or after a tax-free exchange under IRC §1031, would disqualify the transaction from nonrecognition treatment. (Rev Rul 77-297, 1977-2, Cum Bull 304; Rev Rul 77-337, 1977-2 Cum Bull 305. See also Magneson v Commissioner (1983) 81 TC, 767 aff'd (9th Cir 1985) 753 F2d 1490)

Both the property surrendered and the property acquired must be held for productive use in a trade or business or for investment. IRC §1031(a). Although this provision does not specify a minimum holding period, the IRS takes the position that if the relinquished property was acquired immediately before the exchange or if the replacement property is disposed of immediately after the exchange, the taxpayer held the property primarily to dispose of it rather than for productive use in a trade or business or for investment.

The courts, particularly the Tax Court and the Ninth Circuit, have been more liberal in allowing transactions involving transfers of property to or from a controlled entity contemporaneously with an exchange to qualify for nonrecognition under IRC §1031, but the IRS has not acquiesced in those decisions. (See Magneson v Commissioner, supra; Bolker v. Commissioner (1983) 81 TC 782), aff'd (9th Cir 1985) 760 F2d 1039) Moreover, Congress amended IRC §1031 immediately after those cases were decided to undermine the foundation of the court decisions. (IRC §1031(a)(2)(D))

In at least two private rulings, the IRS ruled that a taxpayer's transfer of replacement property directly to the taxpayer's wholly owned, single-member LLC in the second leg of a IRC §1031 exchange would not disqualify the taxpayer from receiving nonrecognition treatment. (IRS Letter Rulings 9807013, 9751012) The IRS concluded that, because the single-owner LLC is disregarded as an entity (unless it elects to be taxed as a corporation), the transactions in question would be viewed as if the taxpayer itself had directly received the replacement property, and therefore satisfied the holding requirement of IRC §1031.

Although IRC §6110(k)(3) prevents these rulings from being used or cited as precedent, they do constitute substantial authority for purposes of the accuracy-related penalty rules. (See Treas. Reg. §1.6662-4(d)) The letter rulings also reflect the Service's position with respect to the use of single-member LLCs in connection with IRC §1031 exchanges under the check-the-box regime (it is unlikely that the IRS would adopt an audit or litigating position contrary to these rulings).

In addition to limiting liability, a transfer of the replacement property directly to the taxpayer's wholly owned LLC, rather than transferring the property to the taxpayer and then to the LLC, will avoid duplicative transfer of taxes and fees (e.g., recording fees and escrow fees). Thus, in a multiple-party exchange involving a qualified intermediary, the escrow instructions should direct the escrow officer to transfer title to the taxpayer's wholly owned LLC and bypass both the intermediary and the taxpayer.

A taxpayer could possibly avoid transfer taxes and fees by transferring his or her entire interest in a wholly owned LLC that holds real property to the buyer of the relinquished property in exchange for real property.

For a single-member LLC disregarded as a separate entity, the transaction would be characterized as if the taxpayer transferred the property directly to the buyer. The buyer, who would become the sole owner of the LLC, could choose to continue holding the property in the LLC or liquidate the LLC and distribute the property tax free under IRC §731.

Exchanges of partnership interests do not qualify for nonrecognition treatment (IRC §1031(a)(2)(D)) The check-the-box regulations clearly provide that a single-member LLC is to be disregarded as an entity (unless an election is made to be treated as a corporation). Therefore, the transfer of interests in single-member LLCs should be deemed a transfer of the underlying assets and such transfers should qualify for nonrecognition treatment.

Conversion of Existing LLC to a California Single-Member LLC

The conversion of a disregarded single-member LLC into a multi-member LLC taxed as a partnership, may result in a taxable sale. (See Rev Rul 99-5, 1999-5 Int Rev Bull) If a new member or members contribute cash or property and the original member does not receive any of the contributed cash or property as part of the transaction, generally no gain or loss will result to the members. However, to the extent that cash or property is distributed to the original member as part of the transaction, that portion is treated as a taxable sale of the LLC's assets. The transaction is treated as if the new member buys the assets directly from the original member and then contributes the assets to the new LLC.

Converting a multi-member LLC taxed as a partnership into a single-member LLC (e.g., on the withdrawal of a 1-percent member who is no longer needed for purposes of having a California

LLC) may cause a taxable event to occur. See Rev Rul 99-6, 1999-5 Int Rev Bull. If a new member purchases the membership interests of the original members, it is treated as a sale of the original members' membership interests and the LLC terminates.

The new member is deemed to have purchased assets directly from the original members. If an existing member acquires all of the other members' interests, the LLC terminates and the departing members are deemed to have sold their interests to the remaining member. The remaining member is deemed to have received a distribution of his or her share of the LLC's assets immediately before the transaction. Gain may result to the extent that any money distributed exceeds the remaining member's adjusted basis in the LLC interest.

Chapter 8 - Limited Liability Companies: California Laws

Effective January 1, 2004, §17001(t) of the California Corporation Code defines a "limited liability company" as an entity having one or more members. The statutory definition does not require an LLC to be organized for a business purpose.

Section 17102 expressly permits members to create different classes of membership, each with its own rights, powers and duties, including rights, powers and duties senior to those of others classes.

Section 17103 gives members the power to vary their respective voting rights in the articles of organization or a written operating agreement. However the statute requires that a majority in interest of the members must approve an amendment to the articles of organization, and all members must be given the right to vote on a dissolution or merger of the LLC.

Section 17151 expressly provides for management of an LLC by on or more managers (who do not have to be members). However, the articles or organization must include a statement to the effect that the LLC is to be managed by managers and not all its members. While it is necessary to include the number or names of managers, it the LLC is to be managed by a sole manager, the articles must also include a statement to that effect. (See also §17051(a)(5))

However, regardless of any management restrictions placed upon members in the operating agreement, §17157 provides that unless a statement regarding management by other than all members is included in the articles of organization, every member will be an agent of the LLC, and the act of any member will bind the company unless the acting member has no authority to so act and the third party involved had an actual notice of the member's lack of authority.

Section 17152 required that where management has been vested in one or more managers pursuant to a statement in the articles of organization, the manager(s) shall be elected by a vote of a majority in interest of the members, and may be removed at any time by a similar vote, with or without cause. Unless a term is specified, managers shall serve until such time as their successors have been elected and qualified.

Pursuant to §17154, managers may appoint officers to serve at the managers' pleasure (subject to any rights under an employment contract).

Section 17202 gives members the right to vary the allocation of profits and losses from the proportion of each member's contribution.

Under the default rule set forth in §17301(a), a membership interest or an economic interest is assignable in whole or in part, provided a majority in interest of non-transferring members consent.

Unless the members have provided otherwise, §17301(a) also states that an assignment of an economic interest entitles the assignee to receive, to the extent assigned, the distributions and allocations to which the assignor would be entitled. The assignor continues to be a member, and to have the right to exercise any rights and powers of a member (including the right to vote in proportion to the interest in current profits that the assignor would have absent the assignment), until such time as the assignee is admitted as a member.

Sections 17100(a) and 17303(a) together provide that a person acquiring a membership interest either directly from the LLC or as an assignee of a current member may become a member only upon the consent of a majority in interest of the members (excluding the vote of the person acquiring membership interest) and the completion of the steps needed to make the acquiring person a party to the operating agreement, unless the members have otherwise provided in the articles or operating agreement.

Section 17303 also states that once admitted as a member of the LLC, an assignee has, to the extent assigned, the rights and powers, and is subject to the restrictions and liabilities, of a member. Upon admittance, the new member also becomes liable for the assignor's obligations to make additional capital contributions and to return any lawful distributions made to the assignee. However, the assignee/member does not become obligated for any liabilities unknown to him or her at the time he or she became a member and that could not be ascertained from the articles or operating agreement. In any event, the assignor's liability continues regardless of whether or not the assignee of his or her membership interest becomes a member.

Section 17301(b) prevents an assignee of an economic interest from having any liability to the LLC for capital contribution or the return of unlawful distributions solely as a result of the assignment, except to the extent assumed by agreement, until such time as he or she becomes a member.

Under §17100 (c), LLC members may provide in the operating agreement for the termination of a member's membership interest or economic interest and the return of such terminating member's contribution, which provision shall be enforceable unless a member establishes that the provision was unreasonable under the circumstances existing at the time the agreement was made. However, the statute also provides that if a member's economic interest in the LLC is terminated pursuant to the operating agreement, such terminating member may demand and shall be entitled to receive a return of his or her contribution. This provision raises a potential valuation problem under IRC §2704(b) if the operating agreement more severely restricts the right to a return of capital contributions.

Section 17252(a) places no limit on member's ability to restrict a member's right to withdraw: the articles or operating agreement may provide either that a member may withdraw from the LLC only at the time or upon the happening of events specified in the operating agreement of that a members may not withdraw at all. However, notwithstanding any restriction placed upon a member's right to withdraw, §17252(a) gives a member the power to withdraw at any time by giving written notice. In the event a member so withdraws in violation of the operating agreement, the LLC may offset any damages it suffers from the breach against any amounts otherwise distributable to the withdrawing member.

Unless otherwise provided, a withdrawing member is not entitled under §17252(a) to any payment for his or her membership interest, and subsequent to his or her withdrawal, a member shall have only the rights of an economic interest holder with respect to distributions. The withdrawn member shall no longer be a member of the LLC.

In 1998, the California legislature amended §17350 to require dissolution of an LLC only upon the happening of the first to occur of the following:

At the time specified in the articles of organization, if any, or upon the happening of the events, if any, specified in the articles of organization or a written operating agreement.

By the vote of a majority in the interest of the members, or a greater percentage of the voting interests of members as may be specified in the articles or organization or a written operating agreement.

Entry of a decree of judicial dissolution.

Chapter 9 - U.S. Taxpayer Federal/State Income Tax Issues

For both United States and California income tax purposes, under a Grantor Trust (i.e., The Trust) the Settlor is treated as if the Settlor owns the Trust corpus (assets). The Trust income, deductions, and credits are reported annually on the Settlor's United States/California income tax returns (Form 1040/540).

In California, if the Trustee and Trustor (Settlor) of a Grantor living Trust are the same person, California follows the federal rule, and does not require a Trustee to file a separate trust tax return (Revenue and Taxation Code Sections 18401, 18405). For any trust, where separate tax returns are required, a fiduciary, acting on behalf of a Trust must file federal/state tax returns if:

Federal tax law requires a Trust tax return be filed if annual Trust gross income exceeds $600.00 or more.

In California, state tax law requires a Trustee to file a tax return if net income exceeds $100.00 or if gross income exceeds $10,000.00.

Under IRC § 6034(a), if the Trust must file a tax return the Trustee must furnish a statement under IRC §6034(a) to each beneficiary or nominee before the filing date if the beneficiaries receive a distribution, or any item was allocated to the beneficiary.

Tax Compliance

Your personal tax returns (Form 1040/540) are due April 15th (unless extended), which includes Trust income and expense. Estates and other Trusts file Form 1041/541 (annually), which is due on the 15th day of the fourth month following the close of the tax year (IRC §6072(a); §6012(a)(3) and (4)).

Other Trusts must use a calendar year, with Form 1041 due on April 15th following the closed of the calendar year.

Exceptions include:

a. Certain tax-exempt Trusts.

b. "Qualified" Revocable Trusts, which may be treated and taxed for income tax purposes as part of an Estate (IRC §645).

c. Estates have the flexibility of using a fiscal year end (unlike Trusts).

d. Real Property Tax (California)

In California (California Constitution, Article XIII(a)), transfer of California real property to a revocable Trust, or from a Trust to a Settlor is not a change of ownership for tax assessment purposes and therefore should trigger no change of ownership or increased tax (see, Revenue and Taxation Code §62(d)).

Real property is reassessed for tax purposes when a Trust becomes irrevocable and the right to possession or enjoyment vests in someone other than the Settlor (see, Revenue and Taxation Code §§ 61(f) and (g)).

Chapter 10 - California Community Property/Liability for Judgments

California Statutory Collection Laws

CCP Section 695.010(a) provides that all property owned by the debtor, subject to certain exceptions, is subject to enforcement of a judgment. Community property owned by a debtor's spouse is included within the "all property owned by the debtor.” (CCP Section 695.020(b))

Additional costs and interest may be added to the judgment. As money comes in from the debtor to the creditor, it is first applied to satisfy any additional costs and interest, and only then, the principal balance of the judgment. (CCP Sections 695.210 and 695.221) Interest accrues only on the original amount of the judgment unless judgments are periodically re-recorded, in which case interest compounds.

Judgments continue to exist for 10 years from the date of entry of the judgment. (CCP Section 683.020) Judgments may be renewed for additional terms of 10 years. (CCP Section 683.110(a) and 683.120(b)).

Judgments are usually collected through the lien mechanism. The creditor will place a lien on the debtor's real and personal property (by recording the judgment with the county recorder's office or entering it with the Secretary of State), and the lien will be satisfied when the property is sold by the debtor or foreclosed upon by the creditor. Once the underlying judgment is satisfied, the lien must be released. (CCP Section 697.050)

A judgment lien on real property is created when the judgment is recorded in the county where the debtor owns real property. (CCP Section 697.310(a)). The judgment must be recorded in each county where the creditor wishes to create a lien against the debtor. The judgment lien continues to exist for 10 years from the date of the judgment, unless it is renewed. (CCP Section 697.310(b).

A judgment lien on personal property is created when notice is filed with the California Secretary of State and continues for 5 years. (CCP Section 697.510)

In addition to collecting through the lien process, a creditor can collect through the writ of execution. (CCP Sections 699.010 through 699.090) A writ of execution is issued by the clerk of the court where the creditor obtained its judgment. (CCP Section 699.510) The writ of execution directs the county sheriff to secure the debtor's property in that county. Thus, the writ of execution is a levy. A separate writ of execution must be issued for each county where the creditor intends to levy on the debtor’s property. The writ of execution is effective for 180 days.

All property owned by the debtor that is subject to a judgment may be levied upon through the writ of execution process. (CCP Section 699.710) This includes real property, but the levy must first be recorded in the county where the real property is located. (CCP Section 700.015(a)) There are several exceptions, which include the interest of a partner in a partnership or a member in a limited liability company, the loan value of a life insurance contract, and the interest of a beneficiary in a trust. (CCP Section 669.720)

Once the levied property is collected by the sheriff, whether real or personal, the property is sold at a foreclosure sale to the highest bidder, for cash or cashier's check. (CCP Section 701.510) For tax liens, the property cannot be sold until the bid amount exceeds the state tax lien on the property and the exemption amount for the claimed property. Once the property is sold at the foreclosure sale, the lien on such property is extinguished.

Following the foreclosure sale the sheriff remits the amount collected, less certain costs, to the creditor, unless the property was subject to other liens with a priority higher than the judgment creditor. In that case the creditors are paid off in the order of their priority, and any amount left over is remitted to the debtor. (CCP Section 701.810) It is important to note that foreclosures of mortgages are subject to special rules. (See CCP Sections 725a-730.5)

In some circumstances, the creditor may attempt to obtain a turnover order – a court order directing the debtor to turn its assets (usually a specific asset) over to the creditor.

Other Creditor Remedies

At any time while the creditor has a judgment outstanding against the debtor, the creditor may serve upon the debtor written interrogatories demanding information from the debtor which will assist the creditor in satisfying the judgment. Similarly, the creditor may demand documents and records from the debtor which will assist in satisfying the judgment. (CCP Sections 708.020 and 708.030)

The creditor may also require the debtor to appear for a debtor exam before a court or a court appointed referee. (CCP Section 708.110) At a debtor exam, the debtor may be required to produce books and records, tax returns, financial information, witnesses and answer a battery of questions about past employment history, ownership and transfers of assets and any other information that would assist the creditor in locating debtor's assets.

If a creditor has a judgment against a partner in a partnership or a member of a limited liability company, the creditor can apply for a court order charging the interest of the partner/member in the entity. (CCP Section 708.310) Notice of the charging order must be given to all partners or all members of the entity. (CCP Section 708.320)

A creditor may also levy on the debtor's wages through the means of a wage garnishment. (CCP Section 706.020-706.034) The creditor cannot garnish the entire wage of the debtor. Pursuant to federal law, followed in California, the maximum the creditor can garnish is the lesser of: (i) 25% of the debtor's disposable earnings for the week, or, (ii) the difference between disposable earnings for the week, and (b) thirty times the federal minimum wage. (15 U.S.C. 1673(a). The current federal minimum wage is $5.15 per hour. 29 U.S.C. 206(a)(1)) However, if the garnishment is to satisfy a support order, up to 50% of disposable earnings can be garnished. (15 U.S.C. 1673(c))

California Law – Community Property

If assets constitute community property, it is usually irrelevant that the assets are titled in the name of one spouse. The creditor can attach all of the community property, even if only one spouse is the debtor. This may hold true even if the debt arose prior to the marriage. (See CCP Sections 695.020, 703.020 and 703.110.)

In community property states, most property acquired during marriage is treated as community property. Even if property so acquired is titled in the name of one spouse, that merely creates a rebuttable presumption as to the community or separate nature of such property. Because each spouse has a coextensive ownership interest in community property, creditors of either spouse can reach all community property of the two spouses.

However, on divorce, the treatment of the spouses' property is different. All property acquired during marriage, (other than by gift or inheritance) regardless of how it is titled, is treated as marital property, and is subject to a division on divorce. Generally, in a common law state, marital property will be any property owned by a spouse except: (i) property acquired prior to marriage; (ii) property acquired during marriage by gift or inheritance; and (iii) property designated as nonmarital through an agreement between spouses.

During marriage, the creditor can reach only the property titled in the name of the debtor spouse. However, on divorce, all marital property will be divided, regardless of how it is titled and may become reachable by a creditor.

Community Property Jurisdictions – Overview of Community Property

In a community property state there are two types of property: separate and community. (There is actually a third form of property in a community property state: quasi-community property. Quasi-community property is real and personal property, wherever it is located, that would have been community property had the spouse been domiciled (resided) in California when he or she acquired it, or any property acquired in exchange for such property.) Separate property is acquired in much the same manner as in common law states: (i) property acquired prior to marriage; (ii) property acquired during marriage by gift or inheritance; and (iii) property acquired during marriage but as to which the spouses entered into an agreement treating it as separate property. (California Family Code Sections 770(a) and 850(a))

Separate property in a community property state is afforded similar treatment to separate property in a common law state. During marriage, a creditor of one spouse cannot reach the separate property of the other spouse. However, the one important distinction is that in a community property state, separate property is separate for all purposes, including divorce. In common law states separate property may also be marital property, subject to an equitable division on divorce.

Community property is a form of joint ownership of property by husband and wife. It is defined as real or personal property, wherever situated, acquired by a married person during the marriage while domiciled in this state. Each spouse can manage, direct and control community property.

The distinctive feature of community property (Community property states include: Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin.) is that both spouses own coextensive interests in all of community property. This means that a creditor of one spouse can reach all the community property of the spouses.

California Family Law Code Section 910(a) provides:

Except as otherwise expressly provided by statute, the community estate is liable for a debt incurred by either spouse before or during marriage, regardless of which spouse has the management and control of the property and regardless of whether one or both spouses are parties to the debt or to a judgment for the debt.

The liability of community property extends to contracts entered into by either spouse during marriage, to torts of either spouse during marriage, and to most pre-marriage obligations of either spouse.

Characterization of Community Property – Generally

The five major factors affecting characterization of property as separate or community are the following: (i) time of the property's acquisition; (ii) the source of funds used to acquire the property; (iii) whether spouses entered into a "transmutation agreement" to change the character of property from community to separate, separate to community, and from the separate property of one spouse to the separate property of the other spouse; (iv) actions by parties, including actions that "commingle" or combine separate and purchased or money borrowed is presumed to be community property. The general rule is that property acquired during marriage is community property.

For property acquired during marriage, it is important to establish not only the actual amounts of separate and community contributions, but also their respective proportions. Thus, when the property appreciates in value, it will be still possible to apportion.

Pursuing a Separate Business

When one spouse devotes time during marriage to develop his or her separate business and the business appreciates in value, then a portion of that appreciation is attributable to the community. During marriage the time of each spouse belongs to the community, and the time expanded on a separate business is community's time. California courts have established complicated formulas to apportion the appreciation in value between separate property and community property.

Transmutation

Married persons may, by agreement or transfer, and with or without consideration, change or "transmute" the character of their property in any of the following ways: (i) from community property to separate property of either spouse; (ii) from separate property of either spouse to community property; (iii) from separate property of one spouse to separate property of the other spouse. (California Family Code Section 850)

To be effective, a transmutation agreement must be in writing, the spouses must fully disclose their properties to each other, and a transmutation of real property will be effective as to third-party creditors only if it is recorded. (California Family Code Sections 852(a) and (b). See, also Estate of MacDonald, 51 Cal. 3d 262 (1990).)

The law of fraudulent transfers applies to transmutation agreements. (California Family Code Section 851)

The Community Property Presumption

There is a legal inference, called a "presumption," that all property acquired during marriage by either husband or wife or both is community property. (California Family Code Section 760)

The general community property presumption specifically applies to the following types of property: (California Family Code Section 760) (i) all real property, including leased property, that is located in California and is acquired during marriage by a spouse while domiciled (living with intent to remain) in California; (ii) all personal property, wherever located, that is acquired during marriage by a married person while domiciled in California; and (iii) all community property transferred by husband and wife to a trust pursuant to Family Code Section 761. However, the general community property presumption that property acquired during marriage is community property may be overcome by evidence that the disputed property is actually separate property.

Evidence that may be used to overcome the community property presumption includes the following: (i) an agreement between the parties to change the character of (transmute) the property from community to separate property; (ii) tracing property to a separate property source; or (iii) reliance on separate property as collateral when property is purchased on credit.

If the community property presumption cannot be overcome, the party who has made traceable separate property contributions to the acquisition of property may obtain reimbursement in certain circumstances. (California Family Code Section 2640)

There are several statutory exceptions to the general presumption that all property acquired during marriage is community property: (i) property acquired by either husband or wife by gift, will, or inheritance;' (ii) property that either spouse acquires with the rents, issues, or profits from separate property; (iii) property held at death and that a spouse acquired during a previous marriage if that marriage was terminated by dissolution more than four years before death; (iv) any real or personal property interest acquired by the wife by written instrument before January 1, 1975; (v) property acquired by either spouse after separation, unless the property is acquired with community property funds; (vi) property designated as separate by a transmutation agreement; (vii) personal injury damages paid by one spouse to the other spouse if the cause of action arises during marriage; and (viii) personal injury damages received by one spouse from a third party after a court renders a decree of legal separation or a judgment of dissolution of marriage. (See, Family Code Sections 770, 781, 802 and 803)

Effect of Title on Community Property – Joint Tenancy and Tenancy in Common

The general community property presumption applies to all property acquired during marriage, including property titled in joint form, such as joint tenancy or tenancy in common. A spouse intending to rebut the community property presumption for jointly titled property may do so in one of two ways: (i) a clear statement in the deed or other documentary evidence of title by which the property is acquired that the property is separate and not community property; or (ii) proof that the spouses have made a written agreement that the property is separate property.

California community property laws suggests holding assets in a community property form is less desirable than separate property, at least from an asset protection perspective. The reason is that all of community property is liable for the debts of either spouse, whether incurred before or during marriage. Contrast that with separate property, which is only liable for the debts of that spouse who owns the separate property (except for obligations with respect to necessities of life).

In the context of asset protection planning, one may want to convert community property to separate. One way of accomplishing that goal is for spouses to transmute their community property into separate. However, transmutation agreements are subject to the fraudulent transfer laws.

In most community property states, the general rule is that community property can be seized to satisfy community debts even after a divorce. This means that once the community incurred a debt, both spouses are liable for that debt, even following a divorce, and even if the liability has been allocated entirely to only one spouse. (Wilkes v. Smith, 465 F. 2d 1142, 1146 (9th Cir. 1972))

In California, this rule has been changed so that community property awarded to a nondebtor spouse as separate property is protected from the claims of his or her ex-spouse's creditors, even if the debts are community debts. This means that a community debt, which is generally an obligation of both spouses, can be assigned to only one spouse, in California. (California Family Code Section 2551)

With respect to the separate property of spouses following a divorce, the allocation and division of liabilities on divorce in California are as follows: (California Family Code Section 916(a))

Separate property owned by a married person and property received by that person pursuant to the division of property is liable for debts incurred by the person before or during marriage whether the debt is assigned for payment by that person or that person's spouse.

Separate property owned by a Married person at the time of the division and other property received by that person is not liable for debts incurred by the person's spouse before or during marriage and the person is not liable for such debt unless it was assigned to him or her in the division of property.

Separate property and other property received by a married person is liable for debts incurred by the person's spouse before or during marriage and the person is personally liable for the debt if it was assigned for payment by the person pursuant to the division of property.

While a community debt can be assigned to only one spouse (in California) that does not mean that the spouses can assign all of the liabilities to one spouse, and all of the assets to the other spouse. Transfers of property pursuant to a divorce, like any other transfers of property, are subject to the fraudulent transfer laws.

For example, in Britt v. Damson, (Britt v. Damson, 334 F. 2d 896, 902 (9th Cir. 1964), cert. denied, 379 U.S. 966 (1965)) the spouses divorced and the husband filed for bankruptcy. There was a claim that the property transferred to the wife pursuant to the divorce was fraudulent. The court held that although the division of property was not fraudulent under state law, it could be under the Bankruptcy Code's fraudulent conveyance provisions. The court stated:

To the extent that the value of the community property ordered to [the wife] was offset by the value of the community property awarded to husband, the 'transfer' to [the wife] was, as a matter of law, supported by 'fair consideration.’

To the extent that the award of community property to [the wife] may have exceeded half of the total value of the community property, there is a question whether, under all the circumstances, [the husband] received fair consideration as a matter of law.

The Ninth Circuit thus made it apparent that even on divorce, transfers of property can be scrutinized and tested under the fraudulent transfer laws.

In a more recent case, the California Supreme Court attempted to harmonize California Family Code Section 2551 and the UFTA. (Mejia v. Reed, 31 Cal. 4th 657 (2003)) Section 2551 provides that the property received by a person on divorce is not liable for debt incurred by the person's spouse before or during marriage, and the person is not personally liable for the debt, unless the debt was assigned pursuant to the divorce to that person. This means that in California divorce overrides the asset protection disadvantages of the community property system.

In contrast to Section 2551 is the UFTA which provides that any transfer of property is subject to the laws of fraudulent conveyances.

The California Supreme Court reasoned that the California Legislature has a general policy of protecting creditors from fraudulent transfers, including transfers between spouses. Just as the fraudulent transfer laws apply to transmutation agreements during marriage, so do those laws apply to transfers of property on divorce.

Despite the court's holding the transfers of property on divorce are subject to the UFTA, challenges under the UFTA are still limited in the context of divorce and leave room for planning opportunities. Under the UFTA, a creditor can allege that the transfer was either actually or constructively fraudulent.

Constructive fraud requires little more than a finding that one of the spouses was left insolvent – a straightforward and objective analysis. However, actual fraud requires a subjective analysis which makes it more difficult for a creditor to prevail in the context of divorce.

Postnuptial and Transmutation Agreements

Postnuptial Agreements

An agreement between spouses after the marriage ceremony and affecting the spouses' property rights is referred to as a postnuptial agreement. A transmutation agreement is a postnuptial agreement that changes the character of the spouses' property from community to separate, or vice versa.

Postnuptial agreements are governed primarily by the California Family Code Sections 721, 1500 and 1620. Section 721 provides that postnuptial agreements (as opposed to premarital) are subject to the general rules governing fiduciary relationships that control the actions of person occupying confidential relations with each other.

Section 1500 provides general authority for spouses to alter their property rights by a marital property agreement. Section 1620 states that, except as otherwise provided by law, a husband and wife cannot, by a contract with each other, alter their legal relations except as to property.

Transmutation Agreements – Generally

Many postnuptial agreements have as their purpose the change, or transmutation, of the character of the parties' property from separate to community, or vice versa. Spouses are free to alter the character of property in this manner, provided that all statutory requirements are met. A transmutation agreement may be used to change the character of property to be acquired in the future, as well as property that the spouses own at the time of the agreement. (California Family Code Sections 850, et. seq.)

The principal limitation on transmutation agreements between spouses is that (i) they must be fair and based on full disclosure of the pertinent facts, and (ii) they must not be a fraudulent transfer of assets.

The following are the major considerations pertaining to transmutation agreements: (i) except for certain interspousal gifts, transmutations of real or personal property are not valid unless made in writing by an express declaration that is made, joined in, consented to, or accepted by the spouse whose interest in the property is adversely affected; (ii) transmutations may be made with or without consideration; (iii) transmutations of real property are not effective with respect to third parties without notice of the transmutation, unless the transmutation is recorded; (iv) transmutations are subject to the laws governing fraudulent transfers; and (v) a statement in a will of the character of property is not admissible as evidence of a transmutation of the property in any proceeding commenced before the death of the person who made the will.

Tax Effects

Transmutation agreements have certain tax implications. For income tax purposes, if spouses file a joint return, then characterization of property as community or separate is irrelevant, as all income is aggregated. However, if spouses file a separate return, then each spouse must report his or her one-half share of community income, and his or her separate income. Because transmutation agreements change the nature of the property (including earnings and other income), they have the greatest income tax impact on separate tax returns.

Transfers of property between spouses are generally nonrecognition events for income tax purposes, as they are always considered to be gifts with basis carryover. There are a couple of exceptions: (i) transfer to a spouse who is a nonresident alien at the time of the transfer; (ii) transfer in trust, to the extent that the sum of the liabilities assumed, plus the liabilities to which the property is subject, exceeds the total adjusted basis of the property; or (iii) transfer in trust, of an installment obligation. (See, IRC Section 1041)

The more important tax aspect of a transmutation agreement is the effect that it has on basis step-up (or step-down) at death.

On a spouses' death, one-half of the community property belongs to the surviving spouse, and the other half belongs to the decedent. (California Probate Code Section 100) If the property has appreciated in value during the time that it was held, the entire property will receive a stepped-up basis equal to its fair market value on the date of the deceased spouse's death, if the decedent's half of the property was included in his or her estate. (IRC Section 1014(b)(6)) The surviving spouse will receive a stepped-up basis in his or her half of the property, and will therefore have a smaller gain on disposition of that property.

By comparison, if the spouses had held the property separately in joint tenancy with a right of survivorship, the surviving spouse would automatically receive his or her half of the property by operation of law through the original joint tenancy title, and not through inheritance or any other type of succession after death. Consequently, his or her basis would not be stepped up if the property has appreciated, but instead would remain at the original cost basis.

While transmutation agreements are generally desirable from an asset protection standpoint, they may have adverse tax consequences, because of the loss of one-half of basis step up. By carefully coordinating the transmutation agreement with the spouses' will or trust, many of the adverse tax consequences can be minimized or eliminated. For example, if the spouses' residence is the separate property of the surviving spouse, then while the residence will not receive a step-up in basis, up to $250,000 of gain will be sheltered on the sale of the residence.

The loss of the basis-step up on one-half of property is important only if it is anticipated that the surviving spouse will be selling his or her separate property. If the surviving spouse retains her separate assets and sells the property inherited from the decedent (which received a basis step up), no adverse tax consequences will result.

Spouses may enter into a transmutation agreement at any time, during marriage. Accordingly, while the spouses are working or practicing their profession (and they are exposed to risks) they can enter into a transmutation agreement and transfer certain assets to the low-risk spouse. When the spouses retire and risks dissipate, the spouses can enter into another transmutation agreement and convert their separate property back to community, regaining the full step up.

While postnuptial agreements are generally subject to the same notice and recording rules as premarital agreements, the rules for transmutation agreements are slightly different.

A transmutation of real property is not effective with respect to third parties who are without notice of the transmutation unless the transmutation instrument is recorded. (California Family Code Section 852(b)) While recording is not a prerequisite to the validity of the transmutation as between the spouses, it is a prerequisite in making the transmutation effective with respect to third parties who are otherwise without notice. This requirement is consistent with the fact that transmutations are subject to the laws governing fraudulent transfers.

Chapter 11 – The Nature and Risks of Litigation

By Alan Jampol, Esq. with Special Contribution by Landon Schwob, Esq.

LITIGATION IN THE UNITED STATES IS WIDESPREAD, AS IT IS THE PRIME METHOD OF RESOLVING DISPUTES AND ENFORCING RIGHTS

Litigation Issues in General

Those who do business in the United States, with citizens of the United States, or with companies located there, necessarily take certain risks in doing business in a society that is virtually dependent upon litigation to enforce economic, personal, and civil rights. The notion in the United States that a lawsuit can be brought to remedy any perceived ill is firmly embedded in our judicial system. This is especially true where people of lower economic status or creditors of any size or nature have turned to the legal system to in effect seek a redistribution of wealth or payment of any asserted debt regardless how (or whether) incurred.

Access to the courts in the United States is viewed as virtually a Constitutional right and is liberally granted. Almost any kind of claim can be put in the form of a lawsuit and filed somewhere. Filing fees are steep, but are often excused for those unable to afford them. Organizations espousing a broad spectrum of political, economic, and social positions have legal arms that bring lawsuits on behalf of their constituents. Federal and state laws entitle people to bring lawsuits on behalf of society at large as “private attorneys general” or in the form of class actions, usually being entitled to recover their legal fees if they prevail.

It is essential for those who wish to take advantage of the benefits of living in the United States or doing business in the United States or with its residents to understand what kinds of litigation could be brought against them if the circumstances are such that someone feels that he or she is entitled to money that you have. Even if the claim has no merit, the mere filing of a lawsuit almost always results in substantial legal costs to defend the claim as well as often undesired publicity and occasionally stigma (“where there is smoke, there must be fire”). And any litigation has inherent risk of loss that cannot be avoided except by somehow finding a way other than litigation to resolve disputes.

The true facts are often overlooked or ignored in lawsuits over civil matters. The almost universal resort to jury trials means that you will rarely have what is referred to as a “jury of your peers,” but more often than not a jury made of people more sympathetic to the plaintiff than to any affluent defendant, individual or corporate. Juries, who almost always chosen specifically because they know nothing of the subject of the lawsuit or the parties to the action, can easily make errors of judgment or be swayed by sympathy, emotion, or even demagoguery.

Judges also make errors of law. Law libraries are filled with thousands of volumes of decisions of courts of appeals and supreme courts, both federal and state, reflecting claims that the judge made some error at trial – and statistics show that around one-quarter of those cases result in a reversal, which is a finding that the trial judge did in fact make a legal error. This figure is almost certainly understated given the number of cases in which a legal error is held not be prejudicial.

The inescapable moral of this litigious bent in America is that every effort must be made to avoid the courts if possible, and you must always be alert to situations in which a lawsuit against you is likely or even possible. Having experienced legal counsel to help avoid the traps and errors that could result in litigation (particularly successful litigation) is essential. Taking advance precautions to minimize the harm of any litigation is also important, as is the understanding that if you wind up in litigation, you will need to make a substantial financial commitment to see it through.

Breach of Contract Actions

The most common form of lawsuit in the business context is a breach of contract action. Contracts are legally enforceable agreements, and many kinds of contracts need not be in writing, but can be oral or even implied by circumstances. In fact, oral contracts are common, especially in certain industries and involving people who have worked together.

Hollywood producer Samuel Goldwyn once famously remarked that “an oral contract is not worth the paper it is printed on.” Although awkwardly worded, this notion was shown to be far from the fact in a famous case which illustrates what can happen when a claim under an oral contract is made. In a California court, the famous actress Kim Basinger was sued by a producer of the motion picture “Boxing Helena” for breach of a “handshake” agreement (common in Hollywood) to star in the film. There was no written evidence of any such agreement, and Ms. Basinger contended that no such agreement was actually made.

The jury rendered a verdict in favor of the producers for several million dollars. The result was that Ms. Basinger was driven to bankruptcy. The multi-million-dollar award was made solely on the basis of the testimony of witnesses whose memory might have been imperfect, simply wrong, or even falsified. The verdict was later overturned by an appellate court, but it illustrates the risk of doing business without sufficient written evidence of a transaction.

Contract remedies can be expansive. They do not include punitive damages (which are awarded to punish the defendant for conduct found to be malicious, oppressive or fraudulent) and rarely include “emotional,” or “pain and suffering” damages, but they can include lost profits far into the future that the plaintiff (the one bringing the lawsuit) can prove would have been made but for the breach. Some kinds of claims also provide for an award of attorneys’ fees to the winning party, sometime by statute and occasionally by a provision in a written contract. Such fees can run into the millions of dollars depending upon the kind of case and the circumstances.

Two specific kinds of contract claims, the breach by an insurance company of the covenant of good faith implied by law into every contract, and the breach by an employer of an employment agreement, can in some circumstances, give rise to additional damages, such as punitive damages, emotional damages that would not otherwise be available for breach of the contract, and the legal fees incurred in pursuing that very claim. For the ordinary businessman, the most common circumstance in which such an extended claim will be faced is in the employment context if a claim is made against you by an alleged employee (and the definition of “employee” is much broader than it might at first appear and is constantly expanding).

Negligence and Similar Actions

The most common form of lawsuit in American courts is a negligence action. Negligence is the failure to use reasonable care. Reasonable care is governed by the “reasonable person” standard – what a hypothetical “reasonable person” would have done in those circumstances. It does not require perfection, but juries are often unable to recognize that something is not unreasonable simply because it resulted in injury to the plaintiff. Negligence claims include a broad spectrum of claims, from automobile accidents to the maintenance of property that has a defect, to professional negligence (“malpractice”) by lawyers, insurance agents and brokers, architects and engineers, and, of course, doctors.

Negligence claims are often accompanied by claims that the defendant breached a fiduciary duty to the plaintiff. Such a duty arises in certain specified contexts, such as from corporate directors and officers to the corporation and its shareholders, from one partner to another, from a trustee to the beneficiary, from a lawyer to his client, and in general from a person in whom the other person has placed great trust and where the recipient of the trust accepts it and uses it in advising or acting for the person.

A claim for breach of fiduciary duty can be important for several reasons, depending upon the state where the lawsuit is pending, including (i) the limitations period in which a lawsuit for breach of fiduciary duty can be brought is longer than the limitations period for a negligence claim, (ii) the claim of breach of fiduciary duty does not require a showing of negligence and is therefore often easier to prove, and (iii) if the plaintiff proves that the breach of fiduciary duty was done intentionally and either maliciously or oppressively, punitive damages can be recovered (which is not the case with negligence).

The remedies for negligence are broad, and include any harm caused by the lack of reasonable care, even if it could not have been expected. This includes past and future medical costs and loss of income, as well as emotional damages. If the acts giving rise to the lawsuit are deemed malicious, oppressive, or fraudulent, punitive damages may be recovered as well. Punitive damages are damages intended to punish or set an example, and are not intended to remedy the wrong or compensate the plaintiff. Punitive damages may not in many states (including California) be insured, and a judgment for punitive damages or damages arising from intentional or fraudulent conduct is usually not dischargeable in bankruptcy.

Often, more than one person participated in the act or omission giving rise to the claim, which complicates the lawsuit by drawing in other parties as co-defendants or as third party defendants (non-parties against whom a defendant has claims arising from the same circumstances), which claims are usually asserted in the form of a cross-complaint. This can result in a tangle of accusations and liability and almost always results in greatly increased litigation costs.

Statutory Actions

The rise of statutes providing a private right of action (the right to bring a private lawsuit to enforce the statute) is a hallmark of modern American jurisprudence. Such statutes run the gamut from violations of securities, antitrust, and racketeering statutes (“RICO”) to anti-discrimination statutes governing the workplace and many other kinds of statutes. All of these statutes include specific remedies available to the plaintiff or plaintiffs, usually including the legal fees incurred in prosecuting the case (but such fees are not awardable to successful defendants), civil fines, occasionally multiple damages, and sometimes punitive damages if found to be malicious, oppressive, or fraudulent.

Statutory actions are often brought by governmental entities, both federal and state. These might include the Securities and Exchange Commission, the Attorney General, the Internal Revenue Service, the Equal Employment Opportunity Commission (“the EEOC”), state equivalents of the EEOC (e.g. California’s Fair Employment and Housing Agency, or “FEHA”), and other agencies. These agencies have huge budgets and legal staffs that often dwarf that of the law firms representing the defendants and can be difficult to negotiate with.

Fraud Actions

Fraud is an all-too-common claim where one person’s expectations are not met by dealings with another person. Fraud is the making of a factual representation that the maker knows is false with the intent to cause the other person to rely on it to his detriment. It can also be a failure to disclose a fact where the person failing to make the disclosure had a duty to make the disclosure – that is usually the case where a fiduciary duty exists.

Fraud damages are different from negligence damages. They include what are called “out of pocket” damages, which is what the plaintiff actually lost rather than what he expected to gain (as is the case with a breach of contract remedy). The key to fraud is that it is a common source of punitive damages.

Class Actions

One of the most costly and disruptive forms of civil action is a creature of relatively recent development referred to as a “class action.” Courts and legislatures are concerned about the inability as a practical matter of average people to bring lawsuits to remedy wrongs where the amount at stake is small and does not economically merit a lawsuit for those damages. For instance, where a credit card company imposes and collects a fee that the law forbids (e.g. because it is contrary to a statute or the standard form of agreement used or is unconscionable), it might have collected hundreds of millions of dollars from its millions of customers, but each customer has lost only a few dollars in such fees – not nearly enough to merit the costs of litigation. In that situation, the rules entitle a nominal plaintiff to sue on behalf of all persons similarly situated – in other words, a class.

In order to proceed as a class action, a lawsuit must be filed by a person alleging that he or she represents the class of persons affected by the wrongful conduct and the court must "certify" the class. In order to certify a class, the court must find that there are a large number of people who are affected in the same way by the alleged wrongful conduct, the issues as to each are generally the same, and damages or a remedy can be awarded to the class as a whole without the need to hear evidence as to each individual class member. Where each person in the class suffers different damages or there are insufficient common questions of law or fact as to class members, the court will generally decline to certify the class. In that case, the lawsuit can proceed on behalf of the named plaintiffs in their individual capacity rather than as a class, but the action is often at that point abandoned as not economically viable.

Class actions, if certified (and many are not certified as class actions), almost always involve huge amounts of money and huge legal costs to defend. Many such actions are brought under statutes that provide for an award of legal fees to the prevailing class. These actions are almost always prosecuted by lawyers for the class who rely on an award of legal fees under the relevant statute, and such awards are usually quite large.

As a practical matter, class action lawsuits are rarely brought to trial because (i) the legal costs are astronomic for both sides and (ii) however strong the defense might be, the award to the class could be huge if the defendant does not prevail. In reality, class actions are primarily beneficial only to the lawyers prosecuting them. The benefit to each member of the class is usually so small as to be virtually worthless, and many, if not most, of the class members never file claims or get anything. In fact, almost all class actions are settled, with the defendant agreeing to a large fee to the plaintiffs' lawyers in exchange for the settlement.

Class action settlements can be valuable to the extent they include a promise by the defendant to change its business method in some way that it says will remedy the problems identified in the lawsuit. Any class action settlement must be approved by the judge, but such approval is customary in almost all cases.

The individual investor in the United States is far more likely to be a member of a plaintiff class than to be a class action defendant, but if you do business with a large number of people (for instance, employees or customers), there is always the chance that a perceived violation of a contract or a statute protecting those class members will be the subject of a class action against you.

Fraudulent Conveyance Actions

A creditor has the right to bring a lawsuit to invalidate a transfer of property (usually real property) or to impose a lien on that property where he can show that the transfer was fraudulent. A transfer is fraudulent where it is made for no or insufficient consideration at a time when the defendant was “insolvent” (which usually means unable to pay his normal debts as they occur). In California, for instance, the showing required is even less onerous, in that the plaintiff need show only that the transfer was made to “hinder or delay creditors.”

Debtors or potential debtors (for instance, persons who are presently defendants in a lawsuit) often try to avoid loss of their property by transferring the property to relatives, children, or others whom they trust. Sometimes transfers are to offshore corporations or trusts. Unless there is sufficient consideration paid for those transfers, they will potentially be subject to a fraudulent conveyance claim.

If the fraudulent transfer claim is successful, the judgment creditor will be permitted to execute on that property as if it were still owned by the judgment debtor or the court can place a lien on the property for the benefit of the creditor. Moreover, damages, including potentially punitive damages for fraud, can be recovered in appropriate cases by the creditor.

Alter Ego Claims – Piercing the Corporate Veil

Often, individuals with substantial assets decide to do business through a corporation which they control. If this is done, great care must be taken to ensure that the separateness of the individual and the corporation is maintained. Otherwise, the individual could be deemed to be the “alter ego” of the corporation. This disregard of the separateness of the corporation and its controlling principal is known as “piercing the corporate veil.”

Alter ego is a doctrine entirely created by courts in their equitable power to avoid fraud on creditors. If an individual uses a corporation as a “shell” to absorb all of the debts and obligations which otherwise are the liability of the individual and if the court deems that recognition of the separate nature of the individual and the corporation would “sanction a fraud and promote injustice,” the court can order that the debts of the corporation are really the debts of the individual – that is, that the individual is deemed to be the alter ego of the corporation.

The indicia of an alter ego relationship include, but are not limited to, the failure to maintain separate books and records, the failure of the corporation to observe corporate formalities (like having board meetings or keeping minutes and resolutions), comingling bank or other accounts, providing insufficient capital to the corporation, and using corporate funds to pay the debts of the individual (or the converse). While the fact that the individual is the sole officer and/or shareholder of the corporation can be viewed as part of the entire relationship, that alone will not signify and alter ego relationship (such unilateral control is permitted by the corporate law of most states). There is no one objective test – it is always a question of the totality of the circumstances, especially the impact upon the individual’s creditors.

An often overlooked, but dangerous, procedural device in California (and in at least some other states) is the motion after a judgment is entered against a corporation to amend the judgment to add the controlling individual as a judgment debtor. That individual is not entitled to a trial on the merits of the claim – it is done entirely by motion and declaration. The basis of the amendment is that the individual is really the alter ego of the judgment debtor, controlled the judgment debtor in the trial, and should be held liable as a joint debtor on the judgment. Courts characterize it as simply correcting the name of the judgment debtor to the individual to reflect the true identity of the debtor.

Lawsuits Involving Real Property

Various other kinds of actions could have a direct impact upon a person's assets. One such action involves real estate. Real property is a popular investment in the United States by affluent individuals or by foreigners because it is viewed as an excellent long-term investment, stable, of enduring value, tangible, and readily salable should the need arise. In addition, many of those outside the United States want to own American property for the purpose of coming to reside here, either permanently or at least upon occasion. However, real property is also a tempting target for those who contend that the owner owes them money or that they have a right to acquire, own, or use the property which the record owner denies.

As a result, many owners of real property find themselves defendants in actions involving that property. People coming on the property might claim that known defects in the property caused them to trip and fall and thereby injure themselves. The property might be subject to claimed encumbrances (deeds of trust), easements, or other rights of which the owner was unaware and which interfere with his use or ownership of the property. The federal government occasionally uses is broad power to declare a forfeiture of the property if it suspects the owner is engaging in drug dealing, money laundering, or other kinds of federal crimes. One of the more common claims is that the plaintiff has a contract or right to purchase the property and seeks to tie up the property while his claim, often of dubious merit, is litigated.

One of the more common lawsuits involving real estate is a claim that the plaintiff either owns the property or has a right to purchase it at a specified price and terms. Once such a lawsuit is filed, the plaintiff will record a document called a "lis pendens," which is the Latin term for notice of pendency of a lawsuit involving the property. Once this lis pendens is recorded in the county in which the property is located, the property becomes for all practical purposes unsalable and unfinanceable, at least to institutional buyers or lenders. There are procedural methods of eliminating the lis pendens from the official records, but they are not always successful.

Real estate cases often differ from the more usual kind of damage case in one important particular: if title to a parcel of real property is the subject of the lawsuit, the court can, in the proper circumstances, order the parties to complete the transaction for the transfer of the property (called "specific performance") or enter an order adjudicating title to the property (called "quieting title"). Given the value of real estate in America and its potential for use and development, these kinds of awards can have a substantial impact upon the parties and their assets. A quiet title decree can be recorded, establishing the record title of the person in whose favor title is quieted, and a court can enforce by contempt its order of specific performance of a contract to transfer property.

Enforcing Judgments – Collecting the Amount Awarded

In General

The ultimate purpose of a lawsuit is to obtain relief, usually a judgment for money. However, such a judgment has no inherent value; its value is wholly dependent upon whether the plaintiff who holds the judgment can collect it. Various methods are provided by statute to collect judgments, but they can be expensive, time-consuming, and often futile if the judgment debtor lacks sufficient non-exempt assets (often referred to as being "judgment proof") or the assets cannot be located. One of the primary goals of "asset protection" is to legally place one's assets in a form or location that will make them difficult or impossible for a judgment creditor to reach.

Attachment

Most of the methods for collecting a judgment necessarily require a judgment to have been entered. However, there are some statutory methods of at least securing payment by placing liens or equivalent restrictions on assets of a defendant even before the lawsuit results in a judgment. However, for Constitutional and other reasons, these methods are few and are severely limited in use. The primary such pre-judgment remedy is called "attachment."

An attachment is the seizure by the sheriff or other official of property of a defendant that is not exempt (and no assets of a corporation or partnership are exempt, only of individual persons) up to the amount of the attachment (the amount of the claim) and hold them pending the final judgment in the lawsuit. Attachment is strictly limited, and few attachments are issued by courts.

In order to obtain an order of attachment, a plaintiff must prove by admissible evidence that (i) the claim is on a contract, express or implied, (ii) the claim is "liquidated," which means it is of a specified amount or can be quickly calculated to be a specific amount, and (iii) the plaintiff will probably prevail on the merits of his claim. In addition, if the defendant is an individual, the plaintiff must show that the debt arose in the course of the conduct by the defendant of a trade or business (attachment may not be granted where the contract is one to purchase or sell real estate).

Attachments often force settlements, because (i) the defendant is deprived of the use of his property while the lawsuit is pending (it is held by the sheriff), (ii) the plaintiff knows that he has at least some security for a judgment should he ultimately obtain one, and (iii) the issuance of an attachment means that the judge has found based upon the evidence that the plaintiff is likely to prevail on the merits of his claim.

Execution – Collection of a Money Judgment

In the normal case, a judgment for money damages is collected by the use of certain specified statutory procedures called, somewhat morbidly, “execution.” There are a number of ways the plaintiff may attempt to satisfy the judgment, and their use will depend upon the nature of the defendant, the claim, and the assets available for execution.

Execution is usually effected by delivering to the sheriff of the county in which a defendant’s assets are located a copy of the judgment and instructions on where to go to seize the assets, which are then sold, with the proceeds being paid to the judgment creditor to pay the judgment. These instructions might include the name and location of the defendant’s bank, his home (for personal property located there), or any other information that might assist, or is required by, the sheriff in order to locate and seize the defendant’s assets. If the judgment debtor operates a business, the court may order a receiver to take over the business and take possession of and sell its inventory and retain any income to satisfy the judgment.

If the defendant debtor owns or acquires real property, a document called an “abstract of judgment” issued by the court on request can be recorded in any county in which the defendant owns or might acquire real property. The recordation of that document (whose title might vary from state to state) creates a judgment lien on any property owned by the debtor or later acquired by him. There are specific procedural rules for conducting a sale of the property to produce the money necessary to satisfy the judgment, and if the property is the residence of the defendant, that defendant has additional exemptions and protections that make execution on such residence both expensive and time-consuming.

Individuals have certain statutory exemptions from execution, including in most states things like a portion of the equity of a personal residence (in some cases called a “homestead”), pensions and retirement accounts, one automobile (sometimes limited in resale value), clothing, tools of the trade, a small amount in a bank account (e.g. in California, $1,000), and other specific exemptions. These must be claimed in the proper way, which is usually laid out by statute, or the exemption might be lost. There are specified methods for execution on certain kinds of assets, such as intangible assets (e.g. rights or claims against others), judgments against others and other kinds of assets that are not strictly tangible or capable of being physically seized.

If the defendant elects to appeal from the judgment against him, such appeal generally does not stop execution on the judgment by the plaintiff while the appeal is pending. However, such execution can be stopped by the filing of an appeal bond, usually in an amount larger than the judgment (in California, if by an admitted surety, is must be for an amount that is 150% of the amount of the judgment, and if by any other method, such as a personal undertaking, the amount is 200% of the amount of the judgment). If the judgment is affirmed, the plaintiff may look to the bond to recover his judgment, which makes it easier for the plaintiff as well as the defendant (who will have to repay the surety and usually has provided security for that obligation).

The Judgment Debtor Examination

In order to ascertain what assets the defendant has and where they are located, most states provide for a judgment debtor examination by the plaintiff. The debtor is served with the equivalent of a subpoena to appear in the court and answer questions under oath about his assets. The plaintiff, or, if represented, the plaintiff's lawyer asks questions as to what the defendant owns and where those assets are located. If the defendant fails to answer a question, there is a judge available to decide the issue and make whatever orders are appropriate to force the debtor to answer the question. Some plaintiffs' lawyers have been successful in getting an order that the defendant turn over any tangible assets on his person right there at the hearing, which have included things like gold jewelry, an expensive watch, any currency (which is not by definition in an account), or other items.

Prepare for Possible Litigation

One of the keys to successfully resolving claims, with or without litigation and regardless whether the claim has merit, is to prepare to confront the claim. Generally, the defendant will at the outset of the matter be in the best position he will probably be in during the entire matter. That is the time to take all of the prudent steps to prepare to resist the claim so that it can be settled or, if necessary, won at trial.

Obtain Insurance and Keep it Current

One of the most effective ways to avoid loss is to have insurance that will provide coverage for the kind of claim most likely to be made against you. This includes professional liability (malpractice) coverage if you are a professional dealing with clients, property (for any kind of real property, whether residential or commercial), art insurance if you have a collection of any kind of art or collectible, automobile insurance, and a large umbrella policy (an umbrella policy acts both as an excess policy affording coverage in an amount over and above the amount provided by your primary policies and on occasion coverage that is not otherwise provided by your primary policies).

It is important to monitor your policies to keep them in force, to cover any new or different risks or property during the policy term, to increase or adjust the indemnity limits of the policies, and to make sure that any exclusions or exemptions can still be tolerated or should be negotiated out of the policy (which often can be done for an additional premium even during the policy term). Having a knowledgeable insurance broker is essential for this purpose; the broker's services are at no cost to you and will assist you in maintaining the proper spectrum and amounts of insurance as well as represent you in tendering a claim to your insurer.

Preserve Evidence

In many, if not most, cases, individuals or businesspeople can anticipate when a lawsuit will or might be filed against them. When that occurs, it is important to take immediate steps, as indicated below, to preserve evidence and protect your interests. Over time, there are risks that memories fade or even change, employees, partners, or other individuals with knowledge of the facts quit, are fired, die, move, or disappear, documents tend to get lost or disappear or are difficult for anyone but the author to read, and steps to deal with an expected lawsuit can be taken quickly and effectively, sometimes eliminating the lawsuit entirely.

Prevent Spoliation Claims – the "Litigation Hold"

There is occasionally a tendency in some people faced with a claim that they feel might be valid to eliminate the evidence of the wrongdoing. They will destroy evidence and later claim it was lost. This has become dangerous in view of recent statutory and court remedies for what is called "spoliation."

Spoliation means the loss or destruction of relevant evidence by a party. It need not be intentional, but intentional spoliation will usually result in draconian sanctions, which might include striking of your answer to the complaint and entry of your default, even without a trial, or the ordering that certain specific issues are resolved in favor of the plaintiff. There are often money sanctions as well.

In order to prevent the loss of or damage to evidence, any person or firm that realizes that a claim is being made or will be made should immediately adopt what is referred to as a "litigation hold." This means that any document or piece of evidence that might be relevant to a claim must be segregated and preserved so that it can be produced to the other side if requested (and it will almost always be requested). Things like deletion of computer documents or emails (including disabling any automatic deletion setting) must be avoided, the discarding of tangible things that might be evidence prevented, backups preserved, and anyone other than a limited number of people (usually the lawyers and perhaps the CEO or principal) prevented from having access to these documents, files, and things.

Collect documents and other evidence that might later be relevant or useful

Once the litigation hold is put into place, all of the documents, whether in paper, tangible, or digital form, must be collected and transferred to a devoted place (e.g. a file on a computer) that is strictly controlled and to which only specified persons (usually the company's lawyers) have access. In the case where there are large amounts of documents or computer files, these should be inputted into document management systems, either in house or provided by outside vendors. This can be expensive, but this procedure, if done properly, will enable you and the lawyers to search the documents, organize or categorize them in any fashion or in multiple fashions, and access them quickly when needed. It is important to search all of the computers or all of the physical places where relevant documents or other evidence might be located.

If there are documents missing, that is the time to search for them. If something cannot be read, get the author to read it to you and include with the original a clear restatement of the murky portions. If there are problems with the documents because certain information is missing or you recognize that it is inaccurate or perhaps was added after the fact, now is the time to recognize that, talk to the person responsible, and be prepared to explain or somehow deal with the problem when it is recognized (as it probably will be) by the plaintiff.

Contact Consultants or Vendors to Preserve Evidence

As noted, it might require an outside vendor to assist in the creation of a document base where a large number of relevant documents exist or where computer files contain large amounts of material. These vendors, while expensive, are experienced in finding, organizing, and inputting data for later retrieval and use.

If employees or other individuals with knowledge of relevant facts are no longer available, it might be justified to retain a private investigator to locate them and take statements from them. If retained by counsel representing you, those statements will, at least initially, be privileged as described below. In that fashion, you preserve the knowledge and information of individuals that is fresher at the outset than it will ever be, and former employees or partners who are cooperative can be prepared in advance should they be contacted by the plaintiff or an investigator retained by the plaintiff.

Digitize and Back Up Evidence Where Possible

Over time, paper documents can be lost, smeared, torn, damaged, or misplaced. It is therefore important to digitize them as soon as possible. Adobe Acrobat or similar products can accomplish this; if the volume of documents is large, an outside vendor can be retained to do the scanning (which will also result in an organized set of documents that can be searched).

All digitized documents should be consistently backed up, preferably to a “cloud” server that can be accessed from anywhere with an internet connection, is not reliant on local mechanical drives, and usually has a level of security that is greater than local servers. In fact, more and more firms of all kinds are going to the “paperless” office in which hard copies of documents are scanned and then discarded.

Closely Review and Monitor Social Media Sites

Depending upon the nature of the threat, websites and social media sites can be fruitful sources of information about the claimant, the claim, or events that might affect the prosecution of the claim. It has been often remarked about how astonishing it is what people will put on their Facebook, Twitter, and similar social media sites, and occasionally on company websites, and evidence garnered from such sites has occasionally proven to be significant.

It is also important for you to monitor what you or your company puts on your website or social media sites. Many companies have seen their defenses in lawsuits undercut by representations on their website as to their special competence or breadth of service when they later attempt to refute any obligation to provide such competence or service.

Line up and Prepare Witnesses

Talk to Present and Past Employees

Claims and lawsuits are fueled primarily by the testimony of people. Even documents need to be authenticated and often explained, and their source identified by someone. Many documents are difficult to read or confusing or ambiguous, and their authors must explain what was meant and the circumstances giving rise to the document. Of course, many facts involved in claims are established by live testimony of witnesses rather than by documents.

Your employees, agents, partners, joint venturers, vendors or subordinates are usually important witnesses (or potential witnesses) to events giving rise to the claim or allegations. Over time, those persons might leave, go missing, die, or generally be unavailable. Worse, employees sometimes leave under unhappy circumstances (e.g. they are terminated or leave on their own after criticism or demotion) and become the archetypical "disgruntled former employee." Such persons can be dangerous because they often seek revenge and use their testimony to attack the former employer – which becomes unduly slanted against you or downright false.

The key is to get to these employees, agents, partners and others immediately while memories are still fresh and while (hopefully) they are on your side. In some instances, it might be necessary to employ an investigator to locate a former employee, partner, or other witness who cannot immediately be contacted. That involves some expense, so you will have to evaluate the importance of that person as against the cost of locating him or her.

Get Written Statements if Possible

It is important to get written statements signed by the employees so that if they change their testimony later or forget the facts, the statement can be used to impeach them or simply refresh their memory. These statements should always be taken by a lawyer or, better, an investigator retained by a lawyer for that purpose. In that manner, the statements generally remain privileged, although they can sometimes be ordered produced if certain conditions are met.

If Necessary, Depose Key Witness Who Will or Might not be Available Later

Discussed below is the procedure known as a "deposition." In short, this is a formal method of interrogating witnesses in the course of a lawsuit but before trial. However, sometimes a witness is recognized as important before a lawsuit is filed, but the witness is ill or for some other reason might become unavailable. Most states provide mechanisms for taking the depositions of such persons even prior to the filing of a lawsuit. This can include video recording of the deposition so it can be shown to a jury later if a lawsuit is filed and goes to trial.

Consult Experts

Experts are people who know more than the average person knows about a particular subject. While many experts have substantial credentials resulting from experience, important posts, or educational background, that is not necessary to be an expert. Experts are used by people all the time to assist them in the conduct of their business and sometimes of their life. Such experts could include, among others, doctors and nurses, accountants and tax advisors, insurance or real estate brokers or agents, bankers, stock brokers or investment advisors, lawyers, mechanical experts (e.g. car repair and performance experts), and computer specialists ("techies").

In lawsuits, experts are almost always required to explain to juries how and why the event or accident occurred or to analyze the conduct of the defendant (including, if a claim against a professional, whether the defendant adhered to the applicable professional standard of care). Many lawsuits are decided almost exclusively based upon the testimony of experts. It is therefore important that you retain or at least consult with an appropriate expert (or experts) in connection with any actual or potential claim or, to be pro-active, with respect to your own decisions and actions.

Experts who are most often retained and consulted by those who have claims against them or fear that such claims will be made, are lawyers, accountants, tax advisors, and asset protection consultants (many of these people are expert in more than one of these fields). Careful planning can go a long way to avoid problems in protecting income or assets in the event of a claim being made and, more importantly, in the event of a claim being successful.

When litigation occurs or is threatened, it is usually helpful to retain appropriate experts early in the proceeding for use in the lawsuit. Such experts can give you preliminary opinions as to whether there is any validity to the claim, what information must be obtained in order to enable the expert to formulate an opinion for use in court, and in many cases the amount of any judgment that might be rendered in favor of the claimant should the claimant prevail at trial. This is essential for planning both of the litigation itself and of strategy to protect assets in the event of an adverse result.

Formulate Objectives

It is important to give close consideration at the earliest possible time as to what is the objective in responding to a threatened or actual claim. The main questions that should be addressed and, as much as possible at the early time, answered include:

What do you really want to do?

Surprisingly, this obvious question is ignored by many litigants and those faced with claims. They tend to react to events as they occur without giving sufficient thought to what objective they actually wish to attain. Sometimes the objective is simply to gain time, while at other times the objective might be to defeat the claim or keep the claim and the evidence from becoming public.

Some claims should just be settled at the earliest possible time even if it is necessary to pay a bit more than you think the claim is worth. Other claims should be aggressively defended either for moral or psychological reasons or because any loss or settlement will be detrimental to you or your business (for example, certain patent or copyright claims or the proverbial "bet the company case").

When the issue is your real property, you must decide whether you wish to retain the property (e.g. for your own home), sell or lease it, otherwise dispose of it, or do something else with it. Vastly different strategies can be appropriate depending upon which option you choose. If the issue is tax liability, you might wish to settle with the IRS and pay the penalty and interest, fight the assessment aggressively, or perhaps move your assets outside the United States (consistent with the law) in an attempt to avoid seizure by the IRS or the United States government.

What outcomes of the claim are reasonably possible?

It is important to understand early on what possible results could flow from the claim. If it is a money damage claim, what is the maximum and most likely amount that, under the facts, a jury might award if the claimant prevails? If real estate is at issue, is it possible that the property will be lost or compromised if you lose? Will the result be simply a money judgment with perhaps a lien on the property to secure the judgment (which in turn might depend upon whether you wish to keep, sell, or develop the property)? If intellectual property is at issue, there might be potential loss of the right (e.g. a patent or trademark), diminution of the right (e.g. limitation on time or area where it will be protected), or the need to share the property with the claimant.

The possible outcomes must be matched up against your objectives as determined in the prior section so that you fully understand the extent and nature of the risk you are taking by resisting the claim or the benefit you might achieve by aggressively pursuing your own claim. These in turn can be matched up against the costs of pursuing those objectives with the potential outcomes in mind.

What will it cost to achieve your objectives?

This is usually the most important single consideration in the analysis of claims. It does not matter what your objectives are if you do not have the financial ability to attain them. The strongest defense will be useless if you cannot afford to litigate the claim. Different objectives or strategies might have different costs associated with them.

The unfortunate fact is that litigation - or almost any dispute resolution process - in the United States is expensive. Legal fees in the hundreds of thousands of dollars are routinely incurred by litigants in all sorts of cases, and fees in the millions are often incurred (and awarded if fees are recoverable) in the larger cases, such as patent cases, class actions, mass tort actions (e.g. claims arising out of an environmental disaster or an air crash), and in many contested divorce proceedings (given claims of spousal support, child support, custody, and the identification and distribution of community property or property in which the spouses both have an interest).

Insurance is often crucial in that a policy that provides coverage or even potential coverage will almost always provide a defense to a claim. Moreover, having the resources of an insurer available means that there is probably a basis for settlement of the claim using the money of the insurer, sometimes along with your own funds.

Retain Competent Counsel

Retain Counsel Experienced in Civil Litigation as Soon as Possible

Any time a claim is either made or expected (or even suspected), it is prudent to obtain the services of an attorney who is knowledgeable about and experienced in litigation. It is usually less important to retain a lawyer who is a specialist in a particular field; such lawyers are important for general counseling and protection, but where an actual or threatened claim is involved, an experienced trial lawyer is essential. Most trial lawyers can easily learn whatever they need know about the particular field involved from you, from appropriate reading or other sources of information, or from experts retained by the lawyer to testify at trial.

Retention of counsel at the earliest possible date can be crucial. A lawyer can conduct an investigation that is protected by the attorney-client and attorney-work product privileges discussed below. He or she can provide you with a strategy to prevent the deterioration of your position or what kind of defense can be constructed. Sometimes a lawyer can negotiate with the claimant or the claimant's lawyer and resolve the claim even before the lawsuit is filed.

Of most importance, what is done at the outset usually cannot be undone. A privilege that is waived is usually waived permanently and the waiver cannot be reversed. Statements might be made by employees, principals, or others that are unplanned, imprudent, and problematic (or even dangerous) because they were not properly prepared by a lawyer (or instructed not to talk to anyone other than the lawyer).

Where a defense is being provided by an insurer, the insurer will choose defense counsel (there are exceptions in certain circumstances). Defense counsel will have the trust of the insurer and usually be competent in the area being litigated. However, in some circumstances, and always where there is no insurance, the defendant will choose defense counsel.

The choice of counsel is often personal. A friend or relative is often chosen even though such person really has no or insufficient expertise in civil litigation (especially high-stakes litigation). The general counsel for a company is often a poor choice, since he is mainly concerned with advising the company on an ongoing basis and is not engaged regularly in court trying or defending cases.

The notion that a large and "powerful" firm should be retained is usually an error. Some of the best lawyers are members of small firms. Technology has in the last few years provided even small firms with weapons that enable them to successfully match large or wealthy firms, and lawyers in smaller firms almost always charge less than lawyers in large firms (who have huge expenses to pay).

Occasionally, a large firm will be chosen because it has some particular specialty that is needed, or because it does other work for the company and the principals of the company know and trust the firm, and sometimes because the issue is so important to the company (again, the "bet the company case") that is politically necessary to choose a large national firm and pay whatever it charges.

The most important factor in the attorney-client relationship is trust. The client must trust the advice of the attorney and follow that advice even where the client feels that there might be better options. The attorney must trust the client to be truthful, to disclose all of the material facts and not hide anything (even for reasons that seem proper to the client) and to work together to formulate strategy and defend the claim. No one is perfect, and there will be times when expectations are not met or strategies do not attain the desired goal. If there is trust between the client and lawyer, these problems can often be overcome and the claim resolved satisfactorily, if not ideally.

You should have a written contract with the lawyer that clearly sets out what he or she is to do and what they are to be paid for their services (this is required in many states, at least with individuals, but is recommended for all clients). Many disputes between client and lawyer can be avoided by a clear understanding by both of them as what the lawyer is and is not agreeing to do in connection with the claim.

If you are the claimant, some lawyers will take claims like yours on a contingent fee basis, which means that the lawyer gets a percentage (usually in the 33%-40% range) of any recovery you make, but if you lose, you owe the lawyer nothing. If the lawyer is retained to defend a claim, he or she will charge at an hourly rate and will render monthly invoices which he or she expects to be paid. These invoices should be reviewed carefully and any questions asked of the lawyer while the matter is still fresh and problems can be worked out.

Lawyers usually request retainers, which are advance deposits used to pay the fees. These are important to lawyers, especially in litigation matters, because a lawyer is often required to perform a large amount of services before the initial invoice or first few invoices can be generated or before they are paid. Lawyers who fail to obtain sufficient retainers often find themselves owed thousands, and sometimes hundreds of thousands, of dollars by the client who simply declines to pay the bill.

In the absence of an insurance defense, you should be ready to provide a large retainer, because litigation is in effect an investment. If you wish to resist a claim, you must be prepared to financially support that effort. If you are not willing to provide a substantial retainer, prudent lawyers will usually decline to represent you, even if it means passing by what could be lucrative business. Simply stated, if you wish to engage in litigation in the United States, you need to retain a competent litigator that you can trust and to make the necessary investment in the cost of such litigation.

Protect Applicable Privileges

The Nature and Application of Privileges

In each state, the legislature has enacted statutes that provide that certain communications are privileged against disclosure to others. Among these privileges are (i) communications between spouses, (ii) communications between physician and patient, and (iii) penitential communications to a clergyman. The statutes specify who is the holder of the privilege (and entitled to assert it), the nature of any exceptions to the privilege, and how the privilege can be waived. Generally, courts are not entitled to expand upon privileges or create new privileges – that is the province of the legislature.

The two most important privileges to most people, especially business people, are the attorney-client privilege and the work-product privilege. These are discussed below.

The Attorney-Client Privilege

The attorney-client privilege insulates from disclosure communications between an attorney and client, so long as the communications are intended to be confidential (that is, they are not communicated to third parties or made in a context in which confidentiality is unlikely, such as in a crowded hallway or where one has to shout to be heard).

There are a few exceptions to the attorney-client privilege. One such exception is referred to as the "crime-fraud" exception. In most states, if there is evidence that the client is participating in a crime or fraud, the court can hold the attorney-client privilege is inapplicable and order the disclosure of communications between the attorney and client. This exception, while rarely applied, has been from time to time used aggressively by government prosecutors to seek communications between defendants accused of crimes and their lawyers.

The most frequent loss of the attorney-client privilege occurs as the result of a waiver, whether intentional or unintentional. Any privilege can be waived by the holder of the privilege; the client is the sole holder of the attorney-client privilege. If the client discloses a part of the communication or it is provided to someone who is not the client's attorney, it will probably be considered to be waived. This occasionally happens when lawyers inadvertently provide a copy of a confidential communication to the other side as part of a large formal production of documents (which is described below).

The Work Product Privilege

The work-product privilege protects the thought process, opinions, and conclusions of lawyers. To that extent, the privilege is absolute, and disclosure of such thought processes cannot be ordered. The work-product privilege also protects the product of investigation done by a lawyer to prepare the case, including taking statements and discovering evidence. This kind of work product is referred to as "conditional" because it is protected for the most part, but can be ordered disclosed if the other party demonstrates a great need for it and that the information cannot be obtained from other sources. This would include, for instance, the statement of a key witness who is expected to testify at the trial.

Spousal Privileges

An important, but often overlooked, privilege is the spousal privileges. In most states, this privilege is actually a combination of two different privileges. The first privilege is to keep confidential and not be forced to disclose any communications between a husband and wife made during the marriage. The second aspect is the privilege of one spouse to prevent the other spouse from testifying at all against that spouse.

People often disclose confidential matters to their spouse. This is usually seen as part of the protected relationship between husband wife and encourages spouses to not withhold important information from each other. It is a sort of social program designed to promote family closeness and truthfulness.

This privilege can be complicated in a number of ways. There might be a divorce, in which case one spouse might not only feel free to disclose something the other spouse wanted to keep confidential, but might actually welcome the opportunity to do so. There are other issues involving whether something short of traditional marriage will be recognized as creating the privilege, such as where the two people live together as husband and wife without actually getting married. There is no parent-child privilege.

Avoid Waiver or Loss of Privileges

Any privilege can be waived. Waiver is the deliberate or negligent surrender of a known right. Once a privilege is waived, it usually cannot be reasserted or the waiver withdrawn. That is one reason it is important to have legal advice at the outset of any situation in which a claim is asserted or might be asserted - to protect all privileges and avoid waiver.

The creation of a privilege is also important to protect communications you do not want your adversary to have. This is why it is usually prudent to have a lawyer or an investigator for a lawyer take the statements of the actual or potential witnesses. Such statements are work product and can be ordered disclosed only if the other party makes a showing of great need.

Don't Get Divorced or Break Up Until the Claim is Resolved

While a bit tongue in cheek, this advice is actually important to anyone who wants to keep certain communications, assets, or other matters confidential. All too often, we hear of someone convicted of a crime or made the subject of a large civil damage award based upon the testimony of, or sometimes just a tip by, the person's spouse or girlfriend or boyfriend. For instance, the wife often knows all or much of the information her husband wants kept secret (or vice versa), and if there is a divorce, the wife is often anxious to "spill the beans" either to get back at her husband or to maximize the odds that additional community or other property in which the wife has an interest will be uncovered and the wife paid her share.

As an example of what can happen, in a case in which the author was involved, a doctor paid two men to steal from his house while he went on vacation some original and valuable oil paintings he owned so he could make a claim under his art insurance policy and collect the proceeds, which were many times the actual value of the paintings, which had been vastly over-insured as the result of a mistake. The doctor reported the loss to his insurers, and despite a lawsuit regarding the alleged theft; he collected several million dollars in insurance proceeds. However, the two thieves had ignored the doctor's orders to destroy the paintings (they were so famous that they would be instantly recognized as the stolen items) and had kept them hidden. When, a couple years later, one of the thieves broke up with his girlfriend, the miffed woman immediately went to the FBI and told them what had happened and where the paintings were hidden. She was then wired, and the thieves not only confessed, but implicated the doctor, who was convicted of the fraud and sent to prison.

Choose the Battlefield - Choosing Where a Lawsuit Against You Can be Brought is Valuable and Can Occasionally be Done

If a lawsuit is going to be brought against you, you might have some ability to influence where the suit can or will be brought. If this is possible, it can be of great assistance, since the laws of various states might differ as to certain crucial issues. There might be privileges recognized in one state but not in another (or a different scope of protection offered). The plaintiff might have certain rights in one state that he or she does not have in another state. Just as an example, some states have caps on different kinds of damages, such as damages for emotional suffering in some kinds of claims or punitive damages, whereas other states have no such caps.

You might be able to affect in which state the lawsuit will be brought in several ways, depending upon the circumstances. First, you can adopt a particular state as your residence. Second, if the dispute involves a contract, many contracts have venue provisions specifying where a lawsuit can be brought (this has to be done at the contract formation stage). These kinds of provisions, referred to as "forum selection clauses," are usually respected by courts if freely negotiated or the parties to the contract are commercial or sophisticated parties.

Another possible way to choose the state for the lawsuit is to file a pre-emptive lawsuit against the claimant. That can be brought in the state in which the claimant resides (if that is a better venue for you) or perhaps in some other state, such as the state in which the events giving rise to the claim took place. Your claim could be for declaratory relief, in which you ask the court to issue a declaration that you did not breach a contract or do anything improper to damage the claimant. In some states, such actions are governed by statute, and in others they are deemed equitable. Federal courts are usually hesitant to hear such lawsuits, but will do so in a proper case.

Jurisdiction – In What State Can a Lawsuit Against You be Prosecuted?

In order to prosecute a lawsuit against you in a given state, you must have some connection with that state. If you reside there, that is enough. If you reside elsewhere, the court will determine if you came into the state in order to do business and whether you have sought the protection of the state's laws. For instance, if you have an office in the forum state, that is sufficient to establish general jurisdiction over you. If you physically came to the state to conduct business, that will usually be enough.

There are some close cases where the defendant neither resides nor does business in the state, but nevertheless has done something that affects people in the forum state. A common issue today is internet communications and sales. The defendant might reside in one state but use the internet to advertise and sell merchandise on eBay to people in other states. Someone might post what is considered to be a defamatory statement about the claimant on a social media site like Facebook, which affects that person in another state.

Persons and entities that are not located in the United States can be sued in a United States court (usually a federal court) in certain circumstances. Doing business in the United States, selling products to American residents, or using the Internet in a manner that affects Americans are some ways of subjecting yourself to jurisdiction in an American court. There are a number of other bases for jurisdiction over foreign nationals, so it is important to have the advice of an attorney familiar with those issues in conducting your business or personal affairs where there is any chance of some effect upon an American resident or company resulting from your actions.

Federal Court vs. State Court

There are two parallel court systems in the United States – the various state courts and the federal courts. Unlike state courts, which can hear almost any kind of lawsuit (courts of "general jurisdiction"), federal courts can hear only those lawsuits that Congress has authorized to be heard in federal court (they are courts of "limited jurisdiction").

There are generally three kinds of lawsuits that can be heard in federal court: (i) lawsuits in which the complaint alleges a violation of a federal law ("subject matter jurisdiction"), (ii) lawsuits in which there is complete diversity – that is, the plaintiff(s) is or are from a different state than all of the defendants ("diversity jurisdiction"), and (iii) lawsuits that Congress by statute has specifically ordered brought in federal court (e.g. claims against federal employees and agencies, claims against an Indian tribe, claims as between foreign nations, patent lawsuits, etc.).

Even if a lawsuit is filed in a state court, it can be removed (i.e. transferred from a state court) to a federal court by the defendants (all defendants must agree) if it meets the conditions of federal jurisdiction and if the removal is done within thirty days of service of the lawsuit. Assignment to a federal judge is random, and there is no way to tell if you will be assigned to a judge you feel is desirable or one you do not want (for whatever reason).

Many defendants feel that defending themselves in a federal court is better than doing so in a state court. Many state courts are more rural and have little sophistication in certain kinds of matters, juries tend to be (in the view of some defendants) more liberal and willing to award large amounts of money than in federal court, and many lawyers feel that federal judges, who have lifetime jobs, are more ready to decide tough legal issues and, where appropriate, turn even a sympathetic plaintiff away if there is insufficient basis for the claim. There are also many lawyers who feel just the opposite, both plaintiffs' and defense counsel.

This is something that must be addressed at the outset of the case. If a complaint is brought against you in a state court and you and your lawyer believe that you would prefer to have it tried in a federal court, and if you qualify for federal jurisdiction, you will have only thirty days from service of the lawsuit to remove the case to the federal court. If you miss that date, you waive the right ever to remove it later.

What Law Will Govern the Lawsuit

Why it Matters

As discussed earlier, various states might have differences in their laws that affect the claim against you. Federal law might create additional claims or rights that are not recognized by state courts. Some kinds of actions can be tried in either a state court or a federal court (e.g. antitrust and RICO actions). It is therefore important to understand any differences in the laws of various states or federal laws to determine whether you should try to persuade the court that the law of a specific jurisdiction should be applied to the dispute.

Choice of law is different from choice of venue or jurisdiction. Any state court can apply the law of any other state (it must be presented to the court), and federal courts routinely apply the laws of the states in which they sit or any other state as appropriate. Many contracts, especially between American and foreign citizens and between sophisticated parties in the United States have specific provisions as to which law will be used to govern any dispute. In most cases, the court will respect this choice and apply the law of the jurisdiction agreed by the parties.

Normally, Law of Forum State, but Conflict of Law Principles Might Justify Application of the Law of a Different State

The "default" or normal rule is that the court will apply the law of the state in which it sits. This is true of federal courts as well where the rule of decision is state law rather than federal law (which is true in all diversity actions, which are not based upon federal laws).

However, there are circumstances which might change this normal rule. First, as indicated above, the parties might have contractually agreed to the application of the law of a state other than the forum state. Second, there are cases in which two or more states might have a sufficient interest to require its law to be applied. When this happens, it is referred to as a "conflict of laws."

Resolving conflicts of laws is a technical and complex process, but overall, it is likely that the state that has the closest tie to the events giving rise to the claim will have its law applied. For instance, if a resident of state 1 has a dispute with a resident of state 2 concerning an event that occurred in state 3, the law of any one of those states could reasonably be applied. It depends largely upon the expectations of the parties and the strength of the interests of the various states in having their laws applied.

Federal Cases can be Transferred to Other Federal Courts or State Claims Dismissed if the Forum is Inconvenient

The federal courts have broad discretion to transfer to another federal court anywhere in the country any lawsuit if the court considers itself to be inconvenient for the parties. A federal court can also order an abatement of the case, which is that the case is stayed, if there is another case in a state court pending that might result in a decision that affects the case in the federal court.

State courts do not have the power to transfer cases to courts in other states or federal courts, but they can dismiss a case if the court deems the forum state to be inconvenient for the parties. This is infrequently done, because unlike federal courts, state courts are courts of general jurisdiction, which means that they must hear any lawsuit brought to the court (if it qualifies as a valid lawsuit and meets applicable rules). However, it can happen, especially where a party is a foreign resident and the state court concludes that a fair trial can be obtained in a foreign court.

Pre-Emptive Lawsuits ("A Good Offense is the Best Defense")

Being the Plaintiff Has Advantages

As noted above, it is possible that in some cases, a person who expects a claim to be filed against him can preemptively file his own complaint first. There are often good reasons for this.

One reason, as discussed, is that it is occasionally possible for the prospective defendant to choose a court or jurisdiction that might be more amenable to his position but would not be the court in which the claimant would file his lawsuit. For instance, a citizen of a state that is different from the residence of the claimant might be able to file a lawsuit against the claimant in a federal court based upon diversity jurisdiction, whereas the claimant would probably file his lawsuit against you and join a resident of your state, thereby eliminating diversity (all plaintiffs are from a different state than all defendants) and any chance of federal jurisdiction, if that is important to you.

Another reason is that many lawyers believe that there is a psychological benefit to being the plaintiff and taking affirmative action rather than in effect "sitting back" and waiting to be sued. Many juries will tend to view a person more positively as a plaintiff seeking relief by claiming he was harmed than they would if that person with the same claims is a defendant being sued. Also, the plaintiff gets to present his case to the jury first, and since primacy (what one hears first) has been said to be common in jurors, it is important that jurors hear your story first. The claimant might have a long time in which to file his lawsuit, while the pendency of the claim alone might cause problems with you psychologically or with your business. In those circumstances, it could be helpful to initiate the action to at least get it going so it can be resolved quickly and regardless how it comes out, the matter can be put behind you.

Choose the Kind of Claim to Assert

The first thing to be decided is whether you can bring a viable affirmative claim against the claimant and, if so, what kind of claim to bring. The most common kind of claim brought by a person who is really responding to a claim by someone else is for declaratory relief – that is, a declaration that there is no duty owed to the claimant or that any duty owed was not breached. In most state courts, those kinds of claims can be brought, but it is more difficult in a federal court given the statutory restrictions on what the court may or need hear.

If you have a damage claim that you can assert, even if small, you can assert it in a complaint in a state court. In a federal court, the claim must involve not only complete diversity, but at least $75,000 in damages.

Choose Where to Bring It

This is the same question addressed earlier, which is where is the best place to bring the claim. If in a state court, you must decide where it can be brought and then bring it in that state. If you wish to bring it in a federal court, you must be sure you can comply with all of the requirements of jurisdiction of a federal court. One of the benefits of bringing the claim first is that it is occasionally the case that an affirmative claim meets the requirements for federal jurisdiction and can be brought in a federal court (if that is the desire), whereas a claim first made by the adversary in a state court often cannot be removed to a federal court.

Expect the Counterclaim

If you file your affirmative claim first, you should expect the adversary (who would otherwise have been the plaintiff) to assert his claim by a counterclaim (some states would call it a cross-complaint). Most courts have the discretion to rearrange the position of the parties, and some judges will see the reality of the fact that the defendant simply got to the courthouse first and order that the positions be changed so that the real claimant is designated as the plaintiff.

What a Civil Lawsuit Involves

The Outline of a Civil Lawsuit

Civil lawsuits can be said to involve three things: time, money, and risk. The United States has exceeded by far all other countries in the extent to which private disputes and claims are resolved by litigation. The United States boasts over one million lawyers (although not all of them actually practice law or do so in law firms), and courts in all states are consistently creating or extending bases for lawsuits. In addition, state legislatures and the United States Congress are busy crafting new laws that inevitably spawn additional grounds for civil actions.

A civil lawsuit can basically be said to be divided up into four phases: (i) the pleadings, which initiate the lawsuit and circumscribe the issues to be resolved; (ii) discovery and trial preparation, in which the parties use formal mechanisms for finding out what evidence exists and get it ready to produce at trial, (iii) the trial, where the evidence is presented to the jury (or the judge if there is no jury requested) and the judge makes the necessary decisions as to what the law is, and (iv) at least in some cases, appeal from the judgment.

All states and the federal courts provide detailed rules for all four parts of a lawsuit, setting forth the requirements of the parties, the powers of the court, and sanctions or penalties for any failure to comply with the rules. These rules are found in statutes, in rules promulgated by state agencies (like the California Judicial Council), by local courts, and sometimes by individual judges. Federal cases are governed by a uniform set of rules, the Federal Rules of Civil Procedure, which are updated by the Supreme Court from time to time.

Pleadings

A civil lawsuit is initiated by the filing in the court of a document called a complaint. The complaint sets forth the facts claimed by the claiming party (called the "plaintiff") and the legal theories asserted (e.g. breach of contract, negligence, fraud, etc.) and asks for monetary or, occasionally, nonmonetary relief (e.g. an injunction or order quieting title) in what is called "the prayer." In some instances specified by statute, the claim could be by a petition, but it serves the same purpose as a complaint.

It is important to carefully analyze any complaint which names you as a defendant. The plaintiff will be bound by any fact alleged in the complaint, and the legal theories asserted will govern the scope of the trial, discovery, and almost all other aspects of the case.

Jurisdiction is exercised over a defendant by personal service upon him of a summons, which tells the defendant that he has been sued, that he must respond within a stated amount of time, that if he does not, his default will be taken, and where he should send his response. There are methods of service other than actual personally handing the summons and complaint to the defendant, but all are designed to notify the defendant of the lawsuit and of his legal obligation to answer the complaint.

In the federal court and in many state courts, each lawsuit is immediately and randomly assigned to a judge for all purposes from that point through the end of the case. In other courts, a "master calendar" method is used; any pretrial proceedings are heard by different judges assigned to those specific kinds of proceedings, and the trial judge is assigned only when the case reports ready for trial on the assigned trial date.

Motions

Once the lawsuit is filed and served, there are a number of different motions that could be made. A motion is simply a request for some ruling or relief from the judge in the case. It is impossible here to describe all of them, but generally the following are common types of motions:

Pleading motions

Initial motions attack the validity of the complaint and in some cases whether the court even has jurisdiction to hear the case. Motions to quash service attack the validity of the service or the jurisdiction of the court (especially in federal court, where jurisdiction is limited by statute).

A common motion is a motion to dismiss for failure to state a claim (in California, called a "demurrer"). This motion asserts that the plaintiff is simply not entitled to any relief even if everything he alleges is true. If the motion is granted, the plaintiff will usually get at least one opportunity to amend his complaint to remedy the flaw found by the judge, but that is not required, and some motions finally dispose of the lawsuit because it does not state a cognizable claim against the defendant. This motion is based solely on the allegations of the complaint, not what the evidence actually is, and such motions are infrequently granted.

A pleading motion that has appeared in the last few years is generally referred to as an "anti-SLAPP" motion. SLAPP is an acronym for "strategic lawsuits against public participation." If the complaint alleges that the defendant did something in the context of a matter of public importance or by which he exercised his Constitutional rights to petition, associate, or speak freely, the defendant can move to strike the complaint unless the plaintiff can present evidence that his claim is valid.

The anti-SLAPP motion is powerful in many ways. If granted, the complaint is dismissed. A prevailing defendant is also entitled to recover from the defendant the attorneys' fees incurred in making the motion. Importantly, once the motion is made, the case is automatically stayed (so that the parties may take no further formal steps, including formal discovery) until the motion is heard and the result is final (often on appeal). These kinds of motions are designed to stop pre-emptive lawsuits by those who are adversely affected by public debate, such as developers whose projects are held up by groups citing environmental or social problems with the project.

Injunctions, attachment, or prejudgment relief

A number of motions can be made while the lawsuit is pending, depending upon the relief sought. An application (made before the defendant answers the complaint) or a motion for a preliminary injunction is made where the plaintiff wants to stop the defendant from doing something until a final judgment is issued. Motions can be made to amend a complaint or to file a cross-complaint (an attack against a person who did not bring the lawsuit). Motions for attachment (or claim and delivery, which is a request to order the turnover of specific property before judgment) are discussed above. Discovery motions are discussed below.

The common characteristics of motions are that they are expensive to prepare and file, expensive to resist, take time which could often be devoted to more constructive actions, and the court usually has the power to require the losing party to reimburse the prevailing party on the motion for the attorneys' fees incurred in bringing or resisting the motion. Thus, careful thought should be given to any motion before bringing or opposing it, and satisfactory relief can often be obtained by agreement between the parties without the need for a motion (and courts in virtually every state will require such an effort be made before a motion is filed).

Summary judgment or summary adjudication

One of the most important pre-trial motions is called summary judgment. This is a dispositive motion that, if granted, will result in a judgment for the prevailing party without the need for a trial (thus "summary" judgment). In some cases, less than all of the issues can be determined by such a motion, called "summary adjudication."

The key to summary judgment is that the "material" facts – the facts that govern the outcome of the case – are not in dispute. The role of a jury is to determine the facts, so if there is no dispute as to what the facts are, there is no need for a jury – no need, in other words, for a trial. The judge makes the determination of the legal consequences of the undisputed facts. Thus, summary judgment is often appropriate where the plaintiff cannot really prove a claim, but that is not necessarily apparent from the complaint itself. Cases in which the defendant contends that he has no duty to the plaintiff (and therefore cannot breach a duty) or where there is no evidence that anything the defendant did was a cause of damage to the plaintiff are often appropriate for summary judgment motions.

Because summary judgment deprives the losing party of a trial, it is rarely granted. There are onerous statutory requirements for such a motion, which makes it quite expensive to prepare and pursue (and oppose as well). It is relatively easy to defeat; all the opposing party needs to do is create a dispute as to one material fact. If such a dispute exists, there can be no summary judgment. It does not matter whether the opposing party will prevail on that fact or whether his witnesses will be believed; all that matter is that there is a dispute as to at least one material fact.

Some summary judgment motions are granted, and they are a powerful weapon if available under the circumstances. The pendency of a summary judgment can often lead to a negotiated settlement, as the opposing party (often the plaintiff) must not only incur the costs to oppose the motion, but he knows that it might be granted (and if it is, he loses his case).

Miscellaneous motions

Complicated procedural rules and statutes provide for a variety of other kinds of motions. They might include a motion to consolidate two cases into one or sever a single case into two or more different cases, motions for continuances (postponements) of trial or hearings, motions to dismiss for failure to prosecute a claim, motions to substitute parties (often necessary when a plaintiff or a defendant dies and his or her estate must be made the formal party), and others.

Discovery

Most lawyers and judges recognize that the single most expensive and time-consuming aspect of civil litigation is discovery. Formal discovery is the use of specified statutory procedures to find out information from the other side or from third parties, to obtain documents and other tangible evidence, and to gain admissions that can be used at trial or occasionally to support a summary judgment motion. Formal discovery is expensive, disruptive, and often gives rise to disputes which take additional money and time to resolve (and sometimes are not resolved).

There are generally four kinds of formal discovery devices:

Depositions

The most expensive and contentious of discovery devices is the deposition. A deposition is the taking of oral testimony before a court reporter under oath exactly as it would be in a courtroom, but done usually at a lawyer's office and without the presence of the judge. Without a judge to rule on objections, lawyers frequently clash as to the propriety or form of questions or the sufficiency of the deponent's answers.

In order to avoid the most egregious of disputes, there have been in recent years limits put on depositions in various courts, sometimes the length of a deposition (e.g. seven hours), the number of days or sessions of a deposition of a person, and how many depositions can be taken without the permission of the judge. There are limitations as to where a deposition may take place and often when. Where the judge considers it helpful, he or she can appoint a discovery referee to decide all discovery disputes. In extreme cases, the referee can actually sit in on a deposition to rule on objects at that time.

Depositions can be recorded on video, but they always result in a written transcript setting forth every question and every answer as well as anything said during the deposition by anyone there unless the lawyers agree that some colloquy is "off the record." The transcript is bound into a booklet that is furnished to the deponent for correction as necessary and for signature under oath. Exhibits referred to in the deposition are often attached to the deposition transcript so the testimony can be followed as to such documents.

Many trials have featured attacks on the testimony of witnesses whose testimony changed between the deposition and their testimony in court. Deposition testimony can be used in court if at the trial, the witness is unavailable to testify (e.g. deceased, incapacitated, moved out of the jurisdiction, or in some cases cannot be found) and can be used to support or oppose a summary judgment motion. Depositions are often the most important part of the pretrial preparation, and attention must be given to preparing witnesses for deposition and in making any corrections to the transcript that are necessary or important to avoid a mischaracterization of the testimony.

Interrogatories

Interrogatories are written questions one party sends to another party (they are not used with non-parties) which must be answered in writing and under oath. Some states, like California, have form interrogatories (issued by the Judicial Counsel for use in every case), which can be supplemented by special interrogatories (those prepared by the attorney regarding the specifics of the case). The answers are drafted by the lawyer for the responding party, and the rules require that party to obtain the information from every source under his control (including at a minimum the lawyer and, for a corporation or business, all of its officers and relevant employees).

Objections can be made to interrogatories, and if made, they must be resolved by a negotiation with the other party or by a motion to the court. Interrogatories are excellent ways to obtain general information about the party or his case, such as witnesses, employees and others who have knowledge of material facts, whether there are any photographs or other tangible evidence, and the legal and factual contentions of the parties.

Interrogatories and the responses must be carefully drafted to avoid ambiguity or the making of an unintended admission. There are often disputes as to the sufficiency of an interrogatory or of a response. Rules almost always require the parties to meet and confer (in person or by telephone or email) about the disputes before bringing the matter to the court on a motion.

Requests to admit facts or the authenticity of documents

A discovery device (which is not really "discovery" in that it is not intended to uncover facts or evidence) that is used far less often than it could be is the request for admissions. A party (these are not used with non-parties) can be asked to admit that certain facts are true or that certain documents exist and are authentic (which must be shown to get them admitted in evidence at trial). The response must be in writing and under oath, and can be an admission, a denial, and objection, or a statement that the responding party does not have the information necessary to enable him to admit or deny the request.

If admitted, a fact is established and need not be proved at trial – and may not be disputed by the admitting party. Many preliminary facts can be established this way, as the parties often will not dispute them. Things like proper licensing, the status of persons as employees, partners, or otherwise of the responding party, and other facts that are not really in dispute can be established in this manner. This saves a great deal of time at trial and admissions can be used to support summary judgment motions.

Requests for admission are especially useful in connection with documents. The responding party can be asked to admit that documents are genuine, that they were sent or received (on a certain date if appropriate), that they were never amended or changed, that they were authored, sent, or received by a specific person, or anything else about a document or set of documents.

While denials cannot be challenged, if a responding party denies a fact is true or that a document is authentic and such fact is proved at trial, the trial judge has the power to award to the party proving the fact all of the attorneys' fees incurred in making that proof, which can be substantial.

Independent Medical Examination or Examination of Property

Where medical treatment is an issue (as in a personal injury lawsuit), a party may demand that the plaintiff be subject to a medical examination by a physician selected by the party making the demand. There are usually limits or conditions as to such examinations (as to time, who may be present, whether anything will be recorded, etc.), but they are done as a matter of course where the medical condition of a party is at issue.

In addition, any party may demand to inspect any property or thing at issue in the case. In a product liability suit, it might be the product or the remains of the product. In a case involving a car crash, it might be the autos involved. Where the case involves real estate (common examples are construction defect lawsuits or disputes over a property line), the examination might be of the property involved, including its interior and outbuildings. These procedures are rarely subject to disputes or motions.

Discovery Motions

Any form of discovery can, and many do, result in a motion to compel or prevent a specific kind of discovery. Discovery motions are provided for by the statutory scheme in virtually all courts, but there is almost nothing more likely to stir the anger or frustration of a judge than a discovery motion. Discovery motions consume a lot of time and cost a lot of money to pursue or oppose; judges are convinced (and it is usually true) that the vast bulk of such disputes can be resolved by a good faith negotiations between counsel. Such negotiation (the "meet and confer" process) is a requirement before any discovery motion can be filed, and most discovery motions result in an award of attorneys' fees to the prevailing party.

Designation of Experts

While usually contained in the statutory framework of discovery, the rules governing the designation of expert witnesses at trial are not really discovery. These rules set forth the time within which experts must be designated, how they are to be designated (that is, what must be disclosed to the other parties), and what happens if experts are not timely or properly disclosed. Since the use of experts at trial, and especially in jury trials, has exploded, it is critical to be sure that your experts are chosen early, timely and properly disclosed with all of the required information, and are prepared for their testimony.

Courts in many states have held that where an expert testifies to certain opinions in his deposition, he may not testify to contrary opinions or additional opinions at trial. This can be a problem where the expert is not fully advised as to the issues, is not provided early on with all of the evidence and documents he or she needs to form a proper opinion, or inadvertently fails to disclose all of his or her opinions in the deposition (assuming that the proper questions were asked). In addition, an expert will often be limited at trial to the opinions regarding specific issues set forth in the document designating him or her, so that document must be broad enough to incorporate any opinion the expert is expected to give at trial.

Mediation and Settlement

With the mounting costs of a trial, the financial distress of courts that are unable to provide the number of judges, courts, personnel, and resources to deal with the ever increasing tide of civil lawsuits, the entire legal community and state legislatures have sought ways to reduce court congestion and to resolve cases without the need for the costs, time, and risks of a trial.

The best and most effective way to eliminate unpleasant surprises, to save money, time, and disruption, and to avoid the inevitable risks of a trial, is settlement of the claim. Lawyers feel that almost every claim has a reasonable settlement value once all of the costs, risks, and objectives of litigation are taken into account. Moreover, in addition to insuring against an extreme and unexpected result (a complete loss by plaintiff or a huge judgment against the defendant), settlement prevents what might be embarrassing evidence from being presented in a public forum (a courtroom).

While settlements can be, and many are, negotiated between the parties on their own, a more formal settlement mechanism has evolved in the past two decades – mediation. Mediation is the use of a trained mediator (almost always an experienced attorney or a retired judge) to help the parties recognize the strengths and weaknesses of their cases and reach a negotiated settlement. The best mediators are not necessarily expert in the specific area involved in the litigation (although this helps), but in helping parties reach consensus and agreement without the kind of emotionalism that often prevents clear analysis of the value of a claim.

Mediation is now used in the vast bulk of civil cases, and a whole industry of tribunals with a stable of lawyers and retired judges specially trained in mediation has developed to accomplish mediation in virtually every kind of case. Mediation is supported by statutes which make statements and positions at mediation confidential and inadmissible for any purpose at trial or otherwise. This makes it easier for the parties, their lawyers, and the mediator to discuss openly and frankly the case and its strengths and weaknesses in order to bring the parties together to reach a settlement.

Mediators are expensive (they charge by the hour, as do most lawyers), and there is additional expense of the lawyers attending the mediation and preparing the briefs that are usually filed in advance of the mediation. However, experience has shown that this expense is usually dwarfed by the savings in fees and costs and avoidance of risk (so that the result is liquidated and known) of a settlement that the mediator was able to achieve which the parties probably would not have achieved on their own without mediation.

Courts usually require a formal "mandatory settlement conference" with an active judge (how is not the trial judge) prior to trial, but such settlement conferences can usually be waived if the parties engage in private mediation.

Trial

Jury Trial vs. Court Trial

The formal objective of every lawsuit is a trial (assuming that summary judgment was inappropriate). The trial is a formal courtroom proceeding in which the parties present evidence of the facts and the judge makes decisions as to the law. In most civil cases, the trial can be before a jury or before just a judge (referred to as a "court" or "bench" trial). In most cases (there are exceptions for some kinds of cases involving equitable issues or some statutory claims), any party may demand a jury trial. This requires the demand to be made at the proper time and the payment of jury fees, which can get expensive in a long trial.

The right to a jury trial is a highly regarded and protected right in the United States (there are no jury trials of civil actions other than defamation in Great Britain), but the right to a jury can be waived or in some cases denied as a sanction for violation of a particular rule.

The general feeling among lawyers is that juries tend to be more sympathetic to plaintiffs and injured people, that they are more willing to award large amounts of damages to plaintiffs, they are far more willing than judges to award punitive damages where available, and they are generally unsympathetic to lawyers, professionals in general (other than doctors, who are revered), landlords, vendors, employers, and corporations. Conversely, judges and arbitrators (see the discussion on arbitration later in this article) are viewed as being more conservative and less emotional, more sympathetic toward business owners and professionals, less likely to award large emotional or other damages and less likely to award punitive damages.

These characteristics, whether or not accurate, apply mostly to trials in which an individual is seeking damages from a corporation, a professional, or someone who is perceived as being wealthy. When purely business disputes are presented to juries, they tend to be less emotional and more willing to see both sides of the case.

These are, of course, generalities, and much depends upon the actual nature of the jury selected (if a jury trial) or the character of the judge (in a non-jury trial). Even in a jury trial, the judge will make legal determinations that will probably have a significant effect upon the issues. However, on the whole, other than for purely business cases, plaintiffs' lawyers want a jury from whom they believe they have a much better chance of obtaining a verdict for their plaintiff client for a larger amount of money.

It stands to reason that certain kinds of cases are better for plaintiffs and worse for defendants when tried to a jury. For instance, there are few jurors that are property owners or landlords, but plenty of jurors who are tenants. Few jurors are employers, but most jurors are or were employees. Doctors are usually respected and appreciated by jurors, but most jurors have resentment at long term care facilities and nursing homes – and there are usually no nurses or operators of such facilities on juries in those cases.

Jury trials take much longer (and are therefore more expensive, dislocating, and emotionally taxing), take a great deal of work, and have a marked effect upon how the case is presented. A court trial is usually shorter, costs less, gets to the heart of the matter more expeditiously and effectively where economic or non-emotional claims are involved, and occasionally results in greater or more extensive relief to the plaintiff than a jury would award.

Conduct of a Jury Trial

Jury trials are often difficult because there are so many subjective aspects of a trial. Jurors are chosen mostly because they either have some sort of sympathy for the position of one of the parties or they are completely bereft of any knowledge that might help them decide the case (the lawyers believe that they can better influence a juror who has no preconceptions). It is well known that many prospective jurors do not tell the truth in jury selection, and often prejudices that affect the case come out during deliberations – and many times do not come out until long after the trial is over.

The jurors first must be chosen, which is often a difficult chore. In federal court, the judge will do all of the questioning; in state court, the attorneys do most of it. Jurors are asked questions intended to reveal any biases or preconceptions they might have, and some jurors are excused for cause on the basis of their responses (if they evidence some bias or prejudgment of the case).

Each side is given a number of "peremptory" challenges (usually six or less per side in a civil case depending upon the jurisdiction) which they can use to excuse a juror for no cause at all. Normally, a jury in a state court is made up of twelve people with two or more alternate jurors (in case a juror must be replaced after the trial starts), while in federal court, there are generally six jurors. In state court, a verdict requires the vote of nine of the twelve jurors, while in federal court, the verdict must be unanimous.

After the jury is selected, the lawyers give opening statements as to what they believe the evidence will be (based largely upon the discovery done in in the case). The plaintiff then puts on his evidence, after which the defendant puts on his evidence. The plaintiff is entitled to put on rebuttal evidence, but in many cases, that is dispensed with.

After the evidence is complete, the judge instructs the jury as to what the law is that they must follow. The lawyers have each submitted in writing the instructions they want the judge to give. Most jury instructions are standardized instructions designed for the kind of case tried (occasionally modified to fit the specific facts), but there are almost always some specially prepared instructions by the attorneys to cover the specific issues of the case.

The proposed instructions are discussed with the judge before the matter is submitted to the jury, and usually before the attorneys give their final argument, and the judge decides which ones he or she will give. Thereafter, the lawyers argue to the jury why they should decide for one side or the other, and when that is complete, the matter is submitted to the jury for its verdict. The verdict can come in the form of a simple statement of who won and, if the plaintiff, the amount of damages awarded (a "general verdict") or answers to specific questions posed by the court at the request of the parties (a "special verdict").

Jury trials can be frustrating not only for the parties, but for the jurors as well. Objections to the attorneys' questions are often made. If they are sustained, jurors resent the lawyer because the objection deprives them of testimony they otherwise would hear (and now want to hear).

Objections often have to be discussed with the judge outside the jury's presence, which makes everyone in the court wait until that discussion is over and the ruling is made. There are delays when jurors are late or when a lawyer or the judge must attend to another matter for a short time. As time goes by, especially in a longer trial, the jurors become less receptive to evidence and more interested in when they can go home. Naturally, this tends to work to the detriment of the defendant, who puts on his evidence last.

Conduct of a Non-Jury (Court) Trial

A non-jury trial has most of the features of a jury trial, in that the lawyers can make opening statements, put on evidence, argue objections, and then argue the case to the judge. However, there is no jury selection, opening statements are usually short because pretrial briefs are filed which usually have everything an opening statement would have, there are no jury instructions, and argument is less passionate because there is far less emotionalism involved than when arguing to a jury.

The court (non-jury) trial goes much faster without the need to deal with issues involved in a jury trial. Briefs that are produced outside the court in the lawyers' offices take the place of most argument, and objections can be quickly disposed of quickly in open court. When the matter is concluded, the judge will set forth his factual and legal findings in a document called in most states a "statement of decision" or in federal court "findings of fact and conclusions of law" so that the lawyers will know what facts he found to be true and what his legal reasoning was that supports his ultimate decision.

Post-Trial Proceedings and Appeal

Whether a jury or court trial, there are a number of post-trial motions that can be made to attack a jury verdict or a judge's findings, to seek a reduction in the amount of damages, or to request a new trial on all or some of the issues. There are strict time limits for such motions and some specific requirements as to what must be provided.

All such motions must be decided within the time allowed for appeal, or they are deemed denied. Some motions are made after entry of the judgment, such as a motion challenging the claim by the prevailing party of statutory costs or a motion by the prevailing party in appropriate cases for an award of attorneys' fees.

There are strict time limits in state and federal courts for appeal from a judgment, and these limits are usually jurisdictional – which means that an appeals court does not have the power to extend them or relieve a lawyer from any error that resulted in a late appeal. Appeals can take a long time; they usually require extensive briefing by the parties, provision of a complete trial record (which can be enormous for a long trial), and in the end, argument before a penal of three appellate justices. Depending upon the jurisdiction, the appellate process can last from one year to several years.

The vast majority of judgments are affirmed on appeal. The opinion of the appellate court can be ordered published if it deals with a novel issue of law or is for some other reason instructive to lawyers and clients generally, and when published, the opinion becomes part of the body of law upon which trial courts and other appellate courts may rely in making legal decisions at trial or on appeal.

Appeals to the supreme courts of the states or the United States Supreme Court are not matters of right, but are at the discretion of those courts. Only a tiny fraction of cases in which review by a state supreme court or the United States Supreme Court is sought are accepted by those courts.

What a Lawsuit Costs

The Factors that Govern Cost

Litigation is expensive and growing more so every year. Filing fees for filing a complaint or an answer (there is no fee for filing an answer in a federal court) or for various motions abound. Jury fees are getting more expensive, and for a long trial, the jury fees (which must be advanced by any party requesting a jury) can be substantial. Court reporters must be paid for their work at trial in taking down the testimony, and if transcripts are ordered, expenses can skyrocket.

The most expensive part of a trial is discovery. Depositions involve not only the lawyers' time, but the costs of the court reporter, sometimes the rental of a room, the videographer where depositions are video-recorded, and travel to and from depositions (some of which might occur in other states or cities and occasionally in other countries).

One of the increasing areas of expense is the production, organization, and use of documents. More and more cases involve huge amounts of documents, occasionally going in to the tens of millions of pieces of paper or digitized pages. The cost for digitizing these in an organized fashion so that they can be searched, made available to the lawyers and the court, shown to jurors or the judge at trial, and produced to the other side can be astronomical. Some of the largest law firms have this capacity in-house, although it is still expensive, but most firms use outside vendors for this purpose. It is not unusual for such costs in a case with a large number of documents to run to the hundreds of thousands of dollars.

Attorneys' Fees

The single biggest cost to the client is the fees paid to his attorney. Plaintiffs often retain attorneys on a contingent fee basis, in which case the lawyer takes a percentage (usually between 33% and 40%) of any amount recovered if he wins, but is paid nothing if he loses. While naturally risky to the lawyer, a big “hit” can in one case make a plaintiffs’ attorney wealthier than the highest level partner in the largest business law firm.

Defendants are not in a position to pay a contingent fee, because they are not usually seeking affirmative relief. The largest law firms charge in the four figures or high three figures per hour and tend to assign multiple younger lawyers, or associates, to work on the case. Smaller firms can also rack up substantial charges if the case is large enough and adequately prepared.

Where the defendant is insured, the insurance company will usually control the defense of the case (the obligation to do so is a part of almost every insurance policy where coverage actually or potentially exists). Insurance companies choose lawyers who are competent but who agree to accept much lower rates in exchange for a volume of work. These lawyers represent the insured client, not the insurance company.

In a complex case involving professional liability claims or claims like security law violations, employment claims, complex tort claims (like environmental or air crash cases), and most commonly class actions, the defense fees can reach well into the millions of dollars. Even a smaller case can easily reach mid six figures in fees if taken through a trial (and more if there is an appeal).

Litigation, although often unavoidable, is an expensive and serious matter, and any defendant who is seriously pursued must be prepared to make a substantial financial commitment to properly defend the case or make sure that his insurance company does so where there is coverage of the claim.

Out of Pocket Costs

Out of pocket costs, which are those amounts paid to vendors or the law firm for expenses other than fees for legal services, can also be high. We have discussed the costs of document vendors if there is a large number of documents that must be collated, searched, and made ready for presentation at trial. Copying charges, messenger fees, fees for service of process or service of other documents, court filing fees, and travel costs can all become substantial.

A substantial cost is usually incurred for experts. Some cases need no experts, while some need multiple experts. Experts tend to charge substantial hourly fees depending upon their expertise, experience, and reputation. It is important to get up- front budgets from experts so that some control over fees can be exercised. Six-figure fees to experts is not uncommon, especially in cases (such as product liability claims) that are technical or where multiple experts are often needed.

Fees of Mediators or Arbitrators

As discussed above, mediation almost always takes place at least once in civil cases, and mediators charge for their time. Like experts, mediators can charge several hundred dollars per hour, and mediations can last a few hours or multiple days. However, all the parties share the mediator's cost, so a defendant might wind up paying anything between half and one-fifth of the cost of the mediator, making that cost much more tolerable that it would otherwise be. If the parties choose to arbitrate their claim (see discussion below), the arbitrator will also charge hourly fees, which are usually (but not always) shared by the parties.

Ways to Forestall Litigation

Make Yourself Difficult to Find and Serve

The lesson to be learned is to try to avoid litigation. This can sometimes be done by making yourself difficult to find. A defendant must be served personally with a summons and complaint in order for a court to have jurisdiction to decide the lawsuit against him. There are ways plaintiffs can effect service short of finding you and handing you the summons and complaint, but the more difficult and costly you make it, the more likely it is that he will lose interest or at least be more willing to discuss a settlement of the case on reasonable terms, and the more time you will buy to plan a response to the claim.

Settle the Claim

The best way to resolve a claim quickly (or at all) is to settle it. Settlement means paying something to the plaintiff that is more than you believe you should pay, while the plaintiff accepts less than he believes he will get at trial. However, settlement has a number of advantages to both sides.

First, it eliminates the claim finally and forever. There is no trial, no motions, no appeal, and no possible new trial after appeal, and the risk of a large judgment is avoided. For a defendant, this is usually a good bargain depending upon the amount he pays. As detailed above, litigation is expensive, and settling a case quickly can eliminate what might turn into substantial defense costs that in effect offset much of the amount paid in settlement. The plaintiff also avoids the cost of preparation for a trial, the trial, and appeal, and assures that he will come away with something rather than take the risk that he ultimately loses and gets nothing.

As mediators will emphasize, the real benefit of settlement is that the parties determine the outcome, not a group of twelve uninformed and potentially unsophisticated jurors or a single judge or arbitrator. Settlement also brings finality and establishes the amount of the loss (or gain) so that the parties can move on to other matters and plan accordingly.

One of the important considerations in settlement is privacy and the avoidance of the public disclosure of financial information or of the activities of the defendant and his or its business. For many defendants, publicity is something to be avoided for a host of reasons, but a trial in a courtroom is by law public. Settlement avoids this problem.

File a Bankruptcy Case

While perhaps a last resort, the defendant can file a bankruptcy case. The filing of a bankruptcy automatically stays all actions against him until the bankruptcy is dismissed or the creditor (e.g. the plaintiff) secures from the court an order lifting the stay (which is often difficult to obtain). If the bankruptcy results in a discharge, the debt is eliminated (some debts cannot be discharged, such as those based upon fraud or intentional conduct by the debtor).

The bankruptcy can later be dismissed by debtor, it can result in a reorganization of a business in which the debts are discharged or modified, or it can be converted to a liquidating bankruptcy ("Chapter 7") in which all of the assets are sold and the proceeds used to pay creditors. Many businesses, even large, profitable corporations, occasionally use bankruptcy as a planning device to gain time and arrange adjustment of their debts (huge public companies like General Motors, Chrysler, United Airlines, and many large retailers have used bankruptcy for that purpose).

Before even considering this step, it is important to consult bankruptcy counsel to make sure that all of the consequences of bankruptcy are explored and that it is done properly if done at all.

Demonstrate Poverty

As a practical matter, most plaintiffs do not want to waste their time pursuing a claim against a defendant who has no ability to pay the debt. On occasion, if the defendant can convince the plaintiff that the defendant has no non-exempt assets, there is no insurance available to pay a judgment, and it is unlikely that any judgment will be paid, the defendant can negotiate a cheap settlement. The attraction to the plaintiff is that it is better for him to get something small, which he can only get by settlement, than nothing at all after spending the money to take the claim to trial.

Arbitration - Arbitration is Available Only by Agreement, but it can be an Efficient and Effective Method of Resolving Disputes

Over the past couple of decades, the pressures on courts to handle overwhelming caseloads with the consequent delays in getting to trial, the increasing costs of discovery and court resolution in general, and increasing sophistication and technical aspects of many claims have prompted many to search for an alternative to the court system to resolve their disputes, mainly business-related disputes. During that time, arbitration has filled that need for many companies and individuals.

Over the last thirty years, an entire industry has grown up consisting of entities that furnish arbitrators and mediators who are specially chosen for competence and who operate under rules promulgated by those entities (which entities are referred to as "tribunals"). These presently include the American Arbitration Association, JAMS (originally Judicial Arbitration and

Mediation Services) and a host of smaller tribunals. Their rosters are filled with well-regarded retired judges and lawyers of repute in specific fields of law.

Arbitration is the resolution of a dispute by a privately-selected and neutral third party – the arbitrator. Statutes in almost every state, along with the Federal Arbitration Act, provide certain guidelines for arbitrators and lay out the general requirements for arbitration. The often cited benefits of arbitration are that it is usually less expensive (even though the arbitrator must be paid, that obligation is shared and is almost always more than offset by savings in attorneys' fees and related costs), is quicker, not being subject to the delays inherent in court systems, and involves as the decision maker a person who is particularly competent and chosen by the parties, rather than by a lay jury and a randomly-selected judge.

The main feature of arbitration that must be carefully considered before agreeing to it is that the decision of the arbitrator is in almost all cases final and non-appealable. That is, even if the arbitrator makes an error in the facts or a legal error, the award will not be vacated – in essence, that is the risk the parties take when they agree to arbitration.

Awards of an arbitrator can generally be challenged or vacated only on grounds specified in statutes. These usually include the failure of the arbitrator to make a proper disclosure of any relationships with the parties or the lawyers (in California, by statute, there is a laundry list of disclosures that are required of every arbitrator), a failure of the arbitrator to allow relevant evidence to be provided or grant a continuance of the hearings where good cause existed for the continuance, or in some rare cases, an award that is so contrary to the law regarding important state policies that it cannot be allowed to stand. These grounds are narrow and rarely applied by courts.

Such finality of arbitration awards makes sense in many contexts. If the arbitrator is competent and fair, his decision will be a reasonable one, even if not what one of the parties hopes for and expects. Such a decision would in any event rarely be reversed by a court even if it could be appealed. Therefore, once the decision is made, the matter is final, the parties have a decision upon which they can rely, and there will be no more extended dispute in the form of motions or appeals.

Arbitration is available only by agreement of the parties. That agreement usually comes as a provision in a contract between the parties that creates the relationship. Sometimes, after the dispute has erupted, the parties agree that for the reasons mentioned above (usually speed and privacy), they will agree to submit their dispute to arbitration (this is called a "submission agreement").

The arbitration will usually proceed according to the rules of the tribunal to which the arbitrator belongs, but since arbitration is an agreed method of dispute resolution, the parties are always free to agree to any modifications of the rules or to adopt new and different rules. For example, most rules provide that there is no discovery as a matter of right in arbitrations, but the parties can agree to a specific plan of discovery that the arbitrator will enforce.

Generally, businesspeople favor arbitration for its speed, its finality, and because they can choose an arbitrator who they believe will understand the case and rule reasonably. Juries often do not fully understand or appreciate the issues involved in business disputes, and in such a dispute, neither party will have the sympathy of a jury, as would, for instance, a fired employee or an injured worker.

Lawyers representing injured individuals, employees, and customers of business (especially large businesses, like banks) want to avoid arbitration so that they can take advantage of the natural sympathy of jurors toward their clients and because they believe that arbitrators will tend to award less in damages, especially emotional damages, and avoid punitive damages in most cases. Decisions of state courts finding certain kinds of arbitration agreements unenforceable as unconscionable or contrary to state policy have been overturned by federal courts enforcing the strict provisions of the Federal Arbitration Act, which strongly encourages arbitration of claims involving interstate commerce (which most claims do).

A recent trend has been to prohibit class arbitration in contractual arbitration clauses. Whether this is enforceable has been a topic of heated debate and much litigation, and such exclusions have been upheld in a number of cases (and struck down in others). The prohibition of class arbitrations combined with an arbitration provision in a contract has tended to result in the lack of an effective remedy for asserted victims of various forms of corporate wrongdoing. The story is not yet fully written on the future of the enforceability of class exclusions in arbitration provisions.

Conclusions and summary – Try to Avoid Litigation, but Take Steps to Prepare for it Should it Occur

The overarching theme of this chapter is that litigation in the United States is expensive, risky, and potentially devastating if a jury decides to punish the defendant with a large award. It also is very public, which many individuals and businesses wish to avoid. However, it is a fact of life for those who live or work in the United States or do business with or sell products to American businesses or individuals.

There are ways to avoid litigation, such as having an arbitration provision in any contract for goods or services and settling any claim quickly before court proceedings commence or at least before the major costs of litigation kick in. Preparation should also be made to respond to attempts to reach your assets by plaintiffs who, realistically or just because they can, seek to obtain an award of damages (or possession of your property) to in effect transfer your assets to them.

The key to resisting such attempts in litigation is to secure knowledgeable counsel and prepare carefully to deal with the anticipated claim or the lawsuit once it is filed. Sometimes, making a counterclaim will have the desired effect, essentially creating for the plaintiff a risk of monetary loss, not simply the risk of walking away with nothing. Mediation can be used to get a message to a plaintiff who is being shielded from reality by his or her lawyer that there is money available to settle if the plaintiff is reasonable.

It is impossible to predict in most instances how a jury or a judge, or even an arbitrator, is going to view the dispute, so precautions should be made to anticipate a potential loss. Lawyers and others who specialize in asset protection can often assist you in placing assets in a position from which they cannot be reached, or at least easily reached, by judgment creditors. There are tax implications for all such programs, which must be studied with tax lawyers and accountants. Finally, as a last resort, or perhaps as a method of stopping collection and gaining time, there is bankruptcy. As with every other strategy, this must be reviewed with a lawyer who specializes in bankruptcy matters.

In determining whether and how to resist a lawsuit, it must be kept in mind that plaintiffs do not always win. There will be times when an important principle is at stake or you simply feel that you have done nothing wrong and are willing to take your case to a jury or a judge. There will be times when the matter at stake is so important that it is virtually impossible to concede anything to the plaintiff, and the matter must be fought to the end. Juries, however sympathetic to plaintiffs they might be, almost always try to do the right thing, and if the defense is strong and presented properly, the defendant can prevail at trial.

You must, of course, be prepared to make the financial commitment to defend a lawsuit and perhaps even go through an appeal; insurance sometimes can provide that financial resource, but whether or not you have insurance, litigation will require your personal attention, often be frustrating and slow, and could be disruptive to your business (as well as make public information you would prefer to keep private). Nevertheless, with all of its shortcomings, both practical and legal, litigation is the way Americans have chosen to resolve virtually all of their disputes with others, so it is wise to know about it and prepare for it before it comes knocking on your door.

Chapter 12 - Asset Protection – 2013 Current Issues

Recent statistics confirm:

1) 1.085m lawsuits filed annually in California. (See 2012 Court Statistics Report, page 96).

2) 284k lawsuits filed annually in U.S. Federal District Court. (See Judicial Business Summary 2011, page 2).

Predatory litigation against defendants (Deep Pocket), legal costs, and Estate Planning (to distribute assets to intended heirs not 3rd party creditors) all mandate asset protection.

In the words of Carl Sagan:

"Knowing a great deal is not the same as being smart; intelligence is not information alone but also judgment, the manner in which information is collected and used."

Chapter 13 - Asset Protection – U.S. Case Law

1) Blosam Contractors, Inc. v. Lucyx

(535 So. 352 (Fla. 1st Dist.App 1988)

In Blosam, the lien holder is granted priority before charging order holder. In this case, Blosam obtained a final judgment against debtor and executed a financing statement that covered her interest in a limited partnership (or LLC).

Then Lucyx obtained a final judgment against debtor and filed an application for a charging order, which the lower court granted because the first to get a charging order had priority for the judgment.

The Appeals Court reversed the lower court, holding that a protected security interest (held by Blosam) was superior to the rights of a subsequent lien creditor (i.e. Lucyx).

2) Cadle Co. v. Ginsberg

(2002 WL 725500) CV 9500768115 (Conn. Sup. Ct 2002)

In Cadle, the creditor sought a charging order against the defendant's interest in a LLC, which the defendant opposed because the defendant contended that the LLC must be made a party to the case. The court held:

a. It is not necessary for the LLC to be made a party to the action because the "charging order merely gives the judgment creditor the rights of an assignee" of the LLC's membership interest, but it does not give the assignee the right to manage the LLC.

b. The assignee's right to the LLC membership interest does not equate to the right to manage or participate in the LLC.

3) Koh v. Inno Pacific Holdings, Ltd.

(54 P.3d 1270 (Wash. App. Div. 1, 2002).

In Koh, a creditor was awarded a monetary judgment in California and sought a charging order against the debtor's 50% interest in a LLC formed under Washington law. The LLC's principal place of business was in Malaysia.

The Washington trial court initially quashed a charging order, claiming that the court lacked jurisdiction over the debtor's LLC membership interest in the LLC because the interest as personal property was located outside Washington. The trial court defined the LLC member's interest as personal property and determined that personal property for purposes of levy and attachment is normally adjudicated where it is physically located or where the owner resides.

The Appellate Court reversed, holding that when a LLC organizes under the laws of a state, the entity's interest is located within that state. Therefore, as long as there is a valid foreign judgment (i.e. California's), the creditor can register that judgment (in Washington) and obtain a charging order against the debtor's LLC member interest in Washington.

4) <u>Krauth v. First Continental</u>

("First Come, First Served") (351 So. 2d 1106 (Fla. 4th Dist.App 1977)

In Krauth, the court held that when there are multiple, unsecured judgment creditors against a single debtor, the first creditor that applies for a charging order against the debtor's partnership (or LLC's) interest to a court of proper jurisdiction has priority for the full satisfaction of his judgment. It does not matter when the judgment was entered. Under Krauth, enforcement of charging orders are performed one at a time, with priority given to the order filed first.

Chapter 14 - Asset Protection- Creditor Remedies

In a “veil piercing case”, a court is requested to disregard a corporate entity so as to make available the personal assets of its owner to satisfy a liability of the entity.

When the corporate entity acts as a shell for asset protection purposes, has no actual business purpose, and there is a showing of abuse by the debtor, creditors may not be limited solely to a charging order and may instead be able to apply the equitable remedy of “reverse veil piercing” making the entity liable for the debtor’s personal debts (See: C.F. Trust v. First Flight Ltd. Partnership (306 F.3d 126, CCA-4 2002).

Under EPICA v. Swiss Bank Corp., 507 So. 2d 1119 (Fla. 3d Dist. App. 1987), the court test is stated to determine if there is a “reverse piercing action”, based on two criteria:

1. Whether the debtor had ownership and control of the entity;

2. Whether the debtor used the entity to secrete personal assets as a means to deceive, defraud or mislead his personal creditor.

Under the “reverse piercing test”, a creditor does not need to prove that the debtor committed actual fraud. The test requires that the trial court find that the defendants committed an unjust act in contravention of the plaintiff’s rights.

To succeed in a “reverse piercing action”, the creditor:

1. Must name the entity directly as a party, and

2. Show that an unjust act in contravention of the creditor’s legal rights occurred.

Asset Protection – Creditor Remedy: Resulting Trust

As resulting trust is an equitable remedy. The creditor’s position is that an entity (e.g. a corporation) is owned by a “nominee” owner (who has legal title), but is presumed to be holding it for the benefit of a person holding equitable title, since the beneficial interest is not “enjoyed” by the legal title holder.

The nominee owner is presumed to be acting as a “Trustee” for the benefit of the beneficial owner. The entity has no business purpose (other than asset protection) and is a “trust” for the benefit of the beneficial owners (i.e. the equitable owner). If the creditor can prove that the entity “is a trust”, the creditor may overcome the exclusive remedy of a charging order, and obtain an equitable resulting trust entitling the creditor to access those assets held by the nominee (i.e. the entity) for the benefit of the debtor (i.e. the person holding equitable title).

Asset Protection – Creditor Remedy: Alter Ego/Sole Purpose

Under the alter ego/sole purpose remedy, an entity is established to hold title to a debtor's personal assets, which were transferred to the entity without a business purpose, as a means to shield the assets from creditors (In Re Turner, 335 B.R. 140 (N.D. Cal., 2005), modified 345 B.R. 674 (N.D. Cal. 2006).

The entity is the "alter ego" of the debtor and the creditor is not limited to the charging order, but may be able to disregard the entity to prevent an injustice from occurring. In cases where the courts determined the entity was the debtor's alter ego, the following facts were found to be determinative:

1) The debtor, not the shareholder, was in control of the entity;

2) The debtor paid his expenses (and wife/children's expenses) directly from the entity;

3) There was poor recordkeeping, missing company documents;

4) The entity's assets came from fraudulent transfers; and

5) The entity did not have a business purpose (i.e. fulfilled an economic venture) but was established to "hide" personal assets.

The case law for alter ego/sole purpose creditor remedy focuses on corporate entities but the same legal reasons, i.e., to prevent an injustice from occurring may justify this creditor remedy for an LLC and pre-empt charging order limitations on creditor recovery.

Asset Protection: Creditor Remedy – Constructive Trust

A constructive trust is a remedy that arises against one who holds legal rights to property but, which in "equity and good conscience should belong to another." There does not need to be a showing that the property was acquired by fraud. The creditor does not need to prove an intent to defraud.

The creditor has to prove only that it is unfair for the entity to prevent the creditor from accessing the entity's property.

One case has been cited in which a constructive trust was used to defeat charging order protection (See: Delta Development and Investment Co. v. Hsiyuen, 2002 WL 3174, 8937 (Wash.App. Div. 1, 12/9/2002).

In this case, the facts showed significant fraud by the debtor, including use of company assets to fund personal ventures/opportunities, commingling of personal funds with company funds, use of the company's funds/credit to entice a bank to extend credit, and transforming company funds into a personal account.

The court in Delta determined that the constructive trust could defeat the charging order limitation because it is not a monetary judgment and charging order limitation statutes protect the debtor only against monetary judgments.

Chapter 15 - Asset Protection/Special Issues

Asset Protection – LLCs and Real Estate

"FIRPTA Withholding" (Tax Withholding U.S. Real Estate)

The sale (or other disposition) of U.S. real property interest by a foreign person (transferor) is subject to a tax withholding of 10% of the amount realized in the disposition (35% of gain recognized by foreign corporation on distribution to its shareholders), under FIRPTA (Foreign Investment in Real Property Tax Act of 1980).

In most cases, the transferee (buyer) is the withholding agent for the "disposition of U.S. real estate" (i.e. sale or exchange, liquidation, redemption, gift or transfer).

A U.S. real property interest is any interest, other than solely as a creditor, in real property (including an interest in a mine, well or other natural deposit) located in the U.S. (or the U.S. Virgin Islands), as well as certain personal property that is associated with the use of the real property (e.g. hotel, furniture, farming machinery).

The transferee must deduct and withhold a tax equal to 10% of the total amount realized by the foreign person on the disposition.

The amount realized is the sum of:

1) The cash paid or to be paid (principal only);

2) The fair market value of the other property transferred, or to be transferred, and

3) The amount of any liability assumed by the transferee or to which the property is subject immediately before and after the transfer.

The amount realized is the amount paid for the property. If the property transferred was owned jointly by U.S. and foreign persons, the amount realized is allocated between the transferors listed on the capital contribution of each transferor.

Regarding real property interests held by corporations:

1) A foreign corporation that distributes a U.S. real property interest must withhold all tax equal to 35% of the gain it recognizes on the distribution to its shareholders;

2) A domestic corporation must withhold a tax equal to 10% of the fair market value of the property distributed to a foreign shareholder if:

a. The shareholder's interest in the corporation is a U.S. real property interest;

b. The property is distributed either in a stock redemption or asset liquidation.

To avert the “FIRPTA tax withholding” on the sale, the investor may establish a U.S. based LLC, which issues a Form W-9 to the buyer so there is no tax withholding on the sale. Subsequently, the LLC will withhold an LLC member’s distributions to the foreign person member (verified by the K-1 issued by the LLC).

PART 2 – IRS Tax Audits

Chapter 16 – GAO Report

United States Government Accountability Office (GAO) released a report in March 2013 entitled: Offshore Tax Evasion – IRS Has Collected Billions of Dollars, but May Be Missing Continued Evasion.

What the GAO Found was that as of December 2012, the Internal Revenue Service's (IRS) four offshore programs have resulted in more than 39,000 disclosures by taxpayers and over

$5.5 billion in revenues.

A supplement report was published in January 2014 listing Offshore Voluntary Disclosure Program participants by state and the location of foreign bank accounts reported by 2009 Offshore Voluntary Disclosure Program participants.

The top 7 states were:

California 2,524 24%
New York 1,884 18%
Florida 1,022 10%
New Jersey 631 6%
Texas 512 5%
Massachusetts 307 3%
Illinois 291 3%

The top 7 countries where the bank accounts were located:

Switzerland 5,427 42%
United Kingdom 1,058 8%
Canada 556 4%
France 528 4&
Israel 510 4%
Germany 484 4%
China 394 3%

In a recent study, Gabriel Zucman, Asst. Prof., London School of Economics (an international author who works with Thomas Piketty and Emanuel Saez) estimated:

1) Switzerland has $2.4 Trillion in global offshore funds, 1/3 of projected $7.6 Trillion total (which is 8% of projected global financial assets).

2) 60% of foreign owned deposits in Switzerland belong to British Virgin Islands, Jersey and Panama, the leading countries for domiciliation of shell companies.

3) Offshore funds in Swiss accounts have risen in recent years

4) Data from National Bank of Switzerland confirm only a small percentage of offshore funds in Switzerland have been disclosed to financial authorities

5) In 2017, Switzerland will automatically share banking information with OECD countries (Organization for Economic Co-operation and Development), under the multi-year OECD agreement it recently signed.

Switzerland is the Epicenter of International Tax Evasion & Money Laundering:

1) Under the 2013/2014 US Govt. GAO Report, the IRS Offshore Voluntary Disclosure Program listed the top 7 countries with undisclosed accounts. #1 was Switzerland with 42% of the accounts (UK was a distant second with 8% of the accounts). Switzerland holds more than 5x the bank accounts of "US tax cheats" than the 2d biggest jurisdiction (UK).

2) Major Swiss banks have admitted to tax evasion as their "business": In Feb 2009 UBS agreed to pay a $780m fine and entered into a deferred prosecution agreement with the US Dept. of Justice;

In Jan. 2013, Wegelin Bank, the oldest Swiss Bank (est. 1741) paid a $74m fine and entered a guilty plea to tax evasion charges and announced it would close its bank;

In November 2014, Credit Suisse entered a guilty plea to tax evasion and agreed to a $2.6B penalty.

As of December, 2014 more than a dozen Swiss Banks including major bank: HSBC & Julius Baer continue to be investigated for their roles in helping US taxpayers evade taxes. HSBC appears particularly egregious under investigation in numerous countries e.g. Belgium, Argentina et al. for aiding international tax evasion and money laundering.

The following press release was sent out by the U.S. Department of Justice on 11/21/2014:

Credit Suisse Sentenced for Conspiracy to Help U.S. Taxpayers Hide Offshore Accounts from Internal Revenue Service

Pays $1.8 Billion to Department of Justice and the Internal Revenue Service in a Fine and Restitution

Credit Suisse AG was sentenced today for conspiracy to aid and assist U.S. taxpayers in filing false income tax returns and other documents with the Internal Revenue Service (IRS). Credit Suisse pleaded guilty to conspiracy on May 19. The sentencing of the Swiss corporation is the result of a years-long investigation by U.S. law enforcement authorities that has also produced indictments of seven Credit Suisse employees and the owner of a trust company since 2011—two of those individuals have pleaded guilty so far—and of U.S. clients of Credit Suisse. The announcement was made by Deputy Attorney General James M. Cole, Acting Deputy Assistant Attorney General Larry J. Wszalek for the Justice Department's Tax Division, U.S. Attorney Dana J. Boente for the Eastern District of Virginia and IRS Commissioner John Koskinen.

At sentencing in the U.S. District Court for the Eastern District of Virginia, U.S. District Chief Judge Rebecca Beach Smith entered judgment and conviction and a restitution order requiring Credit Suisse to pay approximately $1.8 billion dollars to the United States by Nov. 28, per the plea agreement. Credit Suisse will pay the Justice Department's Crime Victims Fund, through the District Court Clerk's Office for the Eastern District of Virginia, a fine of approximately $1.136 billion and will pay the IRS $666.5 million in restitution. The parties agreed that Credit Suisse cannot challenge the restitution amount, which can also provide a basis for an IRS civil tax assessment.

“Today, with its criminal conviction and the payment of $2.6 billion in fines and restitution, Credit Suisse is held fully accountable for helping U.S. taxpayers engage in tax evasion,” said Deputy Attorney General Cole.

(Click link above for complete article).

Chapter 17 - Offshore Tax Evasion: Senate Report 8/1/06

US Senate Permanent Subcommittee on Investigations (8/1/06 Report)

TAX HAVEN ABUSES: THE ENABLERS, THE TOOLS AND SECRECY

Summary

Senate Subcommittee investigation issued 74 subpoenas, conducted more than 80 interviews, reviewed over 2 million pages of documents, estimates that:

1) Off-shore assets of high net worth individuals now totals $11.5 trillion;

2) More than 50 offshore jurisdictions with assets total $4.8 trillion;

3) Off-shore assets of high net individuals from North America (U.S.) $1.6 trillion;

4) Individual U.S. taxpayers illegally evade up to $70 billion per year in U.S. taxes by offshore tax schemes;

5) Corporate U.S. taxpayers illegally evade up to $30 billion per year in U.S. taxes by offshore tax shelters

Please click here for complete document.

Chapter 18 - Offshore Tax Evasion: ICIJ report 2013

On April 4, 2013, the Digital Journal, The Guardian and Spiegel online reported that an informational network of journalists (15 month research project), 86 journalists from 46 countries, working with a nonprofit organization, The International Consortium of Investigative Journalists (including media firms: UK: The Guardian and the BBC; France: Le Monde; U.S.: Washington Post) reported a total of 2.5 million secret files of companies and nationals in 170 countries, including 140,000 individuals who placed their money in tax havens (documents investigated over a period of close to thirty years).

In the "largest data leak in history", the data exposed 120,000 letterbox entities, offshore accounts for politicians, celebrities, weapons dealers, oligarchs and financiers.

The ICIJ study estimated:

1. $1.6 Trillion a year from global proceeds of financial crimes flows to offshore havens;

2. Up to $32 Trillion is stashed away in offshore havens (roughly equivalent to the size of the U.S. and Japan's economies combined);

3. Assets managed by the world's 50 largest 'private banks", which provide access to offshore financial services for high net-worth clients, grew from $5.4 Trillion in 2005 to more than $12 Trillion in 2010.

According to the ICIJ report, the names revealed include: American professionals, relatives and friends of African and Asian depositors (including Ferdinand Marcos in the Philippines and Robert Mugabe in Zimbabwe), Wall Street swindlers, global arms dealers and Eastern European, Russian and Asian billionaires. The offshore financial institutions provide financial secrecy to help rich people dodge taxes facilitate official corruption to exacerbate the widening gap between the poor and rich world-wide.

The offshore financial providers and their clients hide funds through multi-layered global structures consisting of multiple companies, foundations and financial products.

Offshore financial services' appoint "sham" officers, directors and shareholders, proxies who serve as stand-ins when the real company owners don't want their identities known. The report identified a cluster of 28 "sham directors" who served as on-paper representatives of more than 21,000 companies, with individual directors representing as many as 4,000 companies each. These "nominees" rent out their names for the real owners to hide behind.

The report stated: "A well-paid industry of accountants, middlemen and other operatives has helped offshore patrons shroud their identities and business interests, providing shelter in many cases to money laundering or other misconduct…this involves many of the world's top banks including UBS, Clariden and Deutsche Bank who aggressively worked to provide their customers with secrecy-cloaked companies in offshore hideaways."

Offshore tax evaders include an array of government officials and rich families from the UK, Canada, U.S., India, Pakistan, Indonesia, Iran, China, Thailand and former Communist states.

The data seen by The Guardian shows that their secret companies are based mainly in the British Virgin Islands.

Sample offshore owners named in the leaked files include:

- Jean-Jacques Augier, Francois Hollande's 2012 election campaign co-treasurer, launched a Cayman Islands-based distributor in China with a 25% partner in a BVI company. Augier says his partner was Xi Shu, a Chinese businessman.

- Mongolia's former finance minister, Bayartsogt Sangajav, set up "Legend Plus Capital Ltd." with a Swiss bank account, while he served as finance minister of the impoverished state from 2008 to 2012. He says it was "a mistake" not to declare it, and says "I probably should consider resigning from my position".

- The president of Azerbajan and his family. A local construction magnate, Hassan Gozal, controls entities set up in the names of President Ilham Aliyev's two daughters.

- The wife of Russia's deputy prime minister, Olga Shuvalova's husband, businessman and politician Igor Shuvalov, has denied allegations of wrongdoing about her offshore interests.

- A senator's husband in Canada, lawyer Tony Merchant, deposited more than [U.S.] $800,000 into an offshore trust. He paid fees in cash and ordered written communications to be "kept to a minimum".

- A dictator's child in the Philippines: Maria Imelda Marcos Manotoc, a provincial governor, is the eldest daughter of former President Ferdinand Marcos, notorious for corruption.

- Spain's wealthiest art collector, Baroness Carmen Thyssen-Bornemisza, a former beauty queen and widow of a Thyssen steel billionaire, who uses offshore entities to buy pictures.

- U.S.: Offshore clients include Denise Rich, ex-wife of notorious oil trader Marc Rich, who was controversially pardoned by President Clinton on tax evasion charges. She put $144M into the Dry Trust, set up in the Cook Islands.

- It is estimated that up to $32 Trillion acquired by wealthy individuals could lie in offshore accounts. The UK-controlled BVI has been the most successful among the mushrooming secrecy havens that cater for them.

Chapter 19 – Offshore Tax Evasion: Swiss Bank Update

For those U.S. taxpayers who do not pay tax on their earnings they face civil tax fraud and criminal tax evasion penalties (both fines and jail terms). If the untaxed earnings are from assets held offshore then criminal penalties increase geometrically and may include:

1) Willful Tax Evasion (IRC 7201)
2) Obstruction of Tax Collection (IRC 7212)
3) Conspiracy to Commit Tax Evasion (18 USC 371)
4) Filing a False Tax Return (IRC 7206)
5) Failure to file FBAR (TD 90-22.1) and FATCA (Form 8938) filings
6) Money Laundering
7) Wire Fraud
8) Mail Fraud

Eight separate felonies total over 85 years in jail.

Offshore tax evasion, i.e. untaxed earnings on undisclosed offshore assets, has become the focal point for U.S. government tax compliance prosecution:

1) In February 2009, Swiss bank UBS agreed to pay a $780million fine and entered into a deferred prosecution agreement (without admitting guilt) to resolve a U.S. Dept of Justice investigation.

2) In January 2013, Swiss bank, Wegelin, the oldest Swiss bank, announced it would close after pleading guilty in January to helping wealthy U.S. citizens avoid paying taxes ultimately resulting in a $74million fine.

3) In July 2013, Liechtenstein's oldest bank, Landesbank AG, agreed to pay a $23.8million settlement to avoid criminal charges for opening and maintaining undeclared bank accounts for U.S. citizens.

4) On 8/16/13, Edgar Paltzer, a Swiss lawyer (and duel U.S.-Swiss citizen) accused of helping U.S. clients conceal millions of dollars in offshore accounts, at the Swiss bank, Bank Frey & Co. AG, pleaded guilty to conspiracy to commit tax fraud (after being charged in April 2013 on one count of conspiracy alongside Stefan Buck, then head of private banking at Bank Frey & Co Ag).

Paltzer entered into a criminal plea agreement and stated: "I was aware that this conduct was wrong." He agreed to forfeit any fees he earned and cooperate with the U.S. government. His lawyer stated: "His cooperation is complete and without any limitation." (U.S. v. Paltzer et al, U.S. District Court, Southern District of New York, No. 13-cr-282)

More than a dozen Swiss banks, including Credit-Suisse Group AG and Julius Baer continue to be investigated for their roles in helping U.S. taxpayers evade taxes. Swiss banks hoped to cooperate but have been stymied by strict Swiss secrecy laws.

In July 2013, the Swiss government unveiled a plan that would potentially allow the banks to cooperate with U.S. authorities who are seeking up to $10billion in penalties.

Chapter 20 - UBS Client Indictments 2009-2014

The following is from the IRS.GOV website - **UBS Clients**

Oct. 20, 2014 — Menasha Cohen, from Hampton, N.H., pleaded guilty to filing a false income tax return for tax year 2009. Cohen, an oriental carpet dealer, and his sister maintained an undeclared bank account at UBS with a balance of approximately $1.3 million.

Oct. 14, 2014 — Gregg A. Kaminsky, a self-employed Internet entrepreneur, was indicted for failing to file a Report of Foreign Bank and Financial Accounts (FBAR) form and failing to disclose his UBS bank account.

Oct. 3, 2014 — Howard Bloomberg pleaded guilty to willfully failing to disclose a foreign bank account he controlled at UBS.

June 18, 2014 — Gabriel Gabella pleaded guilty to failing to file a Report of Foreign Bank and Financial Accounts (FBAR). In the plea agreement, Gabella agreed to pay a civil penalty of $3,140,346 and to pay $239,012 in restitution to the IRS.

May 27, 2014 — Martin Lack, a former UBS AG banker, was sentenced to five years of probation and ordered to pay a $7,500 fine. Lack was charged in August 2011 with conspiracy to defraud the United States. He assisted U.S. customers to open and maintain secret bank accounts.

May 9, 2014 — Dr. Patricia Lynn Hough, of Englewood, FL, was sentenced to 24 months in prison for conspiring to defraud the IRS by concealing millions of dollars in assets and income in offshore bank accounts at UBS and other foreign banks, and for filing false individual income tax returns. Hough was also ordered to pay $15,518,382 in restitution and $42,732 for the costs of prosecution.

March 21, 2014 — Victor Lipukhin, formerly a resident of St. Charles, Ill., was indicted for attempting to interfere with the administration of the Internal Revenue laws and filing false tax returns. Lipukhin, a Russian citizen and former lawful permanent U.S. resident, kept between approximately $4,000,000 and $7,500,000 in assets in two bank accounts with UBS from at least 2002 through 2007.

March 18, 2014 — California attorney Christopher M. Rusch was sentenced to 10 months in prison for helping his clients Stephen M. Kerr and Michael Quiel hide millions of dollars in secret offshore bank accounts. Rusch pleaded guilty on Feb. 6, 2013, to conspiracy to defraud the government and failing to file a Report of Foreign Bank and Financial Accounts (FBAR).

Feb. 26, 2014 — Christopher B. Berg, of Portola Valley, Calif., was sentenced to one year and one day in prison. Prior to sentencing, Berg paid more than $250,000 in restitution to the IRS, as well as a penalty of $287,896 for failure to properly report his foreign account.

Jan. 14, 2014 — H. Ty Warner was sentenced to two years' probation for tax evasion. Warner has paid more than $53 million in a civil penalty, as well as approximately $27 million in back taxes and interest.

Sept. 24, 2013 — Stephen M. Kerr and Michael Quiel were each sentenced to 10 months in prison. Stephen M. Kerr and Michael Quiel were convicted of failing to disclose secret offshore bank accounts in Switzerland. Kerr and Quiel, prominent Phoenix businessmen, were each convicted of two counts of filing false individual income tax returns for 2007 and 2008. Kerr was also convicted of two counts of failing to file a Report of Foreign Bank and Financial Accounts (FBAR).

July 16, 2013 — Peter Troost, of Skokie, Ill., was sentenced to 12 months and a day in prison for evading taxes on more than $3 million held in offshore UBS accounts. Troost has already paid over $1 million in back taxes, as well as a civil penalty of approximately $3.75 million. April 25, 2013 — Mary Estelle Curran, of Palm Beach, Fla., was sentenced for filing false tax returns. Curran pleaded guilty in January 2013 and agreed to pay a civil penalty of $21 million.

Mar 21, 2013 — Rakesh Chitkara, of Marlboro, N.J., pleaded guilty to filing false personal federal income tax returns. Chitkara must repay back taxes and pay a civil penalty of $839,885 for willfully failing to file Reports of Foreign Bank and Financial Accounts (FBARs) on at least two accounts at UBS AG in Zurich, Switzerland.

Jan. 30, 2013 — Christopher B. Berg of Portola Valley, Calif., pleaded guilty today to willfully failing to file a Report of Foreign Bank and Financial Accounts (FBAR) for an account he controlled at UBS in the year 2005.

Oct. 11, 2012 — Wolfgang Roessel, of Fort Lauderdale, Fla., was sentenced to three years probation. Roessel pleaded guilty in May 2012 to filing a false tax return and failing to file a Report of Foreign Bank and Financial Accounts (FBAR). The plea agreement includes a tax loss of more than $312,000 and an FBAR penalty owed of more than $5,750,000.

July 30, 2012 — Sean and Nadia Roberts, of Tehachapi, Calif., were sentenced to 12 months and one day in prison for hiding millions of dollars in secret offshore bank accounts in Switzerland and other banks around the world. They were also ordered to pay $709,675 in restitution to the IRS and to pay more than $2.5 million in civil penalties failing to file Reports of Foreign Bank and Financial Accounts (FBARs).

July 25, 2012 — Luis A. Quintero, of Miami Beach, Fla., was sentenced to four months in prison and fined $20,000. Quintero also paid a $2 million civil penalty. Quintero pleaded guilty in April 2012 to willfully failing to file a Report of Foreign Bank and Financial Accounts (FBAR).

Mar. 29, 2012 — Lothar Hoess was sentenced to three years of probation and ordered to pay over $2 million in restitution for willfully failing to file a Report of Foreign Bank and Financial Accounts (FBAR).

Jan. 11, 2012 — Michael Reiss, a doctor, professor and medical researcher, was sentenced to eight months in a community confinement center for failing to file Reports of Foreign Bank and Financial Accounts (FBAR) with the IRS. Reiss pleaded guilty in August 2011 and agreed to pay back taxes of at least $400,000 and to pay a civil penalty of over $1.2 million.

Dec. 7, 2011 — Amir Zavieh, of San Francisco, Calif., was indicted with conspiring to defraud the Internal Revenue Service (IRS). According to the indictment, Zavieh concealed a bank account at UBS by placing his domestic assets in the name of a nominee and failing to file income tax returns.

Nov. 9, 2011 — Robert E. Greeley, of San Francisco, was sentenced to three years probation and ordered to pay $16,869 in restitution to the IRS. In addition, Greeley will pay over $6.8 million in civil penalties and interest. Greeley pleaded guilty in August 2011 to charges of filing a false federal income tax return. He concealed more than $13 million in two bank accounts he held with UBS AG.

Nov. 9, 2011 — Richard Werdiger, of Purchase, N.Y., was sentenced to one year and one day in prison for conspiring to defraud the IRS by hiding more than $7.1 million at UBS, filing false income tax returns and evading nearly $400,000 in taxes. In addition, Werdiger agreed to pay a civil penalty of over $3.8 million.

Oct. 5, 2011 – Peter Schober, of Boston, Mass., was sentenced to one month in prison and six months of supervised release, of which two months will be served in home confinement. Schober was also ordered to pay $77,870 in restitution and a $777,986 civil penalty. In November 2010, Schober pleaded guilty to willfully failing to file a Report of Foreign Bank and Financial Accounts (FBAR) concealing over $1 million from the IRS.

July 14, 2011 – Anton Ginzburg pleaded guilty to failing to file a Report of Foreign Bank and Financial Accounts (FBAR). Ginzburg agreed to pay a civil penalty of over $1.5 million.

June 27, 2011 — Kenneth Heller, of New York, N.Y., pleaded guilty to income tax evasion. Heller admitted to hiding more than $26.4 million in a bank account at UBS AG and he has agreed to pay a civil penalty of over $9.8 million.

May 24, 2011 — Harry Abrahamsen of Oradell, N.J., was sentenced to three years probation, including 12 months of home confinement with electronic monitoring, and ordered to pay $600,000 in restitution to the Internal Revenue Service (IRS). In addition, Abrahamsen agreed to pay a civil penalty in excess of $300,000. In April 2010, Abrahamsen pleaded guilty to failure to file a (FBAR) report and admitted that he concealed over $1 million in Swiss bank accounts.

May 23, 2011 — Lucille Abrahamsen Jackson, of Hilldale, N.J., was sentenced to one year probation. In addition, Jackson agreed to pay a civil penalty in excess of $379,000. Jackson pleaded guilty in November 2010 to filing a false tax return and failing to file a Report of Foreign Bank or Financial Account (FBAR). She admitted to concealing over $750,000 in a UBS account by transferring ownership of the account to a nominee Panamanian corporation.

April 21, 2011 — Ernest Vogliano, of Manhattan, N.Y., was sentenced to two years probation and ordered to pay a $940,000 civil penalty. He pleaded guilty on Dec. 22, 2010, to filing false tax returns and conspiring to defraud the Internal Revenue Service by hiding $4.9 million in an offshore bank account with UBS, AG.

March 14, 2011 — Jeffrey Chatfield, of San Diego, Calif., was sentenced to three years' probation and ordered to pay more than $96,000 to resolve his civil liability with the IRS for failing to file the required Reports of Foreign Bank and Financial Reports (FBARs). Chatfield pleaded guilty on Nov. 18, 2010, to filing a false tax return in which he failed to report a UBS account containing $900,000. Between 2000 and 2008, Chatfield transferred the $900,000 through several offshore accounts of nominee entities.

March 8, 2011 — Edward Gurary, of Orange Village, Ohio, pleaded guilty to filing false income tax returns for the years 2004 through 2008. Gurary owned and controlled a financial account at UBS AG which was in the name of a Bahamian entity and failed to report interest income earned on his tax returns.

March 4, 2011 — Arthur Joel Eisenberg, of Seattle, Wash., was sentenced to serve three years' probation and to pay a $2.1 million penalty for failing to file a Report of Foreign Bank or Financial Account (FBAR) form. Eisenberg pleaded guilty in December 2010 to willfully filing a false tax return which failed to report over $3.1 million in various UBS bank accounts.

Dec. 7, 2010 — Samuel Phineas Upham, of New York, N.Y., was indicted conspiring with a family member to hide over $11 million in an offshore UBS bank account. He also assisted in establishing a sham foundation in Liechtenstein to further conceal money from the IRS.

Nov. 19, 2010 — Bernard Goldstein, of Carlsbad, Calif., was indicted for conspiracy to defraud the IRS, filing false tax returns, and failing to file Report of Foreign Bank or Financial Accounts (FBARs). Goldstein is alleged to have transferred over $2 million in a UBS account to a sham Panamanian corporation in an effort to conceal the account from the IRS.

Nov. 10, 2010 — Sybil Nancy Upham, of Manhattan, N.Y., pleaded guilty to conspiring to defraud the IRS and subscribing to false federal income tax returns. As part of her plea agreement, Upham has agreed to pay over $5.5 million in penalties for failure to file FBARs. On April 15, 2010, Upham was indicted with five other individuals for hiding millions of dollars in secret Swiss bank accounts.

Oct. 4, 2010 — Gregory Rudolph, of Brookline, Mass., pleaded guilty to failing to comply with foreign bank account reporting requirements. UBS bankers assisted Rudolph with creating a shell company registered in the British Virgin Islands and a shell corporation registered in Hong Kong in hiding in excess of $1 million. In October 2010, Rudolph was indicted with Peter Schober.

Sept. 21, 2010 — Jules Robbins, of New York, N.Y., who owned and operated watch distribution companies, was sentenced to one year probation and ordered to pay a civil FBAR penalty of

$20.8 million. Robbins set up a sham Hong Kong corporation which was listed as the holder of an UBS account in an effort to conceal his income from the IRS. This account and Robbins' other offshore accounts collectively contained almost $42 million in unreported income.

Sept. 17, 2010 — Federico Hernandez, of New York, N.Y., was sentenced to 12 months in prison, six months home confinement, and ordered to pay a civil FBAR penalty of $4.4 million. Hernandez used sham companies set up in the British Virgin Islands and Panama to conceal his ownership of UBS accounts totaling $8.8 million.

July 1, 2010 — Leonid Zaltsberg, of Milltown, N.J., pleaded guilty to filing a false tax return for 2003 and failing to file a Report of Foreign Bank or Financial Accounts (FBAR). In his plea agreement, Zatlsberg admitted failing to disclose the existence of a Swiss bank account on his tax returns for the years 2000 through 2006 and concealing over $2 million in his Swiss account. On Dec. 20, 2010, Zaltsberg was sentenced to four years of probation, including one year of home confinement. In addition, he was ordered to pay civil penalties for failing to file an FBAR and a $3,000 fine.

April 15, 2010 — In Manhattan, N.Y., seven UBS clients were indicted for collectively hiding over $100 million in secret Swiss bank accounts. Two of these individuals, Jules Robbins and Federico Hernandez, pleaded guilty and agreed to pay civil penalties of $20.8 million and $4.4 million, respectively. The remaining indicted clients were Kenneth Heller, Sybil Nancy Upham, Richard Werdiger, Ernest Vogliano and Shmuel Sternfeld.

April 13, 2010 — Paul Zabczuk, of The Woodlands, Texas, pleaded guilty to filing a false tax return wherein he failed to report his interest in or signature authority over financial accounts at UBS AG. Zabczuk was sentenced on July 27, 2010, to three years of supervised release with one year served in home detention and 150 hours community service. In addition, Zabczuk was ordered to file accurate tax returns and pay all taxes, interest and penalties due and owing to the IRS.

Feb. 4, 2010 — Jack Barouh of Golden Beach, Fla., pleaded guilty to filing a false tax return. Barouh admitted to filing a false tax return for 2007 in which he failed to report a foreign bank account. He was sentenced to 10 months in prison and ordered to pay all taxes, interest and penalties due and owing.

Oct. 5, 2009 — Roberto Cittadini of Bellevue, Wash., pleaded guilty to filing a false tax return and admitted to concealing nearly $2 million in Swiss bank accounts. Cittadini, a retired sales manager for Boeing, failed to file a Report Foreign Bank and Financial Accounts for 2001 through 2003. Cittadini was sentenced on Jan. 8, 2010, to six months home detention and one year supervised release and was ordered to pay a $10,000 fee and $17,985 in restitution.

Sept. 25, 2009 — Juergen Homann of Saddle River, N. J., pleaded guilty to failure to file a Report of Foreign Bank or Financial Accounts and accepted responsibility for concealing more than $5 million in Swiss bank accounts. Homann was sentenced on Jan. 6, 2010, to five years probation and was ordered to pay a $60,000 fine.

Aug. 14, 2009 — John McCarthy of Malibu, Calif., pleaded guilty to failing to inform the government of a Swiss bank account as part of a scheme to move at least $1 million from the United States into Swiss bank accounts with the goal of avoiding the payment of federal income taxes. McCarthy was sentenced on March 22, 2010, to three years of supervised release with six months served in home detention and 300 hours community service. In addition, he was ordered to pay a $25,000 fine and to file tax returns for 2003 through 2008 and pay all taxes due and owing.

July 28, 2009 — Jeffrey P. Chernick of Stanfordville, N.Y., pleaded guilty to charges of filing a false tax return. Chernick, who owns a corporation which represents toy manufacturers in China and Hong Kong, accepted responsibility for concealing more than $8 million in Swiss bank accounts. Chernick was sentenced on Oct. 30, 2009, to three months in prison and one year of supervised release with six months served in home detention.

June 25, 2009 — UBS client Steven Michael Rubinstein of Boca Raton, Fla., pleaded guilty to filing a false tax return for tax year 2004. On April 1, 2009, Rubinstein was charged with filing a false tax return that intentionally failed to disclose the existence of a Swiss bank account maintained by UBS of which he was the beneficial owner and failed to report any income earned on that account. Rubinstein was sentenced on Oct. 28, 2009, to three years probation, of which 12 months will be served in home detention.

April 14, 2009 — Robert Moran of Lighthouse Point, Fla., pleaded guilty to a criminal information charging him with filing a false income tax return. Moran accepted responsibility for concealing more than $3 million in assets in a secret bank account at UBS in Switzerland. Moran was sentenced on Nov. 6, 2009, to two months in prison and one year of supervised release with five months in home confinement.

Chapter 21 - The IRS and U.S. Taxpayer Emails

According to a 4/10/13 CNET article, the IRS thinks it doesn't need a warrant to read taxpayer emails in pursuit of tax collection. The files were released to the American Civil Liberties Union, under a Freedom of Information Act request, which demonstrates that the IRS broadly interprets their authority to "snoop through" U.S. taxpayer "inboxes".

The IRS has a "legal leg to stand on": The Electronic Communications Privacy Act allows the IRS to obtain emails older than 180 days without a warrant. An internal 2009 IRS document claimed that "the government may obtain the emails that have been in storage for more than 180 days without a warrant."

Another 2009 IRS file, the IRS Criminal Tax Division's "Search Warrant Handbook", showed "the 4th Amendment does not protect communications held in electronic storage, because 'internet users' do not have a reasonable expectation of privacy".

In December 2010, the 6th Circuit Court of Appeal ruled that just because your email is held in storage does not mean you lose that expectation of privacy, precluding federal and local law information from reviewing contents of U.S. taxpayer emails.

However, the 6th Circuit Court of Appeal was just the ruling of one appeals court, not the Supreme Court, and the IRS' stated position is "the IRS does not need a warrant for emails older than 180 days".

Chapter 22 – International Tax Evasion: Money Laundering

International tax evasion has been the "Sport of Kings" for centuries. Cloaked in secrecy, done surreptitiously, no one could ever prove it. The "Super-rich" (i.e. the top 1%) get away with "tax cheating" and used their "tax cheating proceeds" to buy assets; e.g., real estate, boats, planes, cars, diamonds and art (all of which may constitute "money laundering").

The willful tax cheating by the super-rich may be "tax treason" defined: the betrayal of a trust, treachery; the offense of attempting by overt acts to overthrow the government of the state to which the offender owes allegiance.

So why do tax cheats get away with treason? Why do governments all over the world let the richest people cheat on their taxes and commit "tax treason"? What is the bottom line to tax treason? Is it that billions of people around the world suffer and live without adequate nutrition, housing, clothing, health care and education? Who is responsible for this tax mess?

With the proliferation of the Internet as an information database, after centuries of secrecy, the truth is coming out. Transparency is coming of age, and for the super-rich tax cheats, their days appear numbered.

Consider Recent Events in Spain and Africa

In Spain, there are 1,600 cases involving embezzlement, tax evasion, kickbacks and Swiss bank accounts, including: the former treasurer of Spain's ruling party, indicted, the former head of the country's Supreme Court resigned in disgrace. And now, Spain's Princess, Cristina, could land in jail and topple King Juan Carlos and the Spanish monarchy.

In April 2013, Princess Cristina was indicted on charges of complicity in fraud, tax evasion, money laundering and embezzlement, the first member of a European royal family to be charged in a serious crime in centuries.

The case revolves around her husband, Duke of Palma, Inaki Urdangarin, who is accused of fraud, tax evasion, forgery and the embezzlement of $7.8 million from regional governments through inflated contracts via their non-profit organization, Institute Noor.

Judge Jose Castro oversaw the Princess' indictment, saying she gave her consent to her husband's "shady deals". A specially appointed anti-corruption prosecutor requested the indictments be dropped. On May 7, 2013 an appeals court ruled to dismiss the case in a preliminary judgment. Judge Castro is likely to pursue another indictment.

In Africa on 5/10/13, a 120 page Africa Progress Report was issued stating $63 billion is lost annually in Africa through tax evasion, corruption, secret business deals, more than all the money coming into Africa through aid and investment. Despite Africa's surging economic growth, fueled by a global resources boom, poverty and inequality have worsened.

Kofi Annan, the former U.N. Secretary General, who heads the panel that wrote the report, stated:

“It is unconscionable that some companies, often supported by dishonest officials, are using unethical tax avoidance, transfer pricing and anonymous company ownership to maximize their profits while millions of Africans go without adequate nutrition, health and education.” The report stated:

“Revenues that could have been used to impact lives have instead been used to build personal fortunes, finance civil wars and support corrupt and unaccountable political elites. Revenue losses on this scale cause immense damage to public finance and to national efforts to reduce poverty. Some political elites continue to seize and squander the revenues generated by natural resources, purchasing mansions in Europe or the U.S. or building private wealth at public expense.

In the U.S., tax evasion is a felony (under Internal Revenue (“Code”) Code section 7201) with a penalty of up to five years in prison. In addition, the crime of tax evasion includes other crimes for which a U.S. taxpayer may be prosecuted, including:

1. Obstruct Tax Collection. Under Code section 7212, a penalty of up to three years in prison;

2. Conspiracy to Impede Tax Collection. Under 18 U.S.C. §371, a “Klein Conspiracy” in which two or more persons agree to “impede” IRS tax collection, with a penalty of up to five years in prison;

3. Filing a False Tax Return. Under Code section 7206(1), up to three years in prison;

4. “FBAR” Violation. Willful violation re: disclose foreign aggregate accounts over $100,000 up to ten years in jail. 31 U.S.C. Sec. §5322(b),

If federal prosecutors throw the book at tax cheats, they may face over 25 years in prison.

Tax evasion by itself is punishable by over 25 years in prison. In addition, separate crimes may include: money laundering, wire fraud and mail fraud (each of which are separate felonies punishable by 20 years plus, in prison). So if a tax cheat commits tax evasion, money laundering, wire fraud and mail fraud, their maximum penalties may be over 85 years in prison (with an additional 10 years if the violation affects a financial institution).

For U.S. persons who are involved with international tax evasion (i.e. they collaborate with tax cheats from other countries helping those international tax cheats commit tax evasion and launder money), they may be held liable for money laundering, a separate offense, since foreign tax evasion is a predicate offense, a Specified Unlawful Activity (“SUA”); i.e. a foreign crime, which subjects the U.S. person to penalties for money laundering.

In the Pasquantino case, (96 AFTR 2d 2005-5392 (2005), the U.S. Supreme Court determined that a foreign government (i.e. Canada) has a valuable "property right" in collecting taxes (in Pasquantino, "excise taxes"), The Supreme Court held that international tax evasion (i.e. taxes due to a foreign government) is a "Specified Unlawful Activity ("SUA"), which is both a predicate offense for money laundering (i.e. it is a "foreign crime"), and is a violation of the wire fraud statute (18 U.S.C. Sec. 1343) (i.e. the uncollected Canadian excises were "property" for purposes of the "fraud" element in the "wire fraud statute").

In Pasquantino, the U.S. Supreme Court held that the defendant's failure to pay taxes inflicted economic injury on Canada "no less than had they embezzled funds from the Canadian treasury. (Defendants) used interstate wires to execute a scheme to defraud a foreign sovereign of tax revenues. Their offense was complete the moment they executed the scheme inside the U.S., the wire fraud statute punishes the scheme, not its success.

International tax and estate planning may lead to tax evasion (and additional crimes: money laundering, mail fraud, wire fraud) if the U.S. taxpayer either fails to pay tax due to federal, state or foreign governments. The U.S. taxpayer may be culpable for violation of U.S. wire fraud laws, money laundering laws or mail fraud laws, which may lead to asset forfeiture.

Money laundering is the disguise of the nature or the origin of funds. It includes the transmutation of tax evasion proceeds into personal assets or 3rd party distributions (to family, friends, and others).

Income tax deficiencies (i.e. failure to pay tax due) which create "tax cheating" proceeds, when used to purchase assets or make investments may subject the taxpayer to separate felonies:

- Tax Evasion (failure to pay the tax due);
- Money Laundering. The use of proceeds from a specified unlawful activity, i.e. tax evasion, to purchase or make investments in assets which transmute the original illegal tax-cheating proceeds into another asset;
- Mail Fraud. The use of the postal system to effectuate a scheme to defraud. 18 U.S.C. Sec. 1341;
- Wire Fraud. The use of the telecommunications facilities to effectuate a scheme to defraud. 18 U.S.C. Sec. 1341.

Money Laundering

Money laundering may be linked to tax evasion. A violation of the money laundering statutes includes a financial transaction involving the proceeds of a specified unlawful activity ("SUA") with the intent to either:

1. Promote that activity;

2. Violate IRC Sec. 7201 (which criminalizes willful attempts to evade tax);

3. Violate IRC Sec. 7206 (which criminalizes false and fraudulent statements made to the IRS).

The tax involved in the transaction (and which is avoided) may be any tax: i.e. income, employment, estate, gift and excise taxes (See: U.S. Dept. of Justice, Criminal Tax Manual, Chapter 25, 25.03(2)(a).

Under the money laundering statutes, the IRS is authorized to assess a penalty in an amount equal to the greater of the financial proceeds received from the fraudulent activity, or $10,000 (under 18 U.S.C. Sec. 1956(b)), the authority is granted by statute to the U.S. not the IRS, and is enforced either by a civil penalty or a civil lawsuit.

Violations of statutes for mail fraud, wire fraud, and money laundering are punishable by monetary penalties, civil and criminal forfeiture. (See 18 U.S.C. section 981 (a)(1)(A) which permits property involved in a transaction that violates 18 U.S.C. sections 1956, 1957 and 1960 to be civilly forfeited).

Civil forfeiture statutes include:

1. 18 U.S.C. Sec. 1956, which outlaws the knowing and intentional transportation or transfer of monetary funds derived from specified criminal offenses. For Sec. 1956 violations, there must be an element of promotion, concealment or tax evasion;

2. 18 U.S.C. Sec. 1957, which penalizes spending transactions when the funds are contaminated by a criminal enterprise;

3. 18 U.S.C. Sec. 1960, which penalizes the unlicensed money transmitting business.

Under 18 U.S.C. Sec. 981(b)(2), seizures are made by warrant in the same manner as search warrants. Under 18 U.S.C. Sec. 981(b)(1), the burden of proof is by a preponderance of the evidence. The property may be seized under the authority of the Secretary of the Treasury when a tax crime is involved.

Under 18 U.S.C. Sec. 982(a)(1)(A), if the offense charged is a violation of the Money Laundering Control Act, and the underlying specified unlawful activity is mail or wire fraud, courts may order criminal forfeiture of funds involved in the activity on conviction.

The U.S. Dept. of Justice Tax Division policy requires U.S. attorneys to obtain Tax Division approval before bringing any and all criminal charges against a taxpayer involving a violation of the Internal Revenue Code. Absent specific approval, additional criminal charges for wire fraud, mail fraud and money laundering would not normally be included (U.S. Dept. of Justice Criminal Tax Manual, Chapter 25, 25.01). If the additional criminal charges are approved, the taxpayer risks having the trust assets seized or forfeited.

Regarding asset seizure, the U.S. government may seize assets pursuant to a violation of the money laundering laws. In addition, the IRS has authority for seizure and forfeiture under Title 26. Under IRC Sec. 7321, any property that is subject to forfeiture under any provision of Title 26 may be seized by the IRS.

Code section 7301 allows for the IRS to seize property that was removed in fraud of the Internal Revenue laws. Code section 7302 allows the IRS to seize property that was used in violation of the Internal Revenue laws.

In the case of transfer of funds to an offshore trust, it can trigger a violation of U.S. money laundering laws and lead to asset forfeiture. For example, tax counsel may recommend a tax planning strategy, and provide instructions by telephone, email or U.S. mail, which include client's transfer of funds pursuant to tax counsel's instructions. These combined actions may trigger a violation of U.S. money laundering laws and lead to asset forfeiture.

Tax Counsel, Tax Evasion (and Money Laundering) Offshore Trusts

A U.S. taxpayer's failure to comply with U.S. tax law may implicate tax counsel in tax evasion. The IRS or the U.S. Dept. of Justice may allege that tax counsel aided and abetted the client in evading U.S. tax, if tax counsel:

1. Aided and assisted the U.S. taxpayer in the submission of materially false information to the IRS; Code § 7206(2), or

2. Assisted the client in removing or concealing assets with intent to defraud. Code § 7206(4).

For a U.S. taxpayer's transfer of assets to an offshore trust, despite receiving U.S. tax counsel's tax compliance recommendations, the U.S. taxpayer fails to comply with U.S. tax law, and tax counsel fails to ensure ongoing tax compliance, tax counsel may be implicated in money laundering.

If the U.S. taxpayer's tax noncompliance includes: tax evasion and transfer of the "tax evasion proceeds" to the offshore trust by wire transfer or U.S. mail, the transfer of funds may be classified by the IRS/U.S. Dept. of Justice as wire fraud or mail fraud, both of which are "specified unlawful activities" under the Money Laundering Control Act (18 U.S.C. Sec. 1956 and 1957), the U.S. taxpayer and their tax counsel may be criminally prosecuted for violation of the money laundering statutes.

Specified Unlawful Activities are listed in 18 U.S.C. section 1956(c)(7). SUAs are the predicate offenses for money laundering and come in three categories:

1. State crimes,

2. Federal crimes, and

3. Foreign crimes.

If the U.S. client transfers funds to an offshore trust under a tax counsel's tax-planning strategy and the U.S. tax client is not in compliance with U.S. tax laws (despite tax counsel's recommendations) then tax counsel may be exposed to IRS penalties:

1. Code section 6694 imposes civil penalties on tax preparers;

2. Code section 7212 imposes criminal penalties for interfering with the administration of the Internal Revenue laws.

Chapter 23 - International Tax Evasion: UBS & Wegelin Bank

In America, a country that fought a revolution over taxes, tax evasion is a bad idea. U.S. taxpayers with undisclosed offshore accounts with unreported income face “double jeopardy”: civil tax fraud (with no statute of limitations) and criminal tax evasion (with a six-year statutes of limitation). Severe financial penalties and jail sentences await those U.S. taxpayers who get caught “cheating on their taxes.”

Tax evasion has never been a good idea. In this article, I’ll discuss Wegelin and the UBS Bank cases to make that point.

The UBS Case

UBS, Switzerland’s largest bank, became “the first crack in the Swiss Banking System” when, on February 18, 2009, they entered into a deferred prosecution agreement with the U.S. Department of Justice (DOJ). Under the agreement, UBS agreed to pay a $780 million fine and turn over the names and account information of 285 U.S. account holders who were not reporting their foreign financial accounts, the assets held in these accounts, nor the income from the assets (held in these accounts). On February 19, 2009, the U.S. Dept of Justice filed a civil suit seeking to force UBS disclosure of up 52,000 accounts held by U.S. taxpayers. On August 19, 2009, UBS and the U.S. DOJ entered into a settlement agreement in which an additional 4,450 accounts of non- compliant U.S. taxpayers were disclosed. A parallel agreement was signed on August 19, 2009 between the U.S. and Swiss government, based on the existing U.S.- Switzerland Double Taxation Treaty, which was approved by the Swiss Parliament on June 17, 2010. On October 22, 2010, the U.S. DOJ agreed to dismiss its criminal prosecution against UBS because UBS complied with its obligations.

In total, UBS paid $780 million in fines, and turned over 4,735 U.S. taxpayers, suspected of tax evasion to the U.S. government. These U.S. taxpayers with Swiss bank accounts at UBS who failed to disclose the accounts, the account assets and the income (from the account assets) violated multiple U.S. tax compliance filing requirements as follows:

Form 1040 Individual Tax Returns: Annual reporting of worldwide income;

Report of Foreign Bank and Financial Account, “FBAR” (Form TDF 90-22.1). Annual disclosure of foreign bank and financial accounts in which the U.S. taxpayer has a financial interest in, or signatory authority over any financial accounts in a foreign country, if the total value of such accounts exceeds $10,000 at any time during the calendar year. Signature Authority is defined as the authority (either alone or in tandem with another individual) to control the disposition of assets, funds or money held in a financial institution account, by delivery of written or oral instructions, directly to the financial institution which holds the account.

The U.S. taxpayer must file the FBAR, disclose the foreign account on Form 1040/Schedule B (Part III: Foreign Accounts and Trusts) and report all income earned on the foreign account on

Form 1040;- Form 8938: “Specified Foreign Financial Assets” to disclose foreign financial assets in excess of $50,000 (Form 8938 is attached to Form 1040). The filing of Form 8938 (with Form 1040) does not relieve U.S. taxpayers of the requirement to file the FBAR (Form TDF 90-22.1) if the FBAR filing is otherwise due. For those U.S. taxpayers who established UBS accounts, with the assistance of tax advisors, under 18 USC 371, both the taxpayer and the tax advisors may be held liable for conspiracy to defraud the U.S. A conspiracy to defraud the U.S. for taxes due is known as a Klein Conspiracy.

The U.S. government must prove that there was an agreement by 2 or more persons to impede the IRS, and each participant knowingly, willfully and intentionally participated in the conspiracy.

A U.S. taxpayer’s failure to report their worldwide income, disclose foreign financial accounts over $10,000, disclose foreign financial assets over $50,000, which appears to be the case for the 4,735 U.S. taxpayers with UBS accounts, subjects these U.S. taxpayers to significant civil and criminal penalties as discussed herein.

Civil and Criminal Penalties

U.S. taxpayers face civil and criminal tax penalties when they:

- Fail to report worldwide income on their tax returns (Form 1040);- Fail to report foreign financial accounts, in which they have a financial interest or have signatory authority, account value over $10,000 (Form TDF 90-22.1); and/or- Fail to report foreign financial assets, in which they have an ownership interest, assets over $50,000 (Form 8938).

U.S. Taxpayers include:- U.S. citizens;- U.S. “Green Card” holders;- U.S. resident aliens in the U.S. for 183 days in one year, or 122 days per year over 3 consecutive years.

U.S. taxpayers must file annual U.S. income tax compliance- Form 1040: report worldwide income;- Form TDF 90-22.1 (FBAR): report foreign financial accounts (value over $10,000.) - Form 8938: report foreign financial Assets with value over $50,000, in which they have an ownership interest.

U.S. taxpayer foreign assets must be reported under the “FBAR” filing (foreign financial accounts over $10,000) and the FACTA filing for foreign assets over $50,000. These foreign assets must also be reported under Form 1040 Schedule B.

Form 8938 (reporting specified foreign financial assets) must be attached to tax return/Form 1040. Filing Form 8938 does not relieve U.S. income tax residents of obligation to file FBAR (Form TDF 90-22.1) if FBAR filing is otherwise due.

Criminal Penalties

Unreported income, undisclosed foreign financial accounts and undisclosed foreign financial assets subject U.S. taxpayers to criminal penalties.

Unreported Income

- Internal Revenue Code ("Code") section 7201, Tax Evasion (Willful Evasion of Tax): up to 5 years in prison; fine up to $100,000 (individual); $500,000 (corporation);
- Code section 7212, Obstruct (Impede Tax Collection): up to 3 years in prison, a fine of up to $5,000;
- 18 U.S.C. § 371, Conspiracy to Impede Tax Collection (separate charge of impeding): up to five years in prison;
- Code section 7203, Failure to File Tax return: Up to one year in prison; a fine of up to $25,000 (individual); $100,000 (for corporation);
- Code section 7206(1), Filing a false tax return: Up to 3 years in prison and a fine of up to $250,000.

FBAR Violation

31 U.S.C. §5322(b) and 31 C.F.R. §103.59(c): willful violation up to 10 years in jail and a $500,000 fine.

Foreign Account Tax Compliance Account (FATCA) Form 8938

Taxpayers who fail to file Form 8938, report an asset or have an underpayment of tax may be subject to criminal penalties.

Civil Penalties

FBAR (Willful Failure To File)

Civil penalty is the greater of $100,000 or an annual penalty of 50% of the greatest amount in the account. The 50 percent penalty is imposed for each year there is no FBAR filed for the foreign financial account, so if the FBAR is not filed for 4 years, the penalty is 200% of the highest account balance (e.g., if the highest account balance is $1 million, the penalty for four years of non-FBAR filing, is $2 million).

FATCA (Form 8938)

Taxpayers who fail to file Form 8938, fail to report an asset, or have an underpayment of tax may be subject to civil penalties.

A 40 percent accuracy-related penalty for underpayment of tax distributable to an undisclosed foreign financial asset understatement, or a 75 percent fraud penalty for underpayment of tax due to fraud.

Unreported Income: Civil Tax Fraud

- Code section 6651(f), Fraudulent Failure to File Tax Return: Maximum penalty of 75% of the amount of the unpaid tax;
- Code section 6663(d), Fraudulent Tax Return (Unreported Income): Maximum penalty of 75% of the amount of the unpaid tax;
- Code section 6662(b)(1)-(5): Accuracy-Related Penalty. Penalty of 20% of the unpaid tax;
- Code section 6663(c): Spousal Liability. On a joint tax return, both spouses are subject to joint and several liability for the entire tax liability. The civil fraud penalty applies only to the spouse responsible for the tax underpayment attributable to fraud;
- Code section 6651(a)(2): Failure to pay tax shown as due on a tax return penalty of up to a maximum of 25% of unpaid tax.
- Code section 6651(a)(3): Unpaid tax not shown as due on a return (i.e., unreported income) penalty of up to a maximum of 25% of unpaid tax. Offsetting Penalties: Under code section 6651(c)(1), the amount of the penalty for failure to file is reduced by the amount of the penalty for failure to pay (the amount shown on a return for any month for which both penalties apply). Under Code section 6651(a)(3), there is no offset for the penalty for failure to pay tax not shown as due on a return (i.e., unreported income);
- No credit is allowed against the civil fraud penalty for any criminal fines paid for income tax evasion and conspiracy to defraud the United States.

U.S. Taxpayers Swiss Bank (Wegelin)

On January 4, 2013, Wegelin & Co., Switzerland's oldest bank (est. 1741), which had $25 billion under management, pled guilty in a New York court to helping Americans evade their taxes. Wegelin agreed to pay a $57.8 million fine to U.S. authorities, forfeit an additional $16.2 million held in a U.S. account (total fines/forfeiture: $74 million) and "cease to operate as a Bank". In 2012, in a separate civil lawsuit by the U.S., the judge entered a default judgment against the Bank when it failed to appear, ordering it to forfeit $16.2 million held in the U.S. account.

Wegelin admitted to allowing more than 100 American citizens (who are from UBS) to hide $1.2 billion in undeclared assets from the IRS for almost 10 years. Wegelin became the first foreign bank to plead guilty to tax evasion charges in the U.S.

Previously, UBS agreed to pay a $780 million fine related to tax evasion charges, disclose the details of nearly 5,000 U.S. account holders, but they neither pleaded nor were found guilty. Instead, UBS and U.S. prosecutors had a deferred prosecution agreement, with the fine being paid in exchange for the charges being dropped.

U.S. Attorney Preet Bharara said it was "a watershed moment in our efforts to hold to account both the individuals and the banks — wherever they may be in the world — who are engaging in unlawful conduct that deprives the U.S. Treasury of billions of dollars of tax revenue." He also stated:

“There is no excuse for wealthy Americans flouting their responsibilities as citizens of this great country to pay their taxes, and there is no excuse for foreign financial institutions helping them to do so.... Wegelin became a haven for U.S. taxpayers seeking to circumvent the tax code by hiding their money in secret offshore accounts, and the bank willfully and aggressively jumped in to fill a void that was left when other Swiss banks abandoned the practice due to pressure from U.S. law enforcement. Today’s guilty plea is a watershed moment in our efforts to hold to account both the individuals and the banks — wherever they may be in the world — who are engaging in unlawful conduct that deprives the U.S. Treasury of billions of dollars of tax revenue. We will continue our efforts until this practice is eliminated in its entirety.”

Otto Bruderer, Managing Partner at Wegelin, admitted that between 2002-2010, Wegelin sheltered U.S. clients from tax while aware that its conduct had been “wrong”. Mr. Bruderer further admitted that “assisting tax evasion was common practice in Switzerland.”

Under the proposed plea agreement, entered by Otto Bruderer on behalf of Wegelin and Co., Wegelin entered a plea to a single count of conspiring to commit tax evasion. The technical language of the charge is “willfully and knowingly would and did defraud the U.S.A. and the IRS for the purpose of impeding, impairing, obstructing and defeating the lawful government functions of the IRS.”

Sentencing

In U.S. v. Wegelin & Co., et al., U.S. District Court for the Southern District of New York, Case No. 12-CV-00002, on March 4, 2013, U.S. District Judge Jed Rakoff ordered Wegelin & Co., the oldest Swiss private bank, to pay $22 million in fines, $20 million in restitution, over $15 million in forfeitures in addition to over $16 million in previous forfeitures, amounting to a total over $74 million, as well as a period of probation.

Judge Rakoff questioned whether the size of the settlement appropriately reflected the extent of the wrongdoing, saying there was a “funny tension” between the U.S. Department of Justice’s decision not to seek the maximum $40 million fine and its assertion Wegelin acted with “extreme willfulness.”

“Not much pain there, is there?” said Judge Rakoff.

U.S. taxpayers, who used Swiss Bank accounts to hide unreported U.S. income and annual earnings from those accounts, face a myriad of civil and criminal tax penalties. The “spotlight” may now shine on these U.S. taxpayers who committed tax evasion because 13 other Swiss Banks are under IRS investigation, including:

- Credit Suisse, with over 1 trillion dollars in total assets, another trillion dollars in clients’ money;
- HSBC Holdings, P.C., who paid a $1.5 billion fine for laundering drug money (and other offenses);

- Basler Kantonalbank;
- Julius Baer;
- Nine other local, central Swiss banks.

Wegelin ceased to function as a Swiss Bank in 2011, selling off its core Swiss and other non-U.S. businesses in January 2011, to protect non-U.S. clients from the legal battle “fall out.” The sale left Wegelin responsible only for its American clients. In February 2012 Wegelin, as an institution, was indicted by U.S. authorities and later declared a fugitive from justice when the Bank’s executives failed to appear in a U.S. court (the three Wegelin bankers, Michael Berlinka, Urs Frei and Roger Keller, are still fugitives).

Wegelin had previously vowed to fight the charges, claiming that because it only had branches in Switzerland, it was bound only by its home country’s banking laws, not by U.S. law. The Bank’s guilty plea ensured their demise.

Wegelin told U.S. taxpayers their undeclared accounts would not be disclosed to the U.S. authorities because the bank had a long tradition of secrecy and unlike UBS, had no offices outside of Switzerland and was less vulnerable to U.S. law enforcement.

To further the goals of the conspiracy from 2002-2011, Wegelin took steps including:
- Opening and servicing undeclared accounts for U.S. taxpayer-clients in the names of sham corporations and foundations formed under the laws of Liechtenstein, Panama and Hong Kong (and other jurisdictions) to conceal clients’ identities from the IRS;

- Wegelin and Company accepted documents falsely declaring that the sham entities were the beneficial owners of certain accounts, when in fact the accounts were beneficially owned by U.S. taxpayers;

- U.S. taxpayers maintain Wegelin accounts (undeclared), using code names and numbers to minimize references to the actual names of the U.S. taxpayers on Swiss Bank documents;
Wegelin Bank ensured that account statements and other mail were not mailed to U.S. clients in the U.S.; they were instead sent to U.S. taxpayer clients’ personal e-mail accounts, to reduce risk of detection by law enforcement;

- Wegelin issued checks drawn on, and executing wire transfers to, its U.S. correspondent bank accounts for the benefit of U.S. taxpayers with undeclared accounts at Wegelin (and at least two other Swiss banks);

- Wegelin separated the transfers into batches of checks or multiple wire transfers in amounts that were less than $10,000 to reduce the risk that the IRS would detect the undeclared accounts;

- Wegelin used its correspondent bank accounts at UBS to help U.S. taxpayers with undeclared accounts repatriate money that they had hidden in Wegelin;

- U.S. taxpayers asked Wegelin to issue and send their checks drawn on Wegelin's correspondent bank accounts, and that represented funds held in their bank accounts at Wegelin;

- Wegelin permitted at least two other Swiss banks to issue checks drawn on its correspondent bank account for the benefit of U.S. taxpayers holding undeclared accounts at these other banks;

The sheer volume of transfers in Wegelin's correspondent bank accounts served to conceal the repatriation of money from U.S. taxpayers' undisclosed accounts at Wegelin and other banks.

On January 3, 2013, Otto Bruderer admitted:

"From about 2002-2012, Wegelin agreed with certain U.S. taxpayers to evade the U.S. tax obligations of these U.S. taxpayer clients who filed false tax returns with the IRS." "In furtherance of its agreement to assist U.S. taxpayers to commit tax evasion in the U.S., Wegelin, among other things, opened and maintained accounts at Wegelin in Switzerland for U.S. taxpayers who did not complete Form W-9 tax disclosure forms to report their income to the IRS."

Bruderer admitted that Wegelin and Company knew the U.S. taxpayers were creating non- W-9 accounts at Wegelin and Company in order to evade their U.S. tax obligations in violation of U.S. law, he stated: "Wegelin intentionally opened and maintained non W-9 accounts for U.S. taxpayers" with the knowledge, that by doing so, Wegelin and Company was assisting these taxpayers in violating their legal duties and that "Wegelin was aware that this conduct was wrong."

For U.S. taxpayers, although under the Fifth Amendment they cannot be forced to incriminate themselves, the courts have held that offshore banking records fall within the required records exception. The Ninth Circuit in In re: Grand Jury Investigation M.H., 648F.3d 1067 (9th Cir. 2011, cert, denied, 133 S.Ct. 26 (2012) compelled an offshore account holder to produce account data even if it was self-incriminating.

Jeffrey Neiman, a former U.S. federal prosecutor, stated: "It is unclear whether the bank was required to turn over American clients who held secret Swiss bank accounts. What is clear is that the Justice Department is aggressively pursuing foreign banks who have helped Americans commit overseas tax evasion."

James Mastracchio, of Baker Hostetler's National Tax Controversy Practice stated:

"This is an unprecedented plea by a foreign institution subjecting itself to U.S. jurisdiction ... as the global banking community becomes FATCA controversy compliant - particularly for those foreign institutions operating in countries with inter-governmental agreements - transparency and the sharing of information will continue with U.S. and by agreement and in practice, such that FFI will be under greater pressure to make unprecedented agreements to follow U.S. law and regulations. This plea does provide an example of what might become the normal relations between the U.S. and FATCA- compliant jurisdictions."

Tax Evasion And Money Laundering

U.S. taxpayers who hide money in Swiss bank accounts, and their tax advisors who assist them, may be held liable for tax evasion, conspiracy and money laundering.

In the Wegelin case, for the first time a Swiss Bank has pled guilty to a felony; i.e., conspiracy to commit tax evasion. Wegelin facilitated tax fraud by accepting deposits from U.S. taxpayers who did not pay income tax on the earnings (i.e. interest) from the bank accounts. The U.S. taxpayers relied on "Swiss Banking Secrecy" (i.e. the U.S. taxpayers did not disclose their Swiss income or the assets in the accounts, which earned the income, "hiding behind" Swiss Banking Secrecy) the knowledge that the Swiss Bank, Wegelin, would not disclose either the assets in the accounts or the income from the accounts.

As Wegelin director Otto Bruderer stirringly admitted, Swiss banking practices "profit" by committing tax fraud. Swiss Banks entice foreign (i.e. US and other) investors to establish Swiss Bank accounts, which accounts are maintained secretly listing "nominee owners", (i.e. corporations, trusts, limited liability corporations and third party individuals). The income from the Swiss Bank accounts is unreported and the banks do not disclose the actual account owner's country of tax residence, rendering them not subject to tax reporting or payment of tax in their country.

In the U.S., under "Klein Conspiracy," if two or more parties intentionally impede the IRS from collection of tax, they are liable for conspiracy to commit tax fraud, which is a felony (with a five-year prison sentence). The object of the conspiracy, the unlawful activity (tax evasion) is a predicate offense for a second felony, money laundering (i.e. a specified unlawful activity).

By Wegelin director Otto Bruderer admitting that Swiss Banks intentionally commit tax evasion, by shielding client accounts from reporting taxable income, his admission is evidence of willfulness (i.e. the U.S. taxpayer "intentionally" committed tax fraud) which makes the U.S. taxpayer and the bank criminally liable for tax evasion, conspiracy and money laundering, tax crimes which are subject to severe civil and criminal penalties.

IRS Summons

On January 29, 2013, Judge Pauley directed the IRS to issue a summons requiring the Swiss Bank, UBS, to produce information about U.S. taxpayers who were trying to evade U.SD. income taxes by holding accounts at other Swiss banks that did business with UBS;

Judge Pauley entered an order on 1/28/13 authorizing the IRS to require UBS to produce records on U.S. taxpayers with accounts at Swiss Bank Wegelin and other Swiss banks that used Wegelin's U.S. correspondent account at UBS;

Judge Pauley's order would enable U.S. authorities to determine the identity of U.S. taxpayers who hold or held interests in financial accounts at Wegelin and other Swiss financials that used Wegelin's UBS account.

Chapter 24 - International Tax Evasion: Tax Evasion & Money Laundering (Additional Issues)

“Money Laundering” is the disguise of the nature or the origin of funds. The predicate offenses (known as Specified Unlawful Activities; i.e. “SUA”), under the Money Laundering Control Act (18 U.S.C. Sec. 1956 and 1957) include: state tax evasion, federal tax evasion and foreign tax evasion.

A U.S. Taxpayer (or Foreign Taxpayer) may be held liable for Tax Evasion if: - They willfully fail to pay a tax due.- They willfully fail to file a tax return due.- They willfully file a false or fraudulent tax return.

U.S. Taxpayers (and tax advisors) implicated in U.S. tax evasion face separate felonies for tax evasion and money laundering. Foreign Taxpayers, who commit Foreign Tax Evasion, may implicate U.S. tax advisors in money laundering felonies, for the foreign client transfer of funds, which involve the U.S. tax advisors.

For both U.S. and Foreign Taxpayers, undisclosed foreign accounts, may be the depository accounts used to commit tax evasion, including:

Taxpayer failure to pay tax, file tax returns, or file false (fraudulent) tax returns for the original funds (which are the source of the proceeds used to fund the foreign accounts). Taxpayer failure to pay tax, file tax returns, or file false (fraudulent) tax returns for the earnings, on the assets held in the undisclosed foreign accounts

Depending upon the counsel’s role in taxpayer’s non-compliance, counsel may be held liable for aiding and abetting the client in tax evasion. Counsel may be held liable for:

- Aiding and assisting in the submission of materially false information to the IRS (IRC Sec. 7206(2).

- Assisting the client in removing or concealing assets with intent to defraud (IRC Sec. 7206(4).

Under Pasquantino, 96 AFTR 2d 2005-5392 (2005), the U.S. Supreme Court held that a foreign government has a valuable property right in collecting taxes (in this case Canadian excise taxes), and that right may be enforced in a U.S. court of law. Counsel who advise on international tax issues could be viewed as interfering with a foreign government’s right to collect taxes. In this case, taxpayer used interstate wiring to execute a scheme to “defraud a foreign sovereign of tax revenue” (both wire fraud and tax evasion, two separate predicate offenses for foreign money laundering).

Under Pasquantino, international tax evasion is deemed a “Specified Unlawful Activity,” which is a predicate offense for money laundering.

“Klein Conspiracy Prosecution”

Under 18 U.S.C. Sec. 371 it is a crime for two or more persons to conspire to commit an offense against the U.S. Under Klein an agreement by two or more persons to impede the IRS with each participant knowingly, willfully and intentionally participating in the conspiracy.

International Estate Plan

Tax counsels who advise a client on an international estate plan, may subject themselves to liability. Once the estate plan is in place, a client's subsequent actions may lead to U.S. or foreign tax evasion; e.g., violation of U.S. money laundering, wire fraud or mail fraud laws.

If a Tax Attorney forms entities (e.g. Trust, Limited Liability Company, Corporation) sends instructions to a client via telephone, email, U.S. Mail, and a client transfers funds pursuant to counsel's instructions, it may lead to tax evasion, a predicate offense (an "SUA"), which can trigger a violation of U.S. money laundering laws.

After the entities are formed, and despite receiving tax compliance guidance from counsel, the client fails to comply with the tax law, and counsel fails to ensure ongoing full tax compliance, the client may be held liable for both tax evasion and money laundering. If so, tax counsel may be subject to civil and criminal penalties:- IRC Sec. 6694: civil penalties imposed on tax preparers.- IRC Sec. 7212 (criminal penalties imposed for interfering with the administration of the internal revenue law).

U.S. Financial Reports

U.S. financial institutions file Currency Transaction Reports (CTR) and Suspicious Activity Report (SAR) with the Detroit Computing Center (uploaded at the IRS Currency Banking and Retrieval System database at the IRS/DCC).

The combined CTR/SAR currency transaction reports provide a paper trail (i.e. a "road map") for the IRS Criminal Investigation Division ("CID") investigation of "financial crimes" (i.e. tax evasion and money laundering).

A Currency Transaction Report (CTR) is filed by financial institutions that engage in a currency transaction in excess of $10,000.

A Suspicious Activity Report (SAR) is filed on transactions involving at least $5,000 that the financial institution knows, suspects, or has reason to suspect the money was derived from illegal activities. The SAR is also filed when transactions are part of a plan to violate federal laws and financial reporting requirements.

IRS Audits

Under a civil tax audit, the IRS may obtain evidence that may be illegal under criminal proceedings (e.g., Fifth Amendment defenses, objections to "tainted evidence"). With tax evidence obtained from the civil tax audit, the IRS (with the U.S. Attorney) may initiate criminal proceedings.

U.S. Taxpayers with unreported foreign bank accounts (and income) are subject to IRS civil tax audits with civil penalties (monetary penalty, only) and criminal tax prosecution (monetary penalty and jail).

The IRS, under a civil tax audit:

May summon evidence, which support culpability for a crime (e.g., tax evasion) and civil penalties (e.g., 75% fraud penalty).

May trigger investigation into money laundering (i.e., when U.S. Taxpayers attempt to repatriate funds from undisclosed foreign bank accounts, they may be liable for money laundering).

Use evidence obtained under a civil tax audit to support a subsequent criminal prosecution (including culpability for 3rd party co-conspirators for obstructing tax collection and conspiracy).

Tax Conspiracy

18 U.S.C.A. §371 is the Federal Statute for conspiracy which provides that: "If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $ 10,000 or imprisoned not more than five years, or both."

Tax Conspiracy offenses include: willfully aiding or assisting in, or procuring, counseling, or advising, the preparation or presentation under, or in connection with any matter arising under, the Internal Revenue laws, of a false or fraudulent return, affidavit, claim or document (whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim or document).

Tax Conspiracy offenses include: willfully failing to pay any tax or make any return (other than a return required under authority of Part III of Subchapter A of Chapter 61) at the time or times required by law or regulations; for offenses described in Sections 7206(1) and 7207 relating to false statements and fraudulent documents.

Offenses for tax conspiracy arise under Section 371 of Title 18 of the United States Code (Conspiracy), where the object of the conspiracy is to attempt in any manner to evade or defeat any tax or the payment thereof.

If an individual or individuals charged with committing any of the offenses articulated above, are outside the United States or are fugitives from justice, within the meaning of Section 3290 of Title 18 of the United States Code, the Statute of Limitations is tolled.

Money Laundering

When individuals attempt to repatriate into the United States, the funds contained in the undisclosed foreign bank accounts, they may be liable for money laundering. Individuals who maintain foreign bank accounts where disclosure of said bank accounts is not revealed pursuant to law, and who would be culpable under the various offenses recited above, may be liable for money laundering (specifically 18 U.S.C. 1956 and 1957, which is part of the Money Laundering Control Act of 1986).

18 U.S.C 1956 penalizes individuals who knowingly and intentionally transport or transfer monetary proceeds from specified unlawful activities. While the funds reposing in the foreign bank accounts may have been derived from lawful activities conducted within or without the United States by American citizens, the various violations of the Internal Revenue Code and the conspiracy statute, could well subject individuals to charges of money laundering.

If in fact the unreported bank accounts contained funds derived from unlawful activities, it may subject individuals to not only violations of Federal statutes but California statutes as well (e.g., California Penal Code §§ 182 and 186.10, which deal with conspiracy and money laundering).

Undisclosed Offshore Accounts: Records Subpoenas

At the California Tax Bar November 2012 Conference, San Diego speaker Kevin M. Downing (Miller Chevalier, Washington, D.C.) former lead U.S. Attorney prosecuting UBS, advised of new subpoena rules for Foreign Accounts which are undisclosed by U.S. taxpayers.

Once a records subpoena is served, there is no 5th Amendment right not to produce records, no production immunity.

If U.S. taxpayer does not have records, they must get records from the Foreign Financial Institution (i.e., undisclosed offshore account).

A refusal to comply with the records subpoena can result in the U.S. taxpayer being put in jail, with the account subject to an annual 50% penalty (of the highest account balance) under the "FBAR" rules. The U.S. government will not tolerate U.S. taxpayer's "stonewalling" (the incarceration and penalty have been affirmed by the 5th Circuit, the 7th Circuit and the 9th Circuit Court of Appeals).

Civil and Criminal Tax Fraud: Burden of Proof (Evidentiary Standards)

The U.S. taxpayer's exposure to civil penalty/criminal prosecution for unreported income and undisclosed foreign financial accounts is a "double-edged" sword with dual civil/criminal:

- Evidentiary Standards of Proof; - Statute of Limitations;- Collateral Estoppel Issues

If the IRS first institutes a civil tax audit, they may summons evidence, which may support both a civil penalty (e.g. fraud) and criminal culpability (e.g. tax evasion). The evidence from the civil tax audit may then be used for a subsequent criminal prosecution of the same U.S. taxpayer.

Civil and criminal tax deficiencies may differ-

Criminal violations are charged only against the tax deficiency that results from fraud.

Civil tax deficiency includes all tax due on the tax returns (i.e. "evaded income and deductions adjustments).

Under a civil tax audit, the IRS may obtain evidence that may be illegal under criminal proceedings (e.g. Fifth Amendment defenses objecting to "tainted evidence") tax evidence obtained from the civil tax audit may enable the IRS (i.e. the U.S. Attorneys to initiate criminal proceedings against the taxpayer).

Criminal tax fraud requires a higher standard of proof than civil tax fraud. The government must prove "beyond a reasonable doubt" that the defendant is guilty of criminal tax fraud.

In civil tax fraud, the burden of proof required is a preponderance of the evidence (also termed "by clear and convincing evidence") which is a lower evidentiary standard).

A criminal tax decision of a court or jury will bind a civil tax decision, but a civil tax decision does not bind a criminal tax decision.

Collateral Estoppel

When criminal tax proceedings are followed by civil tax proceedings, the legal doctrine of collateral estoppel may apply. This doctrine provides that an issue necessarily decided in a previous proceeding (the first proceeding) will determine the issue in a subsequent proceeding (the second proceeding) but only as to matters in the second proceeding that were actually presented and determined in the first proceeding.

A conviction for criminal tax evasion collaterally estops the taxpayer from contesting the existence of tax fraud for purposes of the civil tax fraud penalty (i.e. 75% of the unpaid tax) because a finding of criminal tax fraud (beyond a reasonable doubt) establishes proof of civil tax fraud (by clear and convincing evidence).

Acquittal of criminal tax evasion does not collaterally estop the government from proving civil tax fraud (by clear and convincing evidence). The criminal acquittal may establish that proof of fraud did not exist beyond a reasonable doubt, but that does not mean that proof of fraud by clear and convincing evidence does not exist.

Unreported Income (Undisclosed Foreign Bank Accounts)

U.S. taxpayers with unreported income and disclosed foreign financial accounts are subject to IRS civil tax audits with civil tax penalties (monetary penalty only) and criminal tax prosecution (monetary penalty and jail).

The U.S. taxpayer's tax records may include evidence, which supports culpability for a crime (e.g. tax evasion) and civil tax penalties (e.g. 75% fraud penalty).

Statutes of Limitation

Civil and criminal tax proceedings have different statutes of limitation.

Civil Tax Fraud - For civil tax fraud (i.e. unreported income/undisclosed foreign bank accounts), there is no statute of limitations. The tax can be assessed at any time.

Criminal Tax Evasion - For criminal tax evasion (i.e. unreported income) the criminal statute of limitations is only on the prosecution of the crime of tax evasion, (not the assessment of the tax owed).

Offenses arising under the Internal Revenue laws generally have a 3-year period of limitation for prosecution (IRC Sec. 6531).

When the prosecution is for the offense of willfully attempting in any manner to evade or defeat any tax, the statute of limitations is 6-years (i.e. unreported Income).

IRC Sec. 6531(1): for offenses involving the defrauding or attempting to defraud the United States (whether by conspiracy or not, and in any manner);

IRC Sec. 6531(2): for the offense of willfully attempting in any manner to evade or defeat any tax;

IRC Sec. 6531(3): for the offense of willfully aiding or assisting in the preparation of a false or fraudulent tax return.

IRC Sec. 6531(4): for the offense of willfully failing to pay any tax or make any tax return.

IRC Sec. 6531(5): for offenses relating to false statements and fraudulent documents under IRC Sec. 7206(1) and Sec. 7207.

IRC Sec. 6531(8): for offenses arising under 18 U.S.C. 371, where the object of the conspiracy is to attempt in any manner to evade or defeat any tax.

Under IRC Sec. 6531, the 6-year statute of limitations shall be tolled, while the U.S. taxpayer who committed the offenses is outside the United States.

Form 8938

Under Form 8938 (Statement of Specified Foreign Financial Assets):

A 3-year statute of limitations for failure to report a specified foreign financial asset or failure to file Form 8938;

A 6-year statute of limitations for U.S. taxpayer's failure to include in gross income an amount relating to specified foreign financial assets and the amount omitted is more than $5,000.

Chapter 25 - International Tax Evasion: Offshore Accounts

Under Treasury Department Circular #230 (Rev. 8/11), Title 31 Code of Federal Regulations, Subject A, Part 10 (published June 3, 2011), Section 1021 requires a tax practitioner who knows that the client has not complied with U.S. revenue laws, or made an error or omission in a tax return, to promptly advise the client of the fact of such non- compliance, error or omission and the consequences under the Internal Revenue Code and Treasury Regulations.

Under Circular #230, Section 1022, a practitioner must exercise due diligence in preparing and filing tax returns.

For U.S. taxpayer offshore accounts, in order to ensure U.S. taxpayer IRS compliance, the tax practitioner should confirm the following, prior to filing a client's tax returns:

Offshore Accounts: Tax Compliance Issues

1. Original source of proceeds?

2. How was the money earned?

3. Were the proceeds reported for tax purposes? If so, what tax year?

4. Was the fund transfer of the original proceeds from the U.S. sent directly to the offshore account?

5. Were there any intermediary transfers to third party banks or accounts? (If so, dates, accounts).

6. Total amount in each account (highest balance/each tax year).

7. Regarding the offshore account, did you file FBARs? Yes/No:

a. Every year?
b. Accounts over $10,000?
c. Did you own the account?
d. What was the name on the account?
e. Did you have signatory authority over the account?

8. Regarding offshore accounts, did you disclose the account on Form 1040/Schedule B, Part III, No. 7?

9. For foreign financial assets over $50,000, did you file Form 8938 for each tax year?

10. For financial assets over $50,000, did you purchase these assets with funds from the offshore account? If not, what was the source of funds for these purchases?

Chapter 26 - International Tax Evasion: Civil/Criminal Penalties

Civil Penalty Issues

1. Civil Tax Fraud (75% of tax due) (no statute of limitations).

2. Underpayment of Tax (25% of tax due).

3. For voluntary disclosures, under the IRS Offshore Voluntary Disclosure Program (2012), the values of foreign accounts and other foreign assets are aggregated for each year and the penalty is calculated during the period covered by the voluntary disclosure. Under the 2012/IRS Voluntary Disclosure, total penalties of up to 85% of unpaid tax, and 27.5% of highest balance total foreign bank accounts/foreign assets as follows:

a. Failure to File a Tax Return (IRC Sec. 6651(a)(1), up to 25% tax due.

b. Failure to Pay Tax (IRC Sec. 6651(a)(2), up to 25% tax due.

c. Accuracy Related Penalty (IRC Sec. 6662), a 40% penalty for tax underpayment attributable to undisclosed foreign financial asset understatement.

d. Title 26 Penalty – 27.5% highest aggregate balance of foreign bank accounts, entities and assets.

IRS/Criminal Penalty Issues

U.S. taxpayers with undisclosed offshore bank accounts and unreported income face criminal charges for:

1. Tax Evasion (IRC 7201), five years in jail, $25,000 fine;

2. Filing False Tax Return (IRC Sec. 7206(1)), three years in jail, $250,000 fine;

3. Failure to File Tax Return (IRC Sec. 7203), one year in jail, $100,000 fine;

4. Willful failure to file FBAR or Filing False FBAR (31 USC Sec. 5322), ten years in jail, fines up to $500,000 with related civil penalty the greater of $100,000 or 50% of the total balance of the foreign account per violation (IRC Sec. 5321(a)(5).

Chapter 27 - International Tax Evasion: Willfulness Defense

U.S. taxpayers, who fail to file tax returns or pay taxes due, face a felony for willful evasion of tax (IRC Sec. 7201). U.S. taxpayers, particularly international investors who are classified as U.S. taxpayers, under either the "Substantial Presence Test" or "Green Card Test", often defend their tax non-compliance by stating that they were "unaware of the law".

Under U.S. tax law, "ignorance of the law is no excuse" (in Latin: ignorantia juris non excusat). The legal principal is that a person who is unaware of a law may not escape liability for violating that law because they were unaware of its content.

U.S. Model Penal Code Section 2.02(9) states that knowledge that an activity is unlawful is not an element of an offense unless the statute creating the offense specifically makes it one.

For federal tax evasion, willfulness is required. This legal position was enshrined in Cheek v. U.S., (1991) 498 U.S. 192, which stated that in a federal criminal tax case, a taxpayer's "good faith" belief that he was not required to file tax returns would negate the 'intent element' of the crime of tax evasion (however, the defendant Cheek was held to not have a "good faith belief" and was convicted by the jury; i.e., the final arbiter of the evidence) and served a year and a day in jail.

On the issue of intent, the jury may consider "willful blindness"; i.e. the defendant willfully, knowingly and intentionally concealed the truth from himself, so that the defendant "intentionally" committed a tax crime.

Chapter 28 - Form W-8 Tax Withholding

Under IRC §§1441 and 1442, a Tax Withholding Agent must withhold 30% of any payment of an amount subject to tax withholding made to a Payee that is a Foreign Person unless the Withholding Agent obtains valid documentation that the Payee is either a U.S. Payee or a Beneficial Owner.

A U.S. Payee is any person required to furnish Form W-9.

A Beneficial Owner is any person or entity that is required to furnish:

1. Form W-8 BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding, [i.e., the Beneficiary is exempt from tax under a treaty]);

2. Form W-8 ECI (Certificate of Foreign Persons Claiming that Income is Effectively Connected with the Conduct of the Trade of Business in the United States, [i.e., the effectively connected income will be declared in the United States by the Beneficiary filing a U.S. Income Tax Return]); or

3. Form W-8 EXP (Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding, [i.e., any Foreign Government, International Organization, Foreign Central Bank of Issue, Foreign Tax-Exempt Organization, Foreign Private Foundation or Government of a U.S Possession]).

Under Form W-8 EXP, the Payee claims an exemption for withholding under IRC §115(2), IRC §501(C), IRC §892, IRC §895, or claims a reduced rate of withholding under IRC §1443(b).

Tax Withholding Agents

Tax Withholding on Payments to Foreign Taxpayer

Non-Resident Aliens and Foreign Corporations are generally subject to a flat 30% tax on U.S. Source Income that is not effectively connected with the conduct of a U.S. trade or business. To insure collection and payment of the tax, a Tax Withholding Agent must withhold 30% of the gross amount paid to a Foreign Taxpayer which is subject to tax (IRC §§1441 and 1442).

A lower tax-withholding rate may apply to scholarship or fellowship grants, gross investment income, and dispositions of U.S. real property interests. In addition, a tax treaty may also reduce the rate of tax withholding.

Only income of a Foreign Taxpayer is subject to tax withholding rules. A Foreign Taxpayer includes any Non-Resident Alien, (including a bona fide Resident of Puerto Rico) or an Alien Resident of Guam, the Northern Mariana Islands, the U.S. Virgin Islands and American Samoa (Treas. Reg. 1.1441-1(c)).

A Non-Resident Alien who elects resident status for income tax purposes will still be considered a Foreign Taxpayer for withholding purposes. A Foreign Taxpayer includes Foreign Corporations, Partnerships, Estates, Trusts (and the Foreign Branch of U.S. Financial Institutions in certain circumstances).

Income Subject to Tax Withholding

Income is subject to tax withholding requirements if it is from sources within the United States and is:

1. Fixed or determinable annual or periodical income ("FDAP" Income, e.g., interest, dividends, rents, royalties and compensation). FDAP Income does not include most gains from the sale of property.

2. Certain gains for the disposal of timber, coal, or domestic iron ore.

3. Gains relating to the contingent payment received from the sale or exchange of patents, copyrights, and similar intangible property.

Income payable for personal services performed in the United States will be treated as from sources who are within the United States, regardless of where the location of the contract, place of payment or residence of Payor.

Effectively Connected Income ("ECI") with the conduct of a U.S. trade or business is not subject to the withholding requirement (including income received as wages). ECI is subject to the tax and withholding rules, as if the Foreign Taxpayer were a U.S. Citizen Resident, or Domestic Entity.

Under IRC §1446, special rules apply to the effectively connected income of a Partnership (Foreign or Domestic) that is allocable to its Foreign Partners.

Withholding Agent

A Withholding Agent is the Person or Entity required to deduct, withhold and pay any tax on income paid to a Foreign Taxpayer (Treas. Reg. 1.1441-7). This duty is imposed on all persons that have the control, receive, custody, disposal, or payment of any items of income which are subject to withholding.

The Withholding Agent may be an Individual, Corporation, Partnership, Trust, or other entity (including a Foreign Intermediary or Partnership). A Withholding Agent may designate an Authorized Agent on its behalf.

The Tax Withholding Agent is personally liable for any tax required to be withheld, except in the case of certain conduit financing arrangements (IRC §1461). This liability is independent of the tax liability of the Foreign Taxpayer for whom any income is paid. Even if the Foreign Taxpayer pays the tax, the Withholding Agent may still be liable for any interest, penalties, or additions for failure to withhold (IRC §1463).

No Withholding

A Withholding Agent will not be required to withhold any amount if it has received documentation that confirms:

1. The Payee is a U.S. Person.

2. The Payee is a Beneficial Owner (i.e., a Foreign Person entitled to a reduced rate of withholding or a withholding exemption. Treas. Reg. 1.1441-1).

The Withholding Agent must obtain valid documentation from the Payee that it is either a U.S. Payee or Beneficial Owner. A U.S. Payee is any person required to furnish Form W-9. The U.S. Payee who furnishes Form W-9 may be subject to Form 1099 tax reporting and tax withholding requirements.

A Beneficial Owner is any person or entity who is required to furnish Form W-8 BEN, Form W-8 ECI, or Form W-8 EXP.

Payments to an intermediary (whether qualified or not), flow-through entity, or U.S. branch of Foreign Entity, may be treated as a U.S. Payee if valid documentation is provided on the Form W-8 IMY.

Withholding Agent Annual Returns

Every Withholding Agent must file an annual information return on Form 1042-S to report income paid to a Foreign Taxpayer during the tax year that is subject to withholding unless an exception applies (Treas. Reg. 1.1461-1, 1.6302-2).

A separate Form 1042-S must be filed for each recipient, as well as for each type of income that is paid to the same recipient. Form 1042 is used by the Withholding Agent to report and pay the withholding taxes.

Form 1042, Form 1042-S, must be filed regardless of whether or not taxes were required to be withheld. Forms 1042 and 1042-S must be filed by March 15th of the year following the year in which the income was paid.

The amount of tax required to be withheld will determine whether the Withholding Agent must deposit the taxes prior to the due date for filing the returns and how frequently such amounts must be deposited. Penalties may be imposed for failure to file, to provide complete and correct information, as well as for failure to pay any taxes.

Chapter 29 - IRS Form W-9

IRS Form W-9 is used by a person who files information returns with the IRS to report transactions. A U.S. Person (including a resident alien) provides their current Taxpayer Identification Number to the person requesting it ("The Requestor").

Summary

The Requestor uses the U.S. Person's Taxpayer Identification Number ("TIN") to report:

1. Income Paid (to the U.S. Person)

2. Real Estate Transactions

3. Mortgage Paid (by the U.S. Person)

4. Debt Cancellation

5. Acquisition or Abandonment of Secured Property

6. IRA Contributions (by the U.S. Person)

Form W-9 is used by a U.S. Person to certify:

1. Their Taxpayer Identification Number

2. They are not subject to "Back-up withholding"

3. If applicable, their allocable share of U.S. partnership income (U.S. trade or business) not subject to withholding tax, on foreign partners' share of "effectively connected income".

Form W-9 is used to claim exemption from back-up withholding for a U.S. Exempt Payee (who is exempt from tax under a U.S. Tax Treaty).

For Federal Tax purposes, a U.S. Person is defined as:

1. An Individual who is a U.S. Citizen or U.S. Resident Alien;

2. A U.S. Partnership, Corporation, Company or Association;

3. A U.S. Estate;

4. A Domestic Trust (defined under Treas. Reg. Section 301.7701-7).

Back-up Withholding

Payors making payments to U.S. Payees, under certain conditions must withhold and pay 28% of such payments to the IRS, known as "back-up withholding".

Payments that may be subject to back-up withholding include:

1. Interest

2. Tax-exempt Interest

3. Dividends

4. Broker and Barter Exchange Transactions

5. Rents

6. Royalties

7. Non-employee Pay

8. Real Estate transactions are not subject to back-up withholding

A U.S. Person is not subject to back-up withholding on payments received if they:

1. Give the Requestor their correct TIN

2. Make the proper certifications

3. Report all taxable dividends and interest on their tax return

Payments received by a U.S. Payee will be subject to back-up withholding if:

1. They do not give their TIN to the Requestor

2. They do not certify the TIN

3. The IRS tells the Requestor the U.S. Payee furnished an incorrect TIN

4. The IRS tells the Requestor the U.S. Payee is subject to back-up withholding because they did not disclose all reportable interest and dividends on their tax return

5. The U.S. Payee did not certify to the Requestor they are not subject to back-up withholding (for reportable interest and dividends for accounts opened after 1983)

Foreign Person (Non-Resident Alien/Foreign Entities)

A Foreign Person gives the Requestor the appropriate Form W-8 (not Form W-9) to confirm they are not subject to back-up withholding.

Non-Resident Alien who becomes a Resident Alien

Generally, only a Non-Resident Alien may use a tax treaty to reduce or eliminate U.S. Tax on income. Most treaties contain a "savings clause" which may specify exceptions which permit an exemption from tax (for certain types of income), even after the payee has become a U.S. Resident Alien (for tax purposes).

A U.S. Resident Alien who claims an exemption from tax (under a Tax Treaty Savings Clause) must attach a Form W-9 statement which specifies:

1. The Treaty Country (under which the Non-Resident Alien claimed a tax exemption)

2. The Treaty Article addressing the income received

3. The Tax Treaty Article which contains the Savings Clause (and its exceptions)

4. The type and amount of income exempt from tax

5. Sufficient facts to justify the tax exemption under the Treaty

Special Rules for Partnerships

U.S. Partnerships (that conduct a U.S. trade or business) are generally required to pay a withholding tax on any foreign partners' share of U.S. partnership income. If a Form W-9 is not received the Partnership is required to presume that a Partner is a Foreign Person, and pay the withholding tax.

The following U.S. Persons are required to give the Form W-9 to the Partnership to establish their U.S. tax status (and avoid withholding on their allocable shares of partnership net income):

1. The U.S. Owner of a Disregarded Entity (not the Entity);

2. The U.S. Grantor of a Grantor Trust (not the Trust);

3. The U.S. Trust (other than a Grantor Trust) and not the Trust beneficiaries.

Penalties

1. Failure to Furnish Correct TIN to Requestor -$50 penalty for each such failure (unless the failure is due to reasonable cause and not willful neglect).

2. Civil Penalty for False Information with Respect to Withholding - $500 penalty (if no reasonable basis for false statement).

3. Criminal Penalty for Falsifying Information - Willful falsifying certifications subject to fines and/or imprisonment.

4. Misuse of TIN's - If the Requestor discloses or uses TIN's in violation of Federal law, the Requestor may be subject to civil and criminal penalties.

Chapter 30 – Summary of HIRE and Foreign Account Tax Compliance ACT

On March 18, 2010, President Obama signed the Hiring Incentives to Restore Employment ("HIRE") Act (P.L. 111-147) (The "Act"), which included the Foreign Account Tax Compliance Act containing new foreign account tax compliance rules.

Under the Act, new reporting and disclosure requirements for foreign assets will be phased in between 2010 – 2014:

1. Foreign Institutional Reporting: Foreign Institutions have new reporting and withholding obligations for accounts held by U.S. Persons (generally effective after 12/31/12, commencing 1/1/13).

2. Foreign Financial Assets ($50,000): Individuals with an interest in a "Foreign Financial Asset" have new disclosure requirements. If foreign financial assets are valued in excess of $50,000, the U.S. Taxpayer must attach certain information to their income tax returns for tax years beginning after March 18, 2010. (U.S. Taxpayers are not required to disclose interests that are held in a custodial account with a U.S. financial institution).

The penalty is substantial ($10,000, plus additional amounts for continued failures, up to a maximum of $50,000 for each applicable tax period). The penalty may be waived if the individual can establish that the failure was due to reasonable cause and not willful neglect.

3. 40% Penalty: A 40% accuracy-related penalty is imposed for underpayment of tax that is attributable to an undisclosed foreign financial asset understatement. Applicable assets are those subject to mandatory information reporting when the disclosure requirements were not met. The penalties are effective for tax years beginning after March 18, 2010.

4. 6-Year Statute of Limitations: Statute of limitations re: omission of income in connection with foreign assets: The statute of limitations for assessments of tax is extended to six (6) years if there is an omission of gross income in excess of $5,000 attributable to the foreign financial asset. The six-year statute of limitations is effective for tax returns filed after March 18, 2010, as well as for any other tax return for which the assessment period has not yet expired as of March 18, 2010.

5. Passive Foreign Investment Companies: The Act imposes an information disclosure requirement on U.S. Persons who are PFIC shareholders. A PFIC is any foreign corporation if:

a. 75% or more of the gross income of the corporation for the taxable year is passive income; or

b. The average percentage of assets held by such corporation during a taxable year which produce passive income or which are held for the production of passive income are at least 50%.

6. Foreign Trusts with U.S. Beneficiaries: The Act clarifies if a foreign trust is treated as having a U.S. Beneficiary, an amount accumulated is treated as accumulated for the U.S. Person's benefit even if that Person's trust interest is contingent.

The Act clarifies that the discretion to identify beneficiaries may cause the trust to be treated as having a U.S. Beneficiary. This provision is effective after March 18, 2010.

7. Rebuttable Presumption/Foreign Trust – U.S. Beneficiary: The Act creates a rebuttable presumption that a foreign trust has a U.S. Beneficiary if a U.S. Person directly or indirectly transfers property to a foreign trust (unless the transferor provides satisfactory information to the contrary to the IRS). This provision is effective for property transfers after March 18, 2010.

8. Uncompensated Use of the Foreign Trust Property: The Act provides that the uncompensated use of the foreign trust property by a U.S. Grantor, a U.S. Beneficiary (or a U.S. Person, related to either of them), is treated as a distribution by the trust. The use of the trust property is treated as a distribution to the extent of the fair market value of the property's use to the U.S. Grantor/U.S. Beneficiary, unless the fair market value of that use is paid to the trust.

The loan of cash or marketable securities by a foreign trust, or the use of any other property of the trust, to or by any U.S. Person is also treated as paid or accumulated for the benefit of the U.S. Person. This provision applies to loans made and uses of property after March 18, 2010.

9. Reporting Requirements, U.S. Owners of Foreign Trusts: This provision requires any U.S. Person treated as the owner of any portion of a foreign trust to submit IRS-required information and insure that the trust files a return on its activities and provides such information to its owners and distributees.

This new requirement imposed on U.S. Persons treated as owners is in addition to the current requirement that such U.S. Persons are responsible for insuring that the foreign trust complies with its own reporting obligations. This provision is effective for taxable years beginning after March 18, 2010.

10. Minimum Penalty re: Failure to Report Certain Foreign Trusts: This provision increases the minimum penalty for failure to provide timely and complete disclosure on foreign trusts to the greater of $10,000 or 35% of the amount that should have been reported.

In the case of failure to properly disclose by the U.S. Owner of a foreign trust of the year-end value, the minimum penalty would be the greater of $10,000 or 5% of the amount that should have been reported. This provision is effective for notices and returns required to be filed after December 31, 2009.

Chapter 31 - Foreign Financial Assets

U.S. Taxpayers who hold any interests in specified foreign financial assets during the tax year must attach their tax returns for the year certain information with respect to each asset if the aggregate value of all assets exceeds $50,000. An individual who fails to furnish the required information is subject to a penalty of $10,000. An additional penalty may apply if the failure continues for more than 90 days after a notification by the IRS to a maximum of $50,000. The penalty may be avoided if the Taxpayer shows a reasonable cause for the failure to comply.

The Joint Committee on Taxation, Technical Explanation of the Hiring Incentives to Restore Employment Act (JCX-4-10) clarifies that although the nature of the information required to be disclosed is similar to the information disclosed on an FBAR, it is not identical.

For example, a beneficiary of a foreign trust who is not within the scope of the FBAR reporting requirements because his interest in the trust is less than 50%, may still be required to disclose the interest with his tax return if the $50,000 value threshold is met. In addition, this provision is not intended as a substitute for compliance with the FBAR reporting requirements, which remain unchanged.

For purposes of IRC Code §6038(D) as added by the HIRE Act, a specified foreign financial asset includes:

1. Any depository, custodial, or other financial account maintained by a foreign financial institution, and

2. Any of the following assets that are not held in an account maintained by a financial institution:

a. Any stock or security issued by a person other than a U.S. Person

b. Any financial instrument or contract held for investment that has an issuer or counterparty other than a U.S. Person, and

c. Any interest in a foreign entity (IRC §6038(D)(b) as added by the 2010 HIRE Act).

The information required to be disclosed with respect to any asset must include the maximum value of the asset during the tax year (IRC §6038(D)(c) as added by the 2010 HIRE Act).

For a financial account, the Taxpayer must disclose the name and address of the financial institution in which the account is maintained and the number of the account.

In the case of any stock or security, the disclosed information must include the name and address of the issuer and such other information as is necessary to identify the class or issue of which the stock or security is a part.

In the case of any instrument, contract, or interest, a Taxpayer must provide any information necessary to identify the instrument, contract, or interest along with the names and addresses of all issuers and counterparties with respect to the instrument, contract, or interest.

Under these rules, a U.S. Taxpayer is not required to disclose interests held in a custodial account with a U.S. financial institution. In addition, the U.S. Taxpayer is not required to identify separately any stock, security instrument, contract, or interest in a disclosed foreign financial account.

An individual who fails to furnish the required information with respect to any tax year at the prescribed time and in the prescribed manner is subject to a penalty of $10,000 (IRC §6038(D)(d) as added by the 2010 HIRE Act). If the failure to disclose the required information continues for more than 90 days after the day on which the notice was mailed (from the Secretary of Treasury), the individual is subject to an additional penalty of $10,000 for each 30-day period (or a fraction thereof) with the maximum penalty not to exceed $50,000.

In addition to the $10,000 penalty (up to $50,000) under IRC §6038(D) a 40% accuracy-related penalty is imposed on any understatement of tax attributable to a transaction involving an undisclosed foreign financial asset.

The statute of limitations for omission of gross income attributable to foreign financial assets (omission of gross income in excess of $5,000 attributable to a foreign financial asset), is extended to six years.

The IRC §6038(D) penalties are not imposed on any individual who can show that the failure is due to reasonable cause and not willful neglect. (IRC §6038D(g), as added by the 2010 HIRE Act.)

The information disclosure with respect to foreign financial assets supplements the FBAR reporting regime. The HIRE Act broadens reporting requirements and extends the rules to ownership of foreign assets such as foreign stocks, securities, interests in foreign companies not covered by the FBAR reporting. The threshold reporting requirement amount for FBARs ($10,000) is increased to $50,000. While the FBAR reporting covers those having signatory or other authority, the new reporting regime focuses on ownership.

Chapter 32 - IRS Form 8938: Statement of Specified Foreign Financial Assets

"FATCA" Tax Reporting

Under the Foreign Account Tax Compliance Act ("FATCA") for tax years beginning after March, 18, 2010, specified persons (i.e. U.S. Citizens, resident aliens), who have an ownership interest in specified foreign financial assets (i.e. foreign financial accounts, foreign stock, any interest in a foreign entity) must file Form 8938 (attached to their form 1040 tax return) if the value of the foreign financial assets exceeds applicable "reporting threshold".

The value of a specified foreign financial asset, for Form 8938 reporting purposes is the asset's fair market value.

For Individuals: more than $50,000 on the last day of the tax year, more than $75,000 at any time during the tax year. If living abroad; $200,000 on the last day of the tax year or more than $300,000 at any time during the tax year.

For Married Taxpayers: more than $100,000 on the last day of the tax year, more than $150,000 at any time during the tax year, if living abroad: $400,000 on the last day of the tax year, or more than $600,000 at any time during the tax year.

The IRS anticipates issuing regulations that will require domestic entity to file Form 8938, if it holds specified foreign financial assets whose value exceeds the applicable reporting threshold. Until the IRS issues such regulation, only individuals must file Form 8938.

Foreign Trusts

The value of an interest in a foreign trust, during the tax year, (if taxpayer doesn't know its fair market value is the Maximum Value of the interest in the foreign trust calculated as the sum of the following amounts:

1) The value of all of the cash (or other property) distributed during the tax year from the trust to the beneficiary, plus

2) The value (using the IRC§7520 Valuation Tables) to receive mandatory distributions as of the last day of the tax year;

Foreign Grantor Trusts

A U.S. Taxpayer, who is the owner of a foreign grantor trust, does not have to report specified financial assets, held by the trust if:

1) The US Taxpayer reports the trust on a timely filed form 3520 for the same tax year;

2) The trust timely files Form 3520-A (Annual Information Return of Foreign Trust with a U.S. owner) for the same tax year;

3) Taxpayer identified on form 8938 how many of these forms they filed.

Specified Foreign Financial Assets

Foreign financial accounts include any depository (or custodial) account maintained by a foreign financial institution, any equity or debt interest in a foreign financial institution including any financial account maintained by a financial institution organized under the laws of a U.S. possession (America Samoa, Guam, The Northern Mariana Islands, Puerto Rico or the U.S. Virgin Islands)

A foreign financial institution is any financial institution that is not a U.S. entity, and satisfies one of the following conditions:

1) It accepts deposits;

2) It holds financial assets for the account of others;

3) It is engaged in the business of investing or trading in securities, partnership interests, or commodities;

4) It includes investment vehicles such as foreign mutual funds, hedge fund and private equity funds.

Interests in Specified Foreign Financial Assets

A U.S. Taxpayer:

1) Has an interest in a specified financial asset if any income, gains, losses, deductions, credits, gross proceeds, or distribution from asset dispositions is required to be reported on U.S. income tax returns;

2) Who is the owner of a disregarded entity, has an interest in any specified foreign financial assets owned by the disregarded entity;

3) Who has an interest in a financial account that holds specified foreign financial assets, do not have to report the assets held in the account;

4) Does not own an interest in any specified foreign financial asset held by a partnership, corporation or estate, as a result of their status as a partner, shareholder or beneficiary;

5) Who is the owner, under the grantor trust rules of any part of a trust, has an interest in any specified foreign financial asset held by that part of the trust;

6) Does not have an interest in a foreign trust or a foreign estate specified foreign financial asset, unless they know (or have reason to know) of the interest. If they receive a distribution from the foreign trust or foreign estate, they are considered to know of the interest.

Exceptions to Tax Reporting (Form 8938)

U.S. Taxpayers do not have to report a specified foreign financial asset on Form 8938:

1. If the financial account is maintained by a U.S. payer which includes: a U.S. financial institution, a domestic branch of a foreign bank or insurance company, a foreign branch or subsidiary of a U.S. financial institution;

2. If the U.S. Taxpayer reports the specified foreign financial asset on timely filed IRS forms:

a. Form 3520: Annual Return to Report Transactions with Foreign Trusts and Receipt of certain foreign Gifts

b. Form 5471: Information Return of U.S. Persons with Respect to Certain Foreign Corporations

c. Form 8865: Return of U.S. Persons with Respect to Certain Foreign Partnerships

Civil Penalties (Form 8938)

1. Failure to File Penalty: A penalty of $10,000 for each 30 day period not filed, (within 90 days after the IRS notifies of the failure to file) after the 90 day period has expired, up to $50,000 maximum penalty.

2. Accuracy-Related Penalty: A 40% penalty on a tax underpayment as a result of an undisclosed specified foreign financial asset.

3. Fraud: A 75% penalty on a tax underpayment, due to fraud.

Criminal Penalties (Form 8938)

Criminal penalties may be imposed for:

1. Failure to file Form 8938;

2. Underpayment of tax;

3. Failure to report asset.

Statute of Limitations

1. For failure to file Form 8938, failure to report a specified foreign financial asset, the statute of limitations remains open until 3 year after the date Form 8938 is filed.

2. For failure to include in gross income, an amount relating to one or more specified foreign financial assets, and the amount omitted in more than $5,000, any tax owed for the tax year, can be assessed at any time within 6 years after the tax return is filed.

Chapter 33 - U.S. Taxpayer FBAR Tax Compliance Issues

FBAR rules are not found in the Code. Rather, they are set forth in the Bank Secrecy Act, first enacted by Congress in 1970. Since 2003, however, the IRS bears responsibility for enforcing these rules.

The FBAR rules require that every U.S. Person report (i) any financial interest or authority over a (ii) financial account in a foreign country with (iii) an aggregate value over $ 10,000 at any time during the taxable year. The report must be filed on a Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (hence the acronym “FBAR”). U.S. Persons must also disclose the existence of the account on their Form 1040, Schedule B, Part III. This is commonly referred to as “checking the ‘B’ box.”

Taxpayers who fail to disclose the account on their Form 1040 could be subject to criminal sanctions for filing a false tax return.

The FBAR report is due on June 30th. This due date is not subject to extensions. The FBAR report must be filed separately from the U.S. Person’s tax return.

Financial Interest Or Authority

A U.S. Person has a financial interest in a foreign account if he or she is the legal or beneficial owner. Attribution rules apply in making this determination. A person serving as a shareholder, partner, and trustee may also be deemed to hold a financial interest if the owner of the account is (i) a person acting as an agent on behalf of the U.S. Person, (ii) a corporation where the U.S. Person owns, directly or indirectly, more than 50 percent of the outstanding stock, (iii) a partnership in which the U.S. Person owns more than 50 percent of the profits, or (iv) a trust in which a U.S. Person has either a present interest in more than 50 percent of the assets or from which the U.S. Person receives more than 50 percent of the income. If these thresholds are met, the U.S. Person has an FBAR reporting obligation, regardless of whether he or she has any authority over the account.

Non-owners with authority over a foreign account are also subject to the FBAR reporting rules. Authority means the U.S. Person has the ability to order a distribution or disbursement of funds or other property held in the account. This is not limited to signature authority, but includes the ability to order distributions by verbal commands or other communication. Authority does not include persons who have the right to invest, but not distribute, the foreign account funds.

There is no limitation for taxpayers who have authority over a foreign account, but only in an official capacity. (For example, the president of a corporation, the general partner of a partnership, or the manager of an LLC may be subject to these rules.)

Both the entity, as beneficial owner, and the representative, who has control over the account, may be required to file an FBAR report. Similarly, when more than one U.S. Person has authority over an account, i.e., president and vice president, both persons may have an FBAR reporting obligation.

Even when the account is subject to joint control, and the signature of someone other than the taxpayer is required to cause a distribution, the taxpayer is still considered to have authority over the account for FBAR reporting purposes.

Financial Account In A Foreign Country

The term financial account is broadly defined as any asset account and encompasses simple bank accounts (checking or savings), as well as securities or custodial accounts. It also includes a life insurance policy or other type of policy with an investment value (i.e., surrender value).

Foreign country naturally refers to any country other than the United States. Puerto Rico, U.S. possessions and territories are included as part of the United States (as they should) for these purposes. Accounts held by U.S. Persons in these areas are not foreign accounts subject to FBAR reporting.

The IRS has indicated that a traditional credit card with a foreign bank is not a foreign account. However, use of a credit card as a debit or check card could trigger foreign account status and thus an FBAR reporting obligation.

$10,000 Threshold

To be reportable, the account must have assets the value of which during the year, exceeds $10,000.

The Instructions to the FBAR report state that if the aggregate value of all financial accounts exceeds $10,000 at any time during the year, the U.S. Person must file an FBAR report. A U.S. Person who possesses multiple foreign accounts, all of which have less than $10,000, but which collectively exceed $10,000, may have an FBAR reporting obligation.

Taxpayers may transfer an appreciating asset to a foreign account, such as stock or securities. As these assets increase in value, they may trigger an FBAR reporting requirement.

Whether the account generates any income is not relevant.

Penalties

In an attempt to improve compliance, Congress enhanced the FBAR penalties in 2004. Under pre-2004 law, civil penalties applied only to willful violations. In 2009, civil penalties up to $10,000 may be imposed on non-willful violations. This penalty may be avoided if there was reasonable cause and the U.S. Person reported the income earned on the account. 31 U.S. C. §5321(a)(5).

Although reasonable cause is not defined, the IRS will likely apply the reasonable cause standard for late-payment/late-filing penalties.

The penalty for willful violations is far more severe. It is equal to the greater of $100,000 or 50 per-cent of the balance of the account at the time of the FBAR violation. No reasonable cause exception exists for a willful violation. 31 U. S. C. §5321(a)(5)(c).

The IRS has six years to assess a civil penalty against a taxpayer that violates the FBAR reporting rules.

Chapter 34 - Amended Tax Returns (Voluntary Disclosure)

U.S. Taxpayers who fail to report offshore accounts by filing FBAR (TD F 90.22-1) face criminal and civil penalties:

1. Failure to Report Income

(3 Felonies and 1 Misdemeanor) up to 14 years in jail, plus 75% Civil Tax Fraud Penalty, 25% Failure to Pay Tax Penalty.

2. Failure to File FBAR's

(a maximum annual penalty of 50% of the account balance, up to 10 years in jail a $500,000 fine).

3. Perjury

Taxpayers Form 1040/Schedule B must declare whether Taxpayers have any authority over, or interest in foreign accounts with a total of more than $10,000.

In the IRS 6/24/09 FAQ update the IRS stated:

What is the distinction between filing amended returns to correct errors and filing a voluntary disclosure?

An amended return is the proper vehicle to correct an error on a filed return, whether a taxpayer receives a refund or owes additional tax. A voluntary disclosure is a truthful, timely and complete communication to the IRS in which a taxpayer shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining the taxpayer's correct tax liability and makes arrangements in good faith to fully pay that liability. Filing correct amended returns is normally a part of the process of making a voluntary disclosure under IRM 9.5.11.9. Taxpayers and practitioners trying to decide whether to simply file an amended return with a Service Center or to make a formal voluntary disclosure under the process described in IRM 9.5.11.9 and the March 23, 2009 memoranda should consider the nature of the error they are trying to correct.

Taxpayers with undisclosed foreign accounts or entities should consider making a voluntary disclosure because it enables them to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution. Making a voluntary disclosure also provides the opportunity to calculate, with a reasonable degree of certainty, the total cost of resolving all offshore tax issues. It is anticipated that the voluntary disclosure process is appropriate for most taxpayers who have underreported their income with respect to offshore accounts and assets. However, there will be some cases, such as where a taxpayer has reported all income but failed to file the FBAR (FAQ 9), or only failed to file information returns (FAQ 42), where it remains appropriate for the taxpayer to simply file amended returns with the applicable Service Center (with copies to the Philadelphia office listed in FAQ 9).

The IRS stated position is that a Taxpayer's voluntary disclosure entitles the Taxpayer to become compliant, avoid substantial civil penalties and generally eliminate the risk of criminal prosecution.

In reality, a taxpayer who makes a voluntary disclosure may:

1. Spotlight their "tax crimes"

2. If the voluntary disclosure is not accepted, jeopardize them and subject them to criminal prosecution

The IRS SBSE 3/23/09 memorandum, Subject: Routing of Voluntary Disclosure Cases, which addresses a change in the processing of voluntary disclosure requests containing offshore issues.

1. Such requests will continue to be initially screened by Criminal Investigation to determine eligibility for voluntary disclosure, and, if involving only domestic issues will be forwarded to Area Planning and Special Programs for Civil Processing;

2. Voluntary disclosure eligibility for offshore issues will be initially screened by Criminal Investigation and forwarded to the Philadelphia Offshore Identification Unit (POIU) for processing.

Voluntary Disclosure risks include:

1. Heightened risk of criminal prosecution (since initial screening is by the IRS Criminal Investigation Division);

2. A voluntary disclosure may be used as an evidentiary admission of Taxpayer's unreported income;

3. A voluntary disclosure may waive Taxpayer's 5th Amendment right against self-incrimination;

4. While a voluntary disclosure is pending the IRS may request more information, commence an audit or initiate criminal prosecution.

As an alternative strategy to a voluntary disclosure, the "quiet filing" (for the Tax Years at issue) of an amended tax return (or original tax return) may instead:

1. Pre-empt criminal charges for the failure to file FBAR returns, Form 1040 tax returns and failure to pay tax;

2. Pre-empt a 75% civil tax fraud penalty, for failure to file or pay tax and a 25% failure to pay tax penalty;

3. If the income is properly reported (i.e., no substantial understatements which are subject to a 6 year statute of limitations), the tax filing will commence the 3-year statute of limitations (for each year) for IRS audit.

Chapter 35 - Statute of Limitations (FBAR)

On 6/24/09, in FAQ #31, the IRS confirmed they would be able to assess taxes under a 6-year statute of limitations if the IRS can prove a substantial omission of gross income:

How can the IRS propose adjustments to tax for a six-year period without either an agreement from the taxpayer or a statutory exception to the normal three-year statute of limitations for making those adjustments?

Going back six years is part of the resolution offered by the IRS for resolving offshore voluntary disclosures. The taxpayer must agree to assessment of the liabilities for those years in order to get the benefit of the reduced penalty framework. If the taxpayer does not agree to the tax, interest and penalty proposed by the voluntary disclosure examiner, the case would be referred to the field for a complete examination. In that examination, normal statute of limitations rules will apply. If no exception to the normal three-year statute applies, the IRS will only be able to assess tax, penalty and interest for three years. However, if the period of limitations was open because, for example, the IRS can prove a substantial omission of gross income, six years of liability may be assessed. Similarly, if there was a failure to file certain information returns, such as Form 3520 or Form 5471, the statute of limitations will not have begun to run. If the IRS can prove fraud, there is no statute of limitations for assessing tax.

The FAQ #42 cites 31 USC 532(b)(1) confirming the 6-year statute of limitations for FBARs

Chapter 36 - Annual Filing Requirements and Reasonable Cause Exception (FBAR)

In April 2003, the Financial Crimes Enforcement Network delegated authority of the TD F 90-22.1 form (i.e., FBAR form) to the Internal Revenue Service (see IR 2003-48 (4/10/03); 31 CFR §103.5(6)(b)(8)). The IRS enforces all penalties associated with the FBAR with the same power it enforces tax reporting and payment compliance.

The IRS has been given the authority to enforce the filing rules and audit the reports as appropriate.

The FBAR filing is due by June 30th of the year following the year of the report with no provisions for extensions. The due date means the date it must be received by the US Treasury. Mailing it on the date it is due will result in a late filing. The FBAR form, filed separately from the income tax, must be mailed to US Department of Treasury, PO Box 32621, Detroit, Michigan 48232-0621.

If there is an emergency, the form can be hand-delivered to a local IRS office for forwarding to the Treasury Department in Detroit.

An amended FBAR may be filed by completing a revised FBAR with the correct information writing the words “Amended” at the top of the revised FBAR and stapling it to a copy of the original FBAR. For Taxpayers amending a late-filed FBAR, they should include a statement explaining their reasons for a late filing (i.e., request a reasonable cause exception from penalty).

A failure to file a FBAR has civil and criminal penalties (which are in addition to any income tax penalties if the income is not reported). The IRS must assess the civil penalties within 6 years of the FBAR violation (31 USC 5321(b)(1)).

For a willful failure to file, the civil penalty increases from $10,000 (non-willful failure to file) to the greater of $100,000 or 50% of the account balance in the foreign account for the tax year.

The civil penalties for non-willful failure to file may be waived by the IRS if the Taxpayer can show reasonable cause. If the Taxpayer has a reasonable cause exception, the FBAR should be filed with an explanation (i.e., the reasonable cause, with an express request for waiver of penalties).

The waiver of civil penalties for a reasonable cause exception may include among other factors:

1. All the income from the foreign account was included on the US Taxpayer’s return.

2. The Taxpayer was unaware of the requirement to file (for example, lack of understanding of what constitutes a financial interest).

3. Once the Taxpayer became aware of the filing requirements, he filed all delinquent reports (up to 6 years).

Chapter 37 - Civil and Criminal Penalties (FBAR)

Each U.S. Person who has a financial interest in, or signature or other authority over, one or more foreign financial accounts (value over $10,000, at any time during a calendar year) is required to report the account on Schedule B/Form 1040, and TD F 90-22.1 (Report of Foreign Bank and Financial Accounts (FBAR)), due by June 30 of the succeeding year (I.R.M. 5.21.6.1. (2/17/09)).

Failure to file the required report or maintain adequate records (for 5 years) is a violation of Title 31 with civil and criminal penalties (or both). For each violation a separate penalty may be asserted.

(I) Non-Willful Violation

Civil Penalty – Up to $10,000 for each violation. 31 U.S.C.§ 5321(a)(5)(A)

(II) Negligent Violation

Civil Penalty – Up to the greater of $100,000, or 35 percent of the greatest amount in the account. 31 U.S.C.

(III) Intentional Violations

1. Willful - Failure to File FBAR or retain records of account

Civil Penalty -Up to the greater of $100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty - Up to $250,000 or 5 years or both

31 U.S.C. §5321(a)(5)(C), 31 U.S.C. § 5322(a) and 31 C.F.R. §103.59(b) for criminal

2. Knowingly and Willfully Filing False FBAR

Civil Penalty – Up to the greater of $100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty – $10,000 or 5 years or both

18 U.S.C. § 1001, 31 C.F.R. § 103.59(d) for criminal

3. Willful - Failure to File FBAR or retain records of account while violating certain other laws

Civil Penalty - Up to the greater of $100,000, or 50 percent of the greatest amount in the account.

Criminal Penalty - Up to $500,000 or 10 years or both

31 U.S.C. § 5322(b) and 31 C.F.R. §103.59(c) for criminal

Chapter 38 - Criminal Penalties – Willful Failure to File (Defenses) (FBAR)

Under IRS Form 1040, at the bottom of Schedule B, Part III, on Page 2, Question 7(a) states: "at any time during the previous year, did you have any interest in or signatory or other authority over a financial account in a foreign country, such as a bank account, a security account, or other financial account? The answer is either yes or no. If yes, Question 7(b) requires the name of the foreign country (with the account). Question 8 requires confirmation of receipt of distribution from the account, or if the Taxpayer was a grantor of, or transferor to a foreign trust (which requires filing Form 3520).

A willful failure to file a FBAR can lead to a felony of up to 10 years in jail and a $500,000 fine. The IRS must prove willfulness in order to assert the $500,000 monetary penalty and the imprisonment for up to 10 years (see 31 USC 5321(a)(5)(B); CCA 200603026; Eisenstein, 731 F.2d 1540 (CA – 11, 1984)).

Willfulness must be proven by the IRS under the standard of clear and convincing evidence. If the Taxpayer knew about the requirement to file, it would affect his defense. If the Taxpayer failed to report the foreign account interest or other income on his income tax return, it would affect his defense.

If a failure to file is deemed to be part of a criminal activity involving more than $100,000 in a 12-month period, the penalty limit increases to $500,000 with up to 10 years in jail. The issue of whether a failure to file is willful or non-willful is based on the facts of each case. Willfulness has been defined as the voluntary, intentional violation of a known legal duty, see Cheek 498 US 192, 67 AFTR 2d 91-344 (Supreme Court 1991).

A Taxpayer's good faith belief that he does not have to file (or even his negligent failure to file) can be a defense to the charge of willful failure to file (i.e., a defense to criminal charges).

A defense may include that the Taxpayer was advised by his advisor that no FBAR was required.

Failure to maintain adequate records of the foreign account for the years the FBAR filing is due may result in additional civil and criminal penalties.

Chapter 39 - Offshore Entities: Foreign Grantor Trusts (FATCA)

Due to changes made by the HIRE Act, effective after March 18, 2010 (for tax years beginning 1/1/11), foreign trusts may be classified as a foreign grantor trust or a foreign non-grantor trust.

A foreign trust is any trust other than a domestic trust. A domestic trust is any trust if:

1. A court within the U.S. is able to exercise primary supervision over the administration of the trust; and

2. One or more U.S. persons have the authority to control all substantial decisions of the trust.

Under the grantor trust rules:

1. A grantor includes any person who creates a trust or directly or indirectly makes a gratuitous transfer of cash or other property to a trust. A grantor includes any person treated as the owner of any part of a foreign trust's assets under IRC Sec. 671-679 (excluding IRC Sec. 678).

2. If a partnership or corporation makes a gratuitous transfer to a trust, the partners or shareholders are generally treated as the trust grantors, unless the partnership or corporation made the transfer for a business purpose of the partnership or corporation.

3. If a trust makes a gratuitous transfer to another trust, the grantor of the transferor trust is treated as the grantor of the transferee trust, except that if a person with a general power of appointment over the transferor trust exercises that power in favor of another trust, such person is treated as the grantor of the transferee trust, even if the grantor of the transferor trust is treated as the owner of the transferor trust.

4. An owner of a foreign trust is the person that is treated as owning any of the assets of a foreign trust under the rules of IRC Sec. 671-679.

5. Property distributed from the trust means any property, whether tangible or intangible, including cash.

Under the grantor trust rules, the foreign trust income reported under Form 3520- A is reported (and taxed) under the grantor's Form 1040 tax return (filed annually).

Under the grantor trust rules, the assets of the foreign trust are treated as owned by the grantor and are includable in the grantor's U.S. estate. However, any grantor distributions under Form 3520 foreign trust rules are reportable by the recipient of the distribution (whether or not the trust is a grantor trust or the recipient is designated as a beneficiary under the trust terms).

Due to changes to IRC Sec. 679(c) made by the HIRE Act, effective after 3/18/10, a loan of cash or marketable securities from a foreign trust with a U.S. grantor, directly or indirectly to a U.S. person, or the use of any other trust property, directly or indirectly by any U.S. person (whether or not a trust beneficiary under the trust terms), will cause a foreign trust to be treated as a grantor trust, unless the U.S. person repays the loan at a market rate of interest, or pays the fair market value of the use of such property within a reasonable period of time.

Additional Trust Distributions

Additional trust distributions include a guarantee. A guarantee:

1. Includes any arrangement under which a person directly or indirectly assumes on a conditional or unconditional basis, the payment of another's obligation;

2. Encompasses any form of credit support, and includes a commitment to make a capital contribution to the debtor, or otherwise maintains its financial viability;

3. Includes an arrangement, reflected in a "comfort letter", regardless of whether the arrangement gives rise to a legally enforceable obligation. If an arrangement is contingent upon the occurrence of an event in determining whether the arrangement is a guarantee, the taxpayer must assume that the event has occurred.

Chapter 40 - Foreign Non-Grantor Trusts (FATCA)

Under IRS Notice 97-34, 1997-25 I.R.B. 22 (Sec. V(A)), if a U.S. grantor, a U.S. beneficiary or a U.S. person related to the U.S. grantor or U.S. beneficiary, directly or indirectly receives a loan of cash or marketable securities from a foreign non-grantor trust, the amount of such loan will be treated as a distribution to the U.S. grantor or U.S. beneficiary, unless the obligation issued by the U.S. grantor, U.S. beneficiary or U.S. person related to the U.S. grantor or U.S. beneficiary in exchange for the loan, is a qualified obligation. A loan by an unrelated third party that is guaranteed by a foreign trust is generally treated as a loan from the trust.

After March 18, 2010, if a U.S. grantor, a U.S. beneficiary or any U.S. person related to the U.S. grantor or U.S. beneficiary directly or indirectly, uses any property of a foreign non-grantor trust, and the U.S. grantor, U.S. beneficiary or U.S. person (related to the U.S. grantor or beneficiary) does not compensate the trust at fair market value for the use of the property within a reasonable period of time, the fair market value of such use will be treated as a distribution by the foreign non-grantor trust to the U.S. grantor or U.S. beneficiary.

A non-grantor trust is any trust to the extent that the assets of the trust are not treated as owned by a person other than the trust. A non-grantor trust is treated as a taxable entity. A trust may be treated as a non-grantor trust with respect to only a portion of trust assets.

U.S. Tax: Beneficiaries of Foreign Non-Grantor Trusts

U.S. taxpayers who are beneficiaries of foreign non-grantor trusts may be subject to U.S. income taxes on distributions of cash or other property (including trust loans) received from the trusts. The U.S. beneficiaries, U.S. income tax liability, with respect to foreign non-grantor trust distributions and loans depends on a number of factors, including:

1. Whether the distribution was made during a year in which the foreign non- grantor trust earned income and the relationship between the size of the income and the value of the distributions made in that year to the U.S. beneficiary and to other trust beneficiaries;

2. Whether, if the amount of the trust’s distributions exceeded the amount of its income for the year of distribution;

3. Whether the trust had undistributed income accumulated from prior years; and 4. Whether the trust previously paid U.S. income tax or foreign income tax.

A U.S. beneficiary of a foreign non-grantor trust is required to include in their gross income for any particular year:

1. The amount of any trust income in each year required to be distributed to them from a "simple trust" (whether or not actually distributed) to the extent of their share of the trust's distributable net income for the year (IRC Sec. 652(a)).

A simple trust is a non-grantor trust that is required to distribute income, is not permitted to make payments to charity, and in that tax year makes no principal distribution.

2. The amount of any trust income required to be distributed to them in that tax year from a "complex" foreign non-grantor trust (whether or not actually distributed) to the extent of the trust's "DNI" (distributable net income) for the year

(IRC Sec. 662(a)(1). A "complex trust" is a non-grantor trust other than a simple trust.

3. The amount actually distributed to them from a foreign complex trust in the tax year, to the extent of their share of the trust's DNI for such tax year (IRC Sec. 662(a)(2).

Specific gifts paid to a trust beneficiary are not treated as a distribution included in income of the beneficiary unless it is paid only from the trust income (IRC Sec. 663(a)(1).

If a U.S. beneficiary receives a distribution from a foreign grantor trust that includes U.S. source income from which U.S. tax has been withheld, they must include in their gross income the amount received but also the amount of the withheld tax and may then credit the withheld tax against their personal income tax liability (Treas. Reg. Sec. 1.1441-3(f) and 1.1462-1(b); Rev. Rul. 56-30, 1956- 1 C.B. 646; Rev. Rul. 55-414, 1955-1 C.B. 385).

A U.S. taxpayer who pays income tax to a foreign country may credit the amount of such taxes against their U.S. income tax liability or may claim such taxes as an itemized deduction (IRC Sec. 901(a) and 164(a)(3). An election to take the credit precludes the deduction (IRC Sec. 275(a)(4). The total amount of the credit is limited to the proportion of the tax against which such credit is taken against their taxable income from foreign sources bears to their entire taxable income (IRC Sec. 904(a)).

If a foreign non-grantor trust makes distributions in excess of its DNI for a tax year, the U.S. beneficiaries who receive such distributions and include such distributions in their gross income may be required to calculate their U.S. income tax under the "throwback rule" and may be subject to interest on those taxes; the tax is increased by an interest charge determined under IRC Sec. 668 (See IRC Sec. 667(a)(3). The interest rate will be the floating rates applied under IRC Sec. 6621 to underpayments of tax.

Chapter 41 - IRC Reporting Requirements for Foreign Financial Assets (FATCA)

Under FATCA, Section 511 of the 2010 HIRE Act added new Sec. 6038D to the Code, effective for taxable years beginning with 12/31/10. IRC Sec. 6038D(a) requires any individual who holds any interest in a specified foreign financial asset during any taxable year to attach to their income tax return for that year the information described in IRC Sec. 6038(1)(c), if the aggregate value of all such assets exceeds $50,000, by filing IRS Form 8938.

Under Treas. Reg. Sec. 1.6038D-5J(f)(3), the value of a beneficiary's interest in a trust equals the sum of the amounts actually received in the taxable year plus the present value of the mandatory right to receive a distribution.

Under FATCA, IRC Sec. 6501(c)(8), as amended by Section 513 of the 2010 HIRE Act, provides that the statute of limitations will not commence to run until the tax return required by IRC Sec. 6038D is filed. Section 513 of the HIRE Act amended IRC Sec. 6501(c) to provide that the statute of limitations on assessment of a return is extended from three to six years if the taxpayer omitted more than $5,000 from gross income.

Foreign Financial Assets

U.S. Taxpayers who hold any interests in specified foreign financial assets during the tax year must attach their tax returns for the year certain information with respect to each asset if the aggregate value of all assets exceeds $50,000. An individual who fails to furnish the required information is subject to a penalty of $10,000. An additional penalty may apply if the failure continues for more than 90 days after a notification by the IRS to a maximum of $50,000. The penalty may be avoided if the Taxpayer shows a reasonable cause for the failure to comply.

The Joint Committee on Taxation, Technical Explanation of the Hiring Incentives to Restore Employment Act (JCX-4-10) clarifies that although the nature of the information required to be disclosed is similar to the information disclosed on an FBAR, it is not identical.

For example, a beneficiary of a foreign trust who is not within the scope of the FBAR reporting requirements because his interest in the trust is less than 50%, may still be required to disclose the interest with his tax return if the $50,000 value threshold is met. In addition, this provision is not intended as a substitute for compliance with the FBAR reporting requirements which remain unchanged.

For purposes of IRC Code §6038(D) as added by the HIRE Act, a specified foreign financial asset includes:

Any depository, custodial, or other financial account maintained by a foreign financial institution, and

Any of the following assets that are not held in an account maintained by a financial institution:

Any stock or security issued by a person other than a U.S. Person

Any financial instrument or contract held for investment that has an issuer or counterparty other than a U.S. Person, and

Any interest in a foreign entity (IRC §6038(D)(b) as added by the 2010 HIRE Act).

The information required to be disclosed with respect to any asset must include the maximum value of the asset during the tax year (IRC §6038(D)(c) as added by the 2010 HIRE Act).

For a financial account, the Taxpayer must disclose the name and address of the financial institution in which the account is maintained and the number of the account.

In the case of any stock or security, the disclosed information must include the name and address of the issuer and such other information as is necessary to identify the class or issue of which the stock or security is a part.

In the case of any instrument, contract, or interest, a Taxpayer must provide any information necessary to identify the instrument, contract, or interest along with the names and addresses of all issuers and counterparties with respect to the instrument, contract, or interest.

Under these rules, a U.S. Taxpayer is not required to disclose interests held in a custodial account with a U.S. financial institution. In addition, the U.S. Taxpayer is not required to identify separately any stock, security instrument, contract, or interest in a disclosed foreign financial account.

An individual who fails to furnish the required information with respect to any tax year at the prescribed time and in the prescribed manner is subject to a penalty of $10,000 (IRC §6038(D)(d) as added by the 2010 HIRE Act). If the failure to disclose the required information continues for more than 90 days after the day on which the notice was mailed (from the Secretary of Treasury), the individual is subject to an additional penalty of $10,000 for each 30-day period (or a fraction thereof) with the maximum penalty not to exceed $50,000.

In addition to the $10,000 penalty (up to $50,000) under IRC §6038(D) a 40% accuracy-related penalty is imposed on any understatement of tax attributable to a transaction involving an undisclosed foreign financial asset.

The statute of limitations for omission of gross income attributable to foreign financial assets (omission of gross income in excess of $5,000 attributable to a foreign financial asset), is extended to six years.

The IRC §6038(D) penalties are not imposed on any individual who can show that the failure is due to reasonable cause and not willful neglect. (IRC §6038D(g), as added by the 2010 HIRE Act.)

The information disclosure with respect to foreign financial assets supplements the FBAR reporting regime. The HIRE Act broadens reporting requirements and extends the rules to ownership of foreign assets such as foreign stocks, securities, interests in foreign companies not covered by the FBAR reporting. The threshold reporting requirement amount for FBARs ($10,000) is increased to $50,000. While the FBAR reporting covers those having signatory or other authority, the new reporting regime focuses on ownership.

Chapter 42 - Foreign Trusts Treated as Having U.S. Beneficiaries (FATCA)

For purposes of treating a foreign trust as a grantor trust, there is a rebuttable presumption that the trust has a U.S. beneficiary if a U.S. Person transfers property to the trust. An amount is treated as accumulated for a U.S. Person even if that person has a contingent interest in the trust.

A foreign trust is treated as having a U.S. beneficiary if any person has discretion to make trust distributions, (unless none of the recipients are U.S. Persons). An amount will be treated as accumulated for the benefit of a U.S. Person even if that person's interest in the trust is contingent on a future event (IRC §679(c)(1) as amended by the 2010 HIRE Act).

If any person has the discretion (by authority given in the trust agreement, by a power of appointment or otherwise, of making a distribution from the trust to or for the benefit of any person), the trust will be treated as having a beneficiary who is a U.S. Person, unless the trust terms specifically identify the class of person to whom such distribution may be made and none of those persons are U.S. Persons during the tax year (IRC §679(c)(4) as added by the 2010 HIRE Act).

If any U.S. Person who directly or indirectly transfers property to the trust is directly or indirectly involved in any agreement or understanding that may result in trust income or corpus being paid or accumulated to or for the benefit of a U.S. Person, that agreement or understanding will be treated as a term of the trust (IRC §679(c)(5) as added by the 2010 HIRE Act). The agreement or understanding may be written, oral or otherwise.

The provision creating a rebuttable presumption allowing the IRS to treat a foreign trust as having a U.S. beneficiary if a U.S. person directly or indirectly transfers property to the trust applies to transfers of property after March 18, 2010. (Act Section 532(b) 2010 HIRE Act.)

Uncompensated Use of Foreign Trust Property

The uncompensated use of foreign trust property by a U.S. Grantor, a U.S. Beneficiary, or a U.S. Person related to either of them is treated as a distribution by the trust for non-grantor trust income tax purposes (which also includes the loan of cash or marketable securities by a foreign trust or the use of any other property of the trust).

The distribution treatment of foreign trust transaction has been expanded to include the uncompensated use of property by certain U.S. Persons. The treatment of foreign trusts as having U.S. beneficiaries for grantor trust purposes has been expanded to include loans of cash or marketable securities or the use of any other trust property to or by a U.S. Person.

If a foreign trust permits the use of any trust property by a U.S. Grantor, a U.S. Beneficiary, or any U.S. Person related to either of them, the fair market value of the use of such property is treated as a distribution by the trust to the Grantor or Beneficiary (IRC §643(i)(1), as amended by the 2010 HIRE Act).

This treatment does not apply to the extent that the trust is paid the fair market value of such use within a reasonable time (IRC §643(i)(2)(E), as added the 2010 HIRE Act). If distribution treatment does apply to the use of trust property, the subsequent return of such property is disregarded for federal tax purposes (IRC §643(i)(3), as amended by the 2010 HIRE Act).

Chapter 43 - Foreign Grantor Trusts: U.S. Tax Compliance (FATCA/FBAR)

A U.S. taxpayer who establishes a foreign trust is classified as the trust owner, under IRC Sec. 679, for those assets transferred to the trust, and must annually report foreign trust income (IRS Forms 3520-A/Form 1040), and asset transfers to the trust (Form 3520). U.S. beneficiaries must annually report distributions received from the foreign trust (Form 3520).

The U.S. grantor of the foreign trust must annually file Form TDF-90.22-1("FBAR") to report the trust foreign financial accounts over $10,000 (which accounts they either own or control (i.e. signatory authority) and IRS Form 8938, to report ownership of foreign assets over $50,000.

The U.S. grantor of the foreign trust's failure to file FBAR, Form 8938, report annual income on Forms 3520-A/Form/Form 1040, report trust transfers (Form 3520) and U.S. beneficiaries' failure to report trust distributions (Form 3520) have civil and criminal tax issues, including:

Money Laundering: (Disguise of the nature or the origin of funds (18 U.S.C. Sec. 1956 and 1957);

FBAR Issues

Unreported Income Issues

FATCA Issues

Perjury

Foreign Bank and Financial Account Report (FBAR)

(TD F 90-22.1), Civil & Criminal Penalties

Each U.S. Person who has a financial interest in, or signature or other authority over, one or more foreign financial accounts (value over $10,000, at any time during a calendar year) is required to report the account on Schedule B/Form 1040, and TD F 90-22.1 (Report of Foreign Bank and Financial Accounts (FBAR)), due by June 30 of the succeeding year (I.R.M. 5.21.6.1. (2/17/09)).

Failure to file the required report or maintain adequate records (for 5 years) is a violation of Title 31 with civil and criminal penalties (or both). For each violation a separate penalty may be asserted.

1. Intentional Violations

Willful - Failure to File FBAR or retain records of account, Up to the greater of $100,000, or 50 percent of the greatest amount in the account., Up to $250,000 or 5 years or both, 31 U.S.C. § 5322(a) and 31 C.F.R. §103.59(b) for criminal

2. Knowingly and Willfully Filing False FBAR, Up to the greater of $100,000, or 50 percent of the greatest amount in the account, $10,000 or 5 years or both, 18 U.S.C. § 1001, 31 C.F.R. § 103.59(d) for criminal

3. Willful - Failure to File FBAR or retain records of account while violating certain other laws, Up to the greater of $100,000, or 50 percent of the greatest amount in the account. Up to $500,000 or 10 years or both, 31 U.S.C. § 5322(b) and 31 C.F.R. §103.59(c) for criminal

IRS/Offshore Accounts

Criminal Penalties

6-Year Statute of Limitations

Tax Evasion (Willful Evasion of Tax)

(IRC Sec. 7201) up to five years in prison

Fine: $100,000 (individual)

$500,000 (corporation)

Obstruct (Impede Tax Collection)

(IRC Sec. 7212) up to three years in prison

Fine: $5,000

Conspiracy to Impede Tax Collection

(18 USC 371) separate charge of impeding

Up to five years in prison

Failure to File Tax Return

(IRC Sec. 7203) up to one year in prison

Fine: $25,000 (individual)

$100,000 (corporation)

File False Tax Return

(IRC Sec. 7206(1)), up to three years in prison

Fine: $250,000

"FBAR Violation"

(31 USC Sec. 5322(b), 31 CFR 103.59(c))

Willful violation: up to ten years in jail and

$500,000 fine

Additional Criminal Penalties:

1. Perjury (U.S. taxpayers who fail to disclose foreign accounts under

Form 1040/Schedule B, Part III, question 7(a))

2. FATCA Filings (i.e. Failure to disclose foreign financial assets on

$50,000/IRS Form 8938)

3. Money Laundering: Disguise of the nature or the origin of funds

(18 USC Sec. 1956 and 1957)

U.S. Tax Compliance Issues

U.S. taxpayers who establish a foreign trust (i.e. a trust which either a U.S. court does not supervise trust administration, or a U.S. person does not control substantial trust decisions. See: IRC Sec. 7701(a)(30)(E) (31)(B), and funds the trust (i.e. transfers property to the trust), if the trust has a U.S. beneficiary, the trust will be treated as foreign “grantor trust” and the U.S. taxpayer will be treated as the owner “of that portion of the trust attributable to the property transferred” (IRC Sec. 678(b), 679).

Trust tax items of income, deduction or credit are for tax purposes treated as belonging to the trust grantor, and these tax items are reflected on the income tax return of the trust grantor; i.e. Form 1040 (originally declared on the Trust Tax Return, Form 3520-A: Annual Information Return of Foreign Trust with a U.S. Owner).

Based on a U.S. person funding the foreign trust, the IRS can presume that the trust has a U.S. beneficiary unless the U.S. person (i.e. transferor of trust assets) submits to the IRS any information that the IRS requires regarding the transfer and demonstrates to the IRS's satisfaction that:

- Under the trust terms, no part of the trust's income or corpus may be paid or accumulated during the tax year, to or for the benefit of a U.S. person, even if that person's interest is contingent on a future event; and

- No part of the trust's income or corpus could be paid to or for the benefit of a U.S. person if the trust were terminated at any time during the tax year.

Generally:

1. The U.S. taxpayer who transfers assets to the trust must ensure that the trust satisfies tax reporting requirements, and submit any information the IRS may require regarding the foreign trust (IRC Sec. 6048(b), 6677(a);

2. The U.S. grantor trust rules will not apply to any portion of a trust that would otherwise be deemed to be owned by a foreign person (IRC Sec. 672(f).

Under Treas. Reg. Sec. 1.671-2(e) a trust grantor is a person (either an individual or a non-natural person) who either creates a trust, or indirectly makes a "gratuitous transfer" of property to a trust

A gratuitous transfer means a transfer made, other than a transfer for fair market value.

A U.S. taxpayer who creates a foreign trust faces a myriad of U.S. tax-reporting compliance issues.

If the foreign trust is irrevocable, the U.S. taxpayer faces a U.S. gift tax on funding. The U.S. taxpayer must file Form 709 to report the gift, subject to the 2013: $5,250,000 gift tax exclusion. If the trust is revocable, the U.S. taxpayer must report any gifts (by filing Form 709) over $14,000 per donee;

File Form 3520 ("Annual Return to Report Transactions with Foreign Trusts) to report transfers to the trust and trust ownership (IRC Sec. 671-679).

Penalties for non-compliance:

a. Thirty-five percent (35%) of the gross value of any property transferred to a foreign trust for failure by a U.S. transferor to report the creation of or transfer to a foreign trust, or

b. On an annual basis, 5% of the gross value of the portion of the trust's assets treated as owned by a U.S. person for failure by the U.S. person to report the U.S. owner information.

3. Form 3520-A is the annual information return of a foreign trust with at least one U.S. owner, which provides annual information about trust income/expense, its U.S. beneficiaries and any person treated as an owner of any portion of the trust. Each U.S. person treated as an owner of any portion of a foreign trust is responsible for ensuring that the foreign trust files Form 3520-A and furnishes the required annual statements to its U.S. owners and U.S. beneficiaries.

Penalties for non-compliance:

The U.S. owner is subject to an initial penalty equal to the greater of $10,000 or 5% of the gross value of the portion of the trust's assets treated as owned by the U.S. person at the close of that tax year, if the foreign trust either fails to timely file Form 3520-A or does not furnish all of the information required by IRC Sec. 6048(b) or includes incorrect information.

Criminal penalties may be imposed under IRC Sections 7203, 7206 and 7207 for failure to file on time and for filing a false or fraudulent tax return.

For both Forms 3520 and 3520-A:

1. Additional penalties will be imposed if the non-compliance continues after the IRS mails a notice of failure to comply with the required reporting.

2. Effective for taxable years beginning after 3/18/10, the IRC Sec. 6662 negligence penalty is increased from 20% to 40% if the deficiency is attributable to an unreported financial asset (See Sec. 512 of the 2010 HIRE Act).

U.S. Tax Reporting Foreign Financial Assets and Foreign Accounts ("FBAR")

USC Sec. 5314 of Title 31 (the Bank Secrecy Act) requires a U.S. person to file Form TDF 90-22.1-Report of Foreign Bank Account ("FBAR") to report all foreign bank and financial accounts in which they have a financial interest, or signatory authority, if the aggregate value of the accounts exceeded $10,000 at any time during the year (31 USC Sec. 5314). A financial account includes a bank or financial account, a securities account, mutual fund or pooled investment fund.

A U.S. person has an indirect financial interest in an account owned by the trust and is required to file an FBAR report for foreign accounts held by the trust if they are the trust grantor (IRC Sec. 671-679) or they have a present beneficial interest in more than 50% of the trust assets or receive more than 50% of the trust income.

The U.S. Treasury Dept., division "Financial Crimes Enforcement Network" ("FINCEN") issued regulations providing that trust beneficiaries (other than those treated as owners under the grantor trust rules) do not have to file an FBAR report for financial assets held by trusts of which they are the trust beneficiary if the trust, trustee of the trust or trust agent is a U.S. person and files an FBAR report disclosing the trust's foreign financial accounts (31 CFR part 103, Sec. 103.24(g)(5), Federal Register Vol. 76, No. 37 at 10234 (Feb. 16, 2011). FINCEN delegates the authority to enforce the FBAR reporting requirement of the Bank Secrecy Act to the IRS (by a memorandum of agreement).

A trust discretionary or remainder beneficiary are not required to file FBARs (Fed. Register Vol. 76, No. 37 at 10234 (Feb. 16, 2011).

IRC Reporting Requirements for Foreign Financial Assets

Section 511 of the 2010 HIRE Act added new Sec. 6038D to the Code, effective for taxable years beginning after 12/31/10.

Section 6038 D(a) requires any individual who holds any interest in a specified foreign financial asset during any taxable year to attach to his or her income tax return for that year the information described in Section 6038 D(c); i.e. Form 8938, if the aggregate value of all such assets exceeds $50,000.

Specified foreign financial assets include: financial accounts, stock or security issued by a non-U.S. person, financial instruments or contracts held for investment that has an issuer or counter-party other than a U.S. person, and any interest in a foreign entity (which includes foreign trusts).

A person who is treated as the owner of a trust under the grantor trust rules is treated as having an interest in any foreign financial assets held by the trust (Treas. Reg. Sec. 1.6038(D)-2T(b)(3).

The value of a beneficiary's interest in a trust equals the sum of the amounts actually received in the taxable year plus the present value of a mandatory right to receive a distribution (Treas. Reg. 1.6038D-5J(f)(3). This valuation rule applies even if the trust is deemed to be owned by another person under the grantor trust rules. A foreign financial asset is subject to reporting even if the asset does not have a positive value (Treas. Reg. Sec. 1.6038D-2T(a)(5).

An FBAR and Form 8938 both have to be filed in full, and filed with different agencies. The penalty for failing to file Form 8939 is $10,000 with additional penalties after notice is given to the taxpayer of $10,000 per 30 day period, after expiration of the 90 day notice period (after notice given to the taxpayer, the penalty cannot exceed $50,000).

The FATCA Form 8938 filing applies only to interests held directly by U.S. individuals (or indirectly through disregarded entities), but does not apply to U.S. entities.

For tax years beginning 1/1/11, the negligence penalty, if imposed by IRC Sec. 6662, is increased from 20% to 40% if the deficiency is attributable to an unreported foreign financial asset. (Sec. 512 of the 2010 HIRE Act.)

The statute of limitations will not commence to run until the return required (Form 8938) is filed, and is extended from three to six years if the taxpayer omitted more than $5,000 from gross income and the omission is attributable to assets with respect to which a return was required by IRC Sec. 6038 D (IRC Sec. 650(c)(8)), as amended by Sec. 513 of the 2010 HIRE Act).

Offshore Tax Evasion: U.S. Taxpayer/Foreign Grantor Trust: U.S. Beneficiaries

(U.S. Tax Compliance)

A U.S person who receives directly, or indirectly, a distribution from a foreign trust must report the gross amount of distributions received from a foreign trust on Form 3520 the information to the IRS regarding the trust name, date of distribution, description of property received, fair market value of property received, fair market value/description of property transferred, if any. (See Form 3520, Part III, line 24).

Under IRC Sec. 6677 (as amended by Sec. 535 of the 2010 HIRE Act) a penalty generally applies if Form 3520 is not timely filed or if the information is incomplete or incorrect. Generally, the initial penalty is equal to the greater of $10,000 or 35% of the gross value of the distributions received from a foreign trust for failure by a U.S. person to report receipt of the distribution (on Form 3520).

Additional penalties can be imposed by the IRS for continuing non-compliance. Although the total penalties may not exceed the reportable amount, the IRS may assess the penalties before the reportable amount is determined. When the reportable amount is determined, the excess must be refunded. The IRS is authorized to assess and collect those penalties without prior judicial review.

FBAR Filing (Foreign Financial Accounts)

31 U.S.C. Sec. 5314 requires a U.S. taxpayer to file Form TDF 90-22.1- Report of Foreign Bank Account ("FBAR") to report all foreign bank and financial accounts in which they have a financial interest or signature authority if the aggregate value of the accounts exceeded $10,000 at any time during the year.

A U.S. taxpayer has a financial interest in an account owned by the foreign trust, and is required to file an FBAR report for foreign accounts held by the trust if they have a present beneficial interest in more than 50% of the trust assets, or receives more than 50% of the trust income. Discretionary beneficiaries and remainder beneficiaries are not required to file FBAR. Trust beneficiaries do not have to file an FBAR report for foreign financial assets held by the trust, if the trust, trustee or agent of the trust is a U.S. person and files an FBAR disclosing the trust's foreign financial accounts (Sec. 103.24(g)(5) of 31 CFR Part 103, Federal Register Vol. 76, No. 37 at 10234 (2/16/11)).

Form 3520: Trust Distributions

A distribution to a U.S. beneficiary is any gratuitous transfer of money or other property from a trust, whether or not the trust is treated as owned by another person under IRC Sec. 671-679, and without regard to whether the recipient is designated as a beneficiary by the terms of the trust. A distribution includes the receipt of trust corpus and the receipt of a gift or bequest described under IRC Sec. 663(a).

A distribution includes constructive transfers from a trust:

1. Personal charges made on a credit card paid by a foreign trust;

2. Personal charges (e.g. credit card) guaranteed or secured by the assets of a foreign trust;

3. Personal checks written on a foreign trust's bank account, the amount will be treated as a distribution.

In addition, a U.S. taxpayer who receives a payment from a foreign trust in exchange for property transferred to the trust, or services rendered to the trust, and the fair market value of the payment received exceeds the fair market value of the property transferred or services rendered, the excess will be treated as a distribution.

Chapter 44 - Foreign Grantor Trusts: International Tax Compliance

Control Rules

Any U.S. Person who controls a foreign corporation or foreign partnership during the tax year must file a Form 5471 (for a corporation) or Form 8865 (for a partnership). (IRC §6038.) These forms must be filed with the U.S. Person's timely filed federal tax return (including extensions).

For foreign corporations, control means ownership (direct or indirect) of more than 50 percent of the outstanding stock or voting power for at least 30 consecutive days during the year. Treas. Reg. §1.6038-2. For foreign partnerships, control means direct or indirect ownership of a more than 50 percent interest in partnership profits, capital, or deductions or losses. It also includes certain groups of U.S. Persons, who collectively own more than a 50 percent and individually own more than a 10 percent interest in the foreign partnership.

Attribution and constructive ownership rules apply (a taxpayer with no direct ownership in the foreign corporation or partnership could potentially have a reporting obligation).

The check-the-box regulations provide default corporate status for certain foreign limited liability entities. A U.S. Person's involvement with a foreign entity that does not resemble a corporation under local law may trigger a foreign corporation reporting obligation.

Penalties

A violation of the Control Rule-, (i.e., failure to timely file a Form 5471 or Form 8865) has a double-penalty impact. First, the U.S. Person's foreign tax amount used to compute the foreign tax credit is reduced by 10 percent. Second, the U.S. Person is subject to a flat $10,000 penalty.

Additional penalties apply if the violation continues for 90 days after IRS notice: (i) the foreign tax reduction increases by five percent for each three-month period, and (ii) there are additional $10,000 penalties for each 30-day period, up to $60,000 ($10,000 initial penalty and $50,000 maximum additional penalties). When both penalties apply, however, the foreign-tax penalty is reduced by the amount of the fixed-dollar penalty imposed.

The IRS must follow deficiency procedures and issue a notice of deficiency to the taxpayer with respect to the foreign tax credit reduction. The IRS may summarily assess the other penalties and collect them upon notice and demand.

These penalties may be avoided when the taxpayer proves that the failure was due to reasonable cause and not willful neglect.

Special Rules For Officers And Directors

Special rules apply for directors and officers of foreign corporations. A U.S. Person who becomes an officer or director of a foreign corporation, and owns at least 10 percent of the corporation's stock (by value or vote), must also file a Form 5471. (IRC §6046.) Constructive stock ownership rules apply, although this rule generally requires that the U.S. Person directly own some amount of stock. The Form 5471 must be filed with the U.S. Person's timely filed federal tax return, including extensions. In the absence of reasonable cause, the penalty for failure to timely file is $ 10,000, with additional penalties up to $50,000 for failure to cure the violation after IRS notice.

Rules For Property Transfers

Subject to certain exceptions, transfers of property by U.S. Persons to foreign corporations must be reported to the IRS. IRC §6038B. The U.S. Person must file a Form 926 with its timely filed income tax return for the year in which the transfer occurred. Transfers of cash to a foreign corporation are also reportable, provided that (i) immediately after the transfer the U.S. Person owns 10 percent (by vote or value) of the corporation, or (ii) the amount of cash transferred by the U.S. Person during the preceding 12 months collectively exceeds $ 100,000.

A reportable transfer by a partnership to a foreign corporation must be reported by each individual partner. The partnership cannot file a single Form 926 and satisfy this obligation on all the partners' behalf.

Transfers by U.S. Persons to foreign partnerships are subject to reporting. A reportable transfer occurs when (1) immediately after the transfer, the person holds, directly or constructively, a 10 percent or greater interest in the partnership, or (ii) the value of the property transferred, when added to the value of the property previously transferred by the person (or related person) to the foreign partnership over the last 12 months, exceeds $100,000. IRC §6038B. The U.S. Person must report the transfer on a Form 8865, which is filed with the person's timely filed federal tax return (including extensions).

If a domestic partnership contributes property to a foreign partnership, the partners of the domestic partnership are each treated as transferring their proportionate share of the contributed property. Each partner has an obligation to file a Form 8865. Unlike the Form 926 discussed above, however, the domestic partnership itself may file the Form 8865 and satisfy the reporting requirements of its partners.

The penalty for failure to file a Form 5471 or Form 8865 is equal to 10 percent of the fair market value of the property at the time of the exchange/ transfer. The penalty will not apply if the failure to comply is due to reasonable cause and not willful neglect. The penalty is also limited to $100,000 unless the failure to comply was due to intentional disregard.

Rules For Ownership Transfers

Reporting rules apply to the transfer of ownership in a foreign corporation or foreign partnership.

With respect to a foreign corporation, a U.S. Person must file a Form 5471 if any of the following occurred during the tax year: (1) the person acquired stock and thereafter possessed a 10 percent ownership interest (by vote or value) in the foreign corporation, (2) the person acquired a 10 percent or more stock ownership interest, or (3) the person disposes of sufficient stock to reduce the person's interest below 10 percent ownership. IRC §6046.

These rules do not require that the transfer occur in a single transaction. Rather, a reporting obligation arises if this threshold is met as a result of one or more transactions during the tax year.

Similar rules apply to foreign partnerships. A U.S. Person must file a Form 8865 if during the tax year (1) the person acquires or disposes of an interest in the foreign partnership, and before or after the transfer the person holds (directly or indirectly) a 10 percent interest in the partnership, or (2) the person's proportional interest in the partnership changes by 10 percent or more. (IRC §6046A.)

Both Form 5471 and Form 8865 must be filed with the U.S. Person's timely filed tax return (including extensions).

A fixed $ 10,000 penalty is imposed on any failure to disclose a reportable transfer. If the failure continues for more than 90 days after IRS notice, an additional penalty of$ 10,000 will apply for each 30-day period (or fraction thereof) during which the failure continues, up to $50,000. IRC §6679.

Does The Taxpayer Own An Interest In A Foreign Disregarded Entity?

Special reporting rules also apply to U.S. Persons who are owners of a foreign disregarded entity.

Any U.S. Person that is treated as the owner of the assets or liabilities of a foreign disregarded entity is required to file a Form 8858 with its timely filed income tax return, including extensions.

A foreign disregarded entity is simply an entity organized outside the United States that, under the check-the-box regulations, is treated as a disregarded entity. The penalties for failing to file a Form 8858, which include:

1. a fixed $ 10,000 penalty,

2. 10 percent foreign tax reduction,

3. Additional penalties for failure to respond to an IRS notice of violation.

The disregarded status of the foreign entity is determined under U.S. law (not the law under which the entity was organized).

A U.S. Person that controls a foreign corporation or a foreign partnership, which corporation or partnership owns a foreign disregarded entity, may also have a reporting obligation. A U.S. Person may be required to file a Form 8858, even when (i) the person has no direct ownership in the foreign disregarded entity, and (ii) the constructive or indirect ownership is less than 100 percent.

Chapter 45 - IRS Voluntary Disclosure: History

A tax crime is complete on the day the false return was filed.

Between 1945 and 1952, the IRS had a "voluntary disclosure" policy under which a taxpayer who failed to file a return or declare his full income and pay the tax due could escape criminal prosecution through voluntary disclosure of the deficiency, (so long as the voluntary disclosure was made before an investigation was started).

If the IRS determined that a voluntary disclosure had been made, no recommendation for criminal prosecution would be made to the Department of Justice.

Under current IRS practice, the review includes whether there was a true "voluntary disclosure" along with other factors in determining whether or not to recommend prosecution to the Department of Justice. (IRM, Chief Counsel Directive Manual (31) 330 (Dec. 11, 1989) (Voluntary Disclosure).

IRM 9781, Special Agents Handbook § 342.14, MT 9781-125 (Apr. 10, 1990) (Voluntary Disclosure). (although prosecution after voluntary disclosure is not precluded, the "IRS will carefully consider and weigh the voluntary disclosure, along with all other facts and circumstances, in deciding whether or not to recommend prosecution"). See also IRM 9131(1), MT 9-329 (Mar. 24, 1989). (Prosecution Guidelines).

IRS administrative practice recognizes that a taxpayer may still avoid prosecution by voluntarily disclosing a tax violation, provided that there is a qualifying disclosure that is (1) timely and (2) voluntary. A disclosure within the meaning of the practice means a communication that is truthful and complete, and the taxpayer cooperates with IRS personnel in determining the correct tax liability. Cooperation also includes making good faith arrangements to pay the unpaid tax and penalties "to the extent of the taxpayer's actual ability to pay."

A disclosure is timely if it is received before the IRS has begun an inquiry that is (1) "likely to lead to the taxpayer" and (2) the taxpayer is reasonably thought to be aware" of that inquiry; or the disclosure is received before some triggering or prompting event has occurred (1) that is known by the taxpayer and (2) that triggering event is likely to cause an audit into the taxpayer's liabilities.

Voluntariness is tested by the following factors: (1) how far the IRS has gone in determining the tax investigation potential of the taxpayer; (2) the extent of the taxpayer's knowledge or awareness of the Service's interest; and (3) what part the triggering event played in prompting the disclosure (where the disclosure is prompted by fear of a triggering event, it is not truly a voluntary disclosure).

No voluntary disclosure can be made by a taxpayer if an investigation by the Service has already begun. Therefore, once a taxpayer has been contacted by any Service function (whether it be the Service center, office examiner, revenue agent, or a special agent), the taxpayer cannot make a qualifying voluntary disclosure under IRS practice.

A voluntary disclosure can be made even if the taxpayer does not know that the Service has selected the return for examination or investigation may be too restrictive. Consequently, if there is no indication that the Service has started an examination or investigation, Tax Counsel may send a letter to the Service stating that tax returns of the taxpayer have been found to be incorrect and that amended returns will be filed as soon as they can be accurately and correctly prepared. This approach has the advantage of putting the taxpayer on record as making a voluntary disclosure at a time when no known investigation is pending. However, neither the taxpayer nor the lawyer can be completely certain that the voluntary disclosure will prevent the recommendation of criminal prosecution.

Where no IRS examination or investigation is pending a taxpayer’s alternative is the preparation and filing of delinquent or amended returns. The advantage of filing delinquent or amended returns without a communication drawing attention to them is that the returns may not even be examined after being received at the Service center. In such an event, the taxpayer not only will have made a voluntary disclosure but will have avoided an examination as well. The disadvantage is that during the time the returns are being prepared, the taxpayer may be contacted by the Service and a voluntary disclosure prevented.

If a taxpayer who cannot make a qualifying voluntary disclosure nevertheless files amended or delinquent tax returns, these returns (1) constitute an admission that the correct income and tax were not reported and (2) if incorrect, may serve as an independent attempt to evade or as a separate false statement.

No formula exists, and a taxpayer must endure the uncertainty of the risk that a voluntary disclosure will not be considered truly voluntary by the Service. If so, an investigation that has already started but has lagged may be pursued more overtly and aggressively as a result of the disclosure.

Chapter 46 - Offshore Voluntary Disclosure Program 2012

The following is from IRS.gov

IRS Offshore Programs Produce $4.4 Billion To Date for Nation’s Taxpayers; Offshore Voluntary Disclosure Program Reopens

WASHINGTON - Jan. 9, 2012 (Updated October 28, 2013) The Internal Revenue Service today reopened the offshore voluntary disclosure program to help people hiding offshore accounts get current with their taxes and announced the collection of more than $4.4 billion so far from the two previous international programs.

The IRS reopened the Offshore Voluntary Disclosure Program (OVDP) following continued strong interest from taxpayers and tax practitioners after the closure of the 2011 and 2009 programs. The third offshore program comes as the IRS continues working on a wide range of international tax issues and follows ongoing efforts with the Justice Department to pursue criminal prosecution of international tax evasion. This program will be open for an indefinite period until otherwise announced.

“Our focus on offshore tax evasion continues to produce strong, substantial results for the nation’s taxpayers,” said IRS Commissioner Doug Shulman. “We have billions of dollars in hand from our previous efforts, and we have more people wanting to come in and get right with the government. This new program makes good sense for taxpayers still hiding assets overseas and for the nation’s tax system.”

The program is similar to the 2011 program in many ways, but with a few key differences. Unlike last year, there is no set deadline for people to apply. However, the terms of the program could change at any time going forward. For example, the IRS may increase penalties in the program for all or some taxpayers or defined classes of taxpayers – or decide to end the program entirely at any point.

“As we’ve said all along, people need to come in and get right with us before we find you,” Shulman said. “We are following more leads and the risk for people who do not come in continues to increase.”

The third offshore effort comes as Shulman also announced today the IRS has collected $3.4 billion so far from people who participated in the 2009 offshore program, reflecting closures of about 95 percent of the cases from the 2009 program. On top of that, the IRS has collected an additional $1 billion from up front payments required under the 2011 program. That number will grow as the IRS processes the 2011 cases.

In all, the IRS has seen 33,000 voluntary disclosures from the 2009 and 2011 offshore initiatives. Since the 2011 program closed last September, hundreds of taxpayers have come forward to make voluntary disclosures. Those who have come in since the 2011 program closed last year will be able to be treated under the provisions of the new OVDP program.

The overall penalty structure for the new program is the same for 2011, except for taxpayers in the highest penalty category.

For the new program, the penalty framework requires individuals to pay a penalty of 27.5 percent of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the eight full tax years prior to the disclosure. That is up from 25 percent in the 2011 program. Some taxpayers will be eligible for 5 or 12.5 percent penalties; these remain the same in the new program as in 2011.

Participants must file all original and amended tax returns and include payment for back-taxes and interest for up to eight years as well as paying accuracy-related and/or delinquency penalties.

Participants face a 27.5 percent penalty, but taxpayers in limited situations can qualify for a 5 percent penalty. Smaller offshore accounts will face a 12.5 percent penalty. People whose offshore accounts or assets did not surpass $75,000 in any calendar year covered by the new OVDP will qualify for this lower rate. As under the prior programs, taxpayers who feel that the penalty is disproportionate may opt instead to be examined.

The IRS recognizes that its success in offshore enforcement and in the disclosure programs has raised awareness related to tax filing obligations. This includes awareness by dual citizens and others who may be delinquent in filing, but owe no U.S. tax. The IRS is currently developing procedures by which these taxpayers may come into compliance with U.S. tax law. The IRS is also committed to educating all taxpayers so that they understand their U.S. tax responsibilities.

More details will be available within the next month on IRS.gov. In addition, the IRS will be updating key Frequently Asked Questions and providing additional specifics on the offshore program.

Chapter 47 - IRS/OVDP 2012 Tax Compliance

Special Contribution by Ryan L. Losi, CPA

The IRS/OVDI program requires:

1. Filing complete and accurate Form 1040(x) amended federal income tax returns for all tax returns covered by the voluntary disclosure, with applicable schedules detailing the type and amount of previously unreported income from the account or entity (Schedule B for interest and dividends, Schedule D for capital gains and losses, Schedule E for income from partnerships, S Corporations, estates or trusts and the years after 2010, Form 8938, Statement of Specified Foreign Financial Assets).

2. File Form TDF 90-22.1 (Report of Foreign Bank and Financial Accounts, "FBAR Filings") for all tax years covered by the voluntary disclosure.

3. Cooperate in the voluntary disclosure process, including providing information on offshore financial accounts, institutions and facilitators and signing agreements to extend the period of time for assessing Title 26 liabilities and FBAR penalties.

4. Payment in full of tax, interest and penalties due. Penalties include:

a. Failure to File a Tax Return (IRC Sec. 6651(a)(1), 5% of the tax due per month, up to 25% (tax due).

b. Failure to Pay Tax Due Shown on Tax Return (IRC Sec. 6651(a)(2), 5% of the tax due shown on return, per month, up to 25% (tax due).

c. Accuracy Related Penalty (IRC Sec. 6662) Taxpayer may be liable for a 20% or 40% penalty. Under the IRC Sec. 6662(b)(7) and (j), a 40% accuracy-related penalty is imposed for any underpayment of tax that is attributable to an undisclosed foreign financial asset understatement.

d. Title 26 Penalty 27.5% of highest aggregate balance in foreign bank accounting/entities, or value of foreign assets, during the period covered by the voluntary disclosure.

Total penalties up to 70% of unpaid tax plus 27.5% of value of assets (total): aggregated foreign accounts and foreign assets (for the highest year's aggregate value during the period covered by the voluntary disclosure).

5. Execute a closing agreement on final return income covering specific matters, Form 906.

6. Agree to cooperate with IRS offshore enforcement effected by providing information about offshore financial institutions, offshore service providers, and other facilitators.

Civil Fraud/Criminal Tax Evasion

Until such time as the U.S. taxpayer and the IRS execute a Form 906 closing agreement, the U.S. taxpayer may be still subject to both imposition of civil tax fraud penalties and prosecution for criminal tax evasion, if and when the IRS "disqualifies the U.S. Taxpayer" from the IRS/OVDI (2012) (as is the case with Israel's Bank Leumi's U.S. clients).

Civil Tax Fraud

Civil fraud penalties imposed under IRC Sec. 6651(f) or 6663, for either underpayment of tax, or a failure to file a tax return due to fraud, the taxpayer is liable for penalties of 75% of the unpaid tax.

Criminal Tax Evasion

U.S. taxpayers with undisclosed offshore bank accounts and unreported income face criminal charges for:

1. Tax Evasion (26 USC Sec. 7201) [5 years in jail; $250,000 fine];

2. Filing False Tax Return (26 USC Sec. 7206(1)) [3 years in jail, $250,000 fine];

3. Failure to File Tax Return (26 USC Sec. 7203); [1 year in jail, $100,000 fine];

4. Willful Failure to File FBAR or Filing False FBAR (31 USC Sec. 5322) [10 years in jail, fines up to $500,000].

In addition, the willful failure to file the FBAR has a civil penalty as high as the greater of $100,000 or 50% of the total balance of the foreign account per violation (31 USC Sec. 5321(a)(5).

Chapter 48 - IRS Voluntary Disclosure 2013: An Update

Two recent cases demonstrate the great risk attendant to the IRS offshore Voluntary Disclosure Program (2012-forward) ("OVDP").

In the Bank Leumi case, dozens of U.S. taxpayers with accounts at Bank Leumi were in 2013 peremptorily disqualified from the IRS OVDP without explanation. The IRS has recently reversed this position and according to tax counsels have readmitted the disqualified U.S. taxpayers. Although the various tax counsels appear satisfied with the IRS reversal of position their "sighs of relief" fail to address the "dangers of the OVDP:

1) As of the 2012 OVDP a 27 1/2% penalty based on the value of the undisclosed offshore assets (in addition to the original income tax due plus interest plus penalties of up to 70% of the tax due.)

2) Waiver of Constitutional Protections against: self-incrimination (5th amendment), unreasonable search and seizure (4th amendment), excessive fines (8th amendment).

These "trifecta" of constitutional protections disappear once a U.S. taxpayer enters the IRS OVDP disclosing: their names, social security numbers, undisclosed income, undisclosed assets, names of the advisors/colleagues/3rd parties who facilitated their "offshore tax evasion."

It is a risky strategy to voluntarily contact the IRS to disclose multiple tax crimes (felonies which if prosecuted may lead to over 25 years in jail with additional 20 year sentences for each instance of money laundering, wire fraud, mail fraud, total jail time over 85 years, if the prosecutor "throws the book" at the taxpayer. If you commit federal crimes, is it advisable to go to the U.S. Attorney to confess your crimes and beg for leniency? If not, then why confess federal tax crimes to the IRS (who may refer the case to the U.S. Attorney since the taxpayer's voluntary disclosure has neither transactional or use immunity.

In the case of Ty Warner (Beanie Bag founder, a member of the Forbes 400 richest Americans, with $2.6 billion net worth) he entered the IRS OVDP only to be rejected (for unknown reasons).

The risk for Ty Warner is best exemplified by his recently disclosed IRS settlement $53million for 202 taxes (on unreported income from undisclosed UBS/Swiss Bank accounts). Ty Warner has agreed to pay $53million on an unreported $3.1million in income which tax would have been $885k (nearly 60x the amount of the original tax due). In addition, he faces charges of criminal tax evasion, with up to a 5 year jail sentence (he awaits arraignment).

The $53million in settlement was due to imposition of a 50% "FBAR" penalty on the $93million he held in his UBS Swiss Bank account. If you are Ty Warner, you have to ask yourself the following question, best expressed by Bob Dylan, "If you can't do the time, don't do the crime.

Chapter 49 - Ty Warner & the IRS Voluntary Disclosure Program

On 10/2/13, Ty Warner, billionaire creator of Beanie Baby Toys, pleaded guilty in U. S. District Court (Chicago) to a single count of tax evasion for failing to report $3.2 million in income on a secret UBS (Swiss) Bank Account (with $93.6million). He paid a $53.6 million civil tax penalty and is scheduled for sentencing on January 15, 2014 (for up to 5 years in jail for tax evasion).

In 2009, Ty Warner tried to avoid criminal prosecution by entering into the IRS Offshore Voluntary Disclosure Program but was denied and it appears the evidence he submitted to the IRS was used against him in the U.S. government criminal prosecution. Warner's plea is not binding on the IRS.

See article, "Beanie Baby Creator Pleads Guilty to Swiss Bank Tax Dodge."

Chapter 50 - IRS Civil/Criminal Penalties-Reasonable Cause (Willfulness)

Under Mortensen v. Commr., 440 F.3d 375, 385 (6th Cir. 2006), it was held that reasonable minds can differ over tax reporting, and under tax audits the IRS may disallow certain transactions.

The U.S. Congress was concerned that taxpayers would participate in the “audit lottery” and take questionable positions on their tax returns in the expectation of not being audited (See: H.R. Rep. No. 101-247, 1388 (1989). H.R. Rep. No. 101-247, as reprinted in 1989 U.S.C.C.A.N. 1906, 2858.

IRC Sec. 6662(b) imposes a civil penalty for substantial understatements of income, or liability overstatements (in addition, other civil penalties may be imposed for negligence and substantial valuation misstatements).

Under IRC Sec. 6064(c), no penalty will be imposed with “respect to any portion of an underpayment if it is shown that there was reasonable cause and the taxpayer acted in good faith.”

Under Treasury Regulation Section 1.6664-4(b)(1), “reasonable cause” and “good faith” require courts to review the following taxpayer issues:

Experience;

Knowledge;

Sophistication;

Education;

Taxpayer reliance on a tax professional; and

Taxpayer’s effort to assess the taxpayer’s proper tax liability.

Under Treas. Reg. Sec. 1.6664-4(c), the IRS minimum requirements for determining whether a taxpayer reasonably relied in good faith on advice including a tax advisor’s professional opinion.

The minimum requirements include:

1. The advice must be based on all pertinent facts and circumstances and the law as it relates to those facts and circumstances;

2. The advice must not be based on unreasonable factual or legal assumptions;

3. The advice must not unreasonably rely on the representations, statements, findings or agreements of the taxpayer or any other person;

4. A taxpayer may not rely on an opinion or advice that a regulation is invalid to establish that the taxpayer acted with reasonable cause and good faith unless the taxpayer adequately disclosed that the regulation in question is invalid (Treas. Reg. Sec. 1.6662-3(c)(2).

Under Treasury Regulation Sec. 1-6664-4(b)(1), reasonable cause and good faith are not necessarily established by reliance on the advice of a professional tax advisor.

However, under Treas. Rg. Sec. 1.6664-4(b)(2), a taxpayer may satisfy the “reasonable cause” and “good faith” exception because the taxpayer believed that the tax professional had knowledge in the relevant aspects of federal tax law.

In United States v. Boyle, 469 U.S. 241, 251 (1985), the U.S. Supreme Court held:

1. Taxpayers may not be sophisticated in tax matters, and that it is unrealistic for taxpayers to recognize errors in the substantive advice of an accountant or attorney;

2. To require the taxpayer to challenge the attorney, to seek a second opinion, or to try to monitor counsel would nullify the purpose of seeking the advice of a presumed expert in the first place.

Under Sklar, Greenstein & Scheer, P.C. v. Commr., 113 T.C. 135, 144-145 (1999) citing Ellwest Stereo Theaters of Memphis, Inc. v. Commr., T.C.M. 1995-610, the Tax Court established a three-prong test to prove reasonable cause, where a taxpayer is asserting a defense against an IRC Sec. 6662 penalty:

1. The tax advisor was a competent professional who had sufficient expertise for justifying reliance;

2. The taxpayer provided necessary and accurate information to the advisor;

3. The taxpayer actually relied in good faith on the advisor’s judgment.

Under Treas. Reg. Sec.1-6664-4(b)(1), reliance on a tax advisor may be considered reasonable when the taxpayer knew that the tax advisor possessed specialized knowledge in the relevant aspects of federal tax law.

In the case Neonatology Assoc., P.A. v. Commr., 115 T.C. 43, 99 (2000), aff’d 299 F.3d 211 (3d Cir. 2002) the court held:

1. Taxpayer reliance on an insurance agent was found to be unreasonable because the insurance agent was not a tax professional;

2. The taxpayers were sophisticated and should have known that the tax benefits discussed were "too good to be true';

3. The court rejected the evidence the taxpayers presented that they also relied on tax attorneys and accountants.

In Stanford v. Commr., 152 F3d 450 (5th Cir. 1998) the court held:

1. Taxpayer could rely on a CPA with extensive experience in international banking law for advice regarding the taxpayer's controlled foreign corporation.

2. It was not reasonable to expect the couple to monitor their CPA to make sure he conducted sufficient research to give knowledgeable advice.

3. Intelligent investors have independent educated experts to advise them, particularly with respect to arcane matters of the law.

4. The Court vacated the penalty since the CPA was diligent in reviewing the taxpayer's business and tax records, and studying the statute, legislative history and regulations.

In Larson v. Commr., TC Memo 2002-295, 84 T.C.M. 608 (2002), the Court held that to satisfy the "reasonable cause" and "good faith" exception, the taxpayer must provide necessary and accurate information to the tax advisor. In Larson, the taxpayer received an incorrect Form 1099 which due to a printing error, read $1,891 (not $21,891). Here, the "reasonable cause" and "good faith" exception did not apply since the taxpayer had reason to believe that the tax reported on the tax return was not accurate and the taxpayer should have made additional efforts to assess the proper amount of his tax liability.

In Woodson v. Commr., 136 T.C. 585 (2001), the court held that the taxpayer's reliance on a return preparer did not constitute reasonable cause, since to qualify for the "reasonable cause penalty exception" the taxpayer must rely in good faith on the tax advisor's judgment or advice.

In Woodson, the tax return failed to include a $3.4M tax item and substantially understated the tax liability, the result of a "clerical mistake". Here the court did not apply the reasonable cause exception because the tax professionals did not provide advice to the taxpayers.

Under Treas. Reg. Sec. 1-6664-4(c)(2), tax advice constitutes analysis on the conclusions of a professional tax advisor. Here, the taxpayers did not provide evidence to show that a professional tax advisor's analysis or conclusions led to the omission of the item on the tax return. The taxpayers were not able to satisfy the "reasonable cause" and "good faith" defense as the taxpayers did not review the proposed return to ensure that the income items were included.

In Thomas v. UBS, 7th Cir. (2013), the court held that the Swiss Bank, UBS, is not liable to U.S. account owners for fines and interest paid when confessing to the IRS about their foreign accounts. The U.S. accountholders sued UBS, claiming the bank didn't give them accurate tax advice and should have kept them from breaking the law. The court threw out their lawsuit, saying they were tax cheats who didn't merit a day in court.

In Canal Corp. v. Commr., 135 T.C. 199 (2010), the court held that taxpayers may defend against the "accuracy-related" penalty, when the taxpayers rely on a tax professional, under a "three-prong test":

1. The taxpayer provided necessary and accurate information to the advisor.

2. The taxpayer acted in good faith on the tax professional's advice.

3. The tax advisor had apparent expertise to justify reliance.

In Canal the test was not satisfied and the court imposed accuracy-related penalties despite the taxpayer's reliance on a sophisticated advisor.

Taxpayers must not rely on tax professionals that provide tax advice that they personally know is incorrect or that they believe might not be correct based on their previous experience or business knowledge. Additionally, taxpayers should review any Form 1099s or other informational returns they receive to ensure they are complete and accurate.

In the case of U.S. v. Williams (U.S. App. Lexis 15017), (4th Cir. Va., July 20, 2012) (unpublished)), the 4th Circuit reviewed a District Court judgment that for civil penalty purposes Williams did not willfully fail to report his interest in two foreign bank accounts under 31 U.S.C. 5314.

The court held that Williams' conduct constituted "willful blindness" since:

1. He chose not to report the income;

2. He knew he had an obligation to report the existence of the Swiss accounts;

3. He knew what he was doing was wrong and unlawful;

4. On his Form 1040 tax return, he "checked no" on Schedule B regarding having an interest in foreign accounts.

The 4th Circuit ruled that Williams willfully violated 31 U.S.C. Sec. 5314 (to report two foreign bank accounts).

Civil Penalties (Tax Advice)

A U.S. taxpayer who relies on the advice of a tax professional may relieve the U.S. taxpayer from civil penalties if there has been no willful neglect. Under the IRC Sec. 6664: "No penalty shall be imposed… with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and the taxpayer acted in good faith with respect to such portion". Under related Treasury Regulations: "Reliance on an information return, professional advice, or other facts constitutes reasonable cause and good faith if under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith."

Under IRS Circular No. 230, U.S. taxpayers may now rely on tax opinions for relief from penalties only, if:

1. The tax opinion is based on a full legal and factual review and covers all the issues;

2. The drafter of the tax opinion may not be involved directly or indirectly with the "tax-shelter" promoter; i.e., it must be an independent tax opinion.

In the case of Canal Corp. v. Commr.,135 T.C. 199 (2010), the court held that the taxpayer could not rely upon Price Waterhouse Cooper's (PWC) tax opinion (for which they paid $800,000) because of PWC's involvement with the "underlying structures"; i.e. the tax shelter.

A U.S. taxpayer may avoid civil penalties if the U.S. taxpayer;

Makes full disclosure;

To an independent tax professional;

Who is experienced in the area of law;

Receives, reviews and understands the advisor's tax opinion;

No "blind reliance" on the tax opinion; i.e. two tests: "You should know better", or "It's too good to be true".

The taxpayer must rely upon the opinion; and

The taxpayer must follow the plan and the opinion.

Criminal Penalties (Willfulness)

For a U.S. taxpayer to avoid criminal prosecution, the tax rules are different than those tax rules for imposition of civil penalties. Tax crimes require "intent"; i.e. the U.S. taxpayer deliberately and intentionally pursued a criminal course of conduct.

The U.S. taxpayer must demonstrate that he had "a good faith belief" that he did not owe tax. If so, the U.S. taxpayer may be able to prevent a criminal conviction but not necessarily prevent being criminally prosecuted. The U.S. taxpayer must demonstrate that their "tax theory" (however misguided) was in "good faith" in order to negate the "intent element" of the crime of tax evasion.

For example, in the case of Vernice Kuglin, she successfully convinced a jury that the IRS's failure to respond to her written inquiry regarding the need to file a tax return or pay tax on over $900,000 in U.S. taxable income was a "reasonable, good faith belief" and she was not convicted of tax evasion.

For example, in the 2007 case of Tom Cryer (an attorney in Louisiana) tax evasion charges were dropped and he was acquitted on charges of willfully failing to file a tax return. Cryer's defense was that the IRS refused to respond to his repeated demand that the government explain why his "tax theories" were not viable, instead they refused to respond to Cryer, stating his tax positions were "frivolous".

At trial, Cryer convinced jurors that he genuinely believed he owed no tax for the years in question, and without proof of criminal intent, he was acquitted.

In the case of the actor Wesley Snipes, he provided the IRS with a 600-page explanation of why he was a "non-taxpayer" which the IRS ignored as a "tax protester" manifesto. He was not convicted of tax evasion (i.e. a felony) but was convicted for failure to file a tax return (misdemeanor) and was sentenced to three one-year consecutive prison terms.

For civil tax penalties, U.S. taxpayers must demonstrate the key element for a penalty defense; i.e. reasonable reliance on counsel. In criminal courts, reliance on counsel is essential but the courts give wide latitude with respect to a willfulness defense and the taxpayer's "good faith belief".

In criminal cases, the prosecutor must prove beyond a reasonable doubt willfulness, or specific criminal intent, which means that the defendant:

1. Knew and understood the law; and

2. Intentionally set out to violate it; i.e. had the purpose of evading assessment or collection of taxes.

Regarding willfulness, the defendant may present a good faith defense, including good faith belief and reliance when reliance includes all that the defendant read and heard. According to the U.S. Supreme Court, good faith is a defense, no matter what the belief. However, the defendant is not allowed willful blindness; i.e. the defendant intentionally concealed the truth from himself.

Criminal penalties may be imposed for intentionally violating federal tax laws (i.e. willful violation). "Ignorance of the law excuses no one" is a legal principle holding that a person who is unaware of a law may not escape liability for violating that law merely because he or she is or was unaware of its content.

Under U.S. Model Penal Code Sec. 2.02(9), knowledge that at an activity is unlawful is not an element of an offense unless the statute creating the offense specifically makes it one.

In Cheek v. U.S. (1991), 498 U.S. 192, willfulness is required for federal tax crimes. In Cheek, the U.S. Supreme court reversed his conviction for willful failure to file a tax return.

Cheek's "tax theory" was that wages did not constitute income and he therefore failed to file a tax return. The U.S. Supreme Court held that Cheek was entitled to a good faith instruction to the jury; i.e. the jurors could acquit him if they found Cheek believed in good faith that he was not required to file. The prosecutor had to prove that Cheek did not rely in good faith on what he heard and read. Cheek was eventually convicted and served a year and a day.

In order to avoid criminal convictions, U.S. taxpayers must rely upon independent, competent counsel. In the case of U.S. v. Lindsey Springer, (Case No. 09 C.R. 043 JHP, Northern District of Oklahoma), the taxpayer and his attorney each received a 15 year sentence for conspiracy to defraud the U.S. and evasion of taxpayer's taxes by use of the attorney's trust account to funnel client funds and from which account client expenses were paid.

Although the good faith belief and reliance arguments may be usable as a defense in a criminal tax case, often these off-shore situations involve "money laundering" (i.e. disguising the nature or origin of the funds), in which the government may criminally prosecute under the principal of "intentional blindness" or "ignoring what is reasonable" as a basis for conviction.

The best defense is a specific tax opinion letter from an independent, competent tax professional.

Chapter 51 - Accuracy Related Penalty

The two penalties primarily applicable to underpayments of tax are the accuracy-related penalty (Code Sec. 6662) and the fraud penalty (Code Sec. 6663).

The accuracy-related penalty consolidates all of the penalties relating to the accuracy of tax returns. It is equal to 20% of the portion of the underpayment of tax (i.e. greater of $5,000 or 10% 0f the tax) that is attributable to one or more of the following: (1) negligence or disregard of rules or regulations, (2) substantial understatement of income tax, (3) substantial valuation misstatement, and (4) substantial overstatements of pension liabilities (Code Sec. 6662(a) and (b))., or 40% of the tax underpayment from an undisclosed foreign financial account understatement.

The accuracy-related penalty is entirely separate from the failure to file penalty and will be imposed if no return, other than a return prepared by the IRS when a person fails to make a required return, is filed (Code Sec. 6664 (b)). In addition, the accuracy-related penalty will not apply to any portion of a tax underpayment on which the fraud penalty is imposed.

Also, no penalty is imposed with respect to any portion of any underpayment if the taxpayer shows that there was reasonable cause for the underpayment and that the taxpayer acted in good faith (Code Sec. 6664(c)).

Chapter 52 - Omission of Over 25% of Income

If the taxpayer omits from gross income (total receipts, without reduction for cost) an amount in excess of 25% of the amount of gross income stated in the return, a six-year limitation period on assessment applies.

An item will not be considered as omitted from gross income if information sufficient to apprise the IRS of the nature and amount of such item is disclosed in the return or in any schedule or statement attached to the return (Code Sec. 6501(e); Reg. §301.6501(e)-1(a)).

Chapter 53 - FBAR Civil Penalties: Reasonable Cause Exception

A failure to file a FBAR has civil and criminal penalties (which are in addition to any income tax penalties if the income is not reported). The IRS must assess the civil penalties within 6 years of the FBAR violation (31 USC 5321(b)(1)).

For a willful failure to file, the civil penalty increases from $10,000 (non-willful failure to file) to the greater of $100,000 or 50% of the account balance in the foreign account for the tax year.

The civil penalties for non-willful failure to file may be waived by the IRS if the Taxpayer can show reasonable cause. If the Taxpayer has a reasonable cause exception, the FBAR should be filed with an explanation (i.e., the reasonable cause, with an express request for waiver of penalties).

The waiver of civil penalties for a reasonable cause exception may include among other factors:

All the income from the foreign account was included on the US Taxpayer's return.

The Taxpayer was unaware of the requirement to file (for example, lack of understanding of what constitutes a financial interest).

Once the Taxpayer became aware of the filing requirements, he filed all delinquent reports (up to 6 years).

Chapter 54 - Collection After Assessment

After assessment of tax made within the statutory period of limitation, the tax may be collected by levy or a proceeding in court commenced within 10 years after the assessment or within any period for collection agreed upon in writing between the IRS and the taxpayer before the expiration of the 10-year period. The period agreed upon by the parties may be extended by later written agreements so long as they are made prior to the expiration of the period previously agreed upon. The IRS has to notify taxpayers of their right to refuse an extension each time one is requested (Code Sec. 6501(c)(4)). If a timely court proceeding has commenced for the collection of the tax, then the period during which the tax may be collected is extended until the liability for tax (or a judgment against the taxpayer) is satisfied or becomes unenforceable.

Generally effective after 1999, the 10-year limitations period on collections may not be extended if there has not been a levy on any of the taxpayer's property. If the taxpayer entered into an installment agreement with the IRS, however, the 10-year limitations period may be extended for the period that the limitations period was extended under the original terms of the installment agreement plus 90 days. If, in any request made on or before December 31, 1999, a taxpayer agreed to extend the 10-year period of limitations on collections, the extension will expire on the latest of:

the last day of the original 10-year limitations period,

December 31, 2002, or

in the case of an extension in connection with an installment agreement, the 90th day after the extension.

Interest accrues on a deficiency from the date the tax was due (determined without regard to extensions) until the date payment is received at the rate specified (Reg. §301.6601-1(a)(1)). Interest may be assessed and collected during the period in which the related tax may be collected (Code Sec. 6601(g)).

Chapter 55 - IRS: Jeopardy Assessment

Under a jeopardy assessment, Taxpayers who have unreported income may be subject to immediate IRS seizure of assets. If the IRS determines that tax collection is at risk, the IRS may immediately seize taxpayer assets without prior notice.

The IRS must have made a determination that a deficiency existed and that tax collection would be jeopardized if the IRS were to follow normal assessment and collection procedures. (IRC § 6861(a)).

In the event of a jeopardy assessment, the IRS is permitted to send a notice and demand for payment immediately. (IRC § 6861(a)).

Normally, the IRS assertion of an income tax deficiency is made after the taxpayer's year closes and the tax return is filed. However, if the IRS determines that a Taxpayer (who received significant income) may prejudice tax collection (e.g., leave the country, place assets beyond IRS reach) the IRS may issue a jeopardy assessment (levy on Taxpayer's property without prior notice (IRC § 6861(a)).

IRS jeopardy assessment requirements:

1. The Taxpayer's year is completed;

2. The due date of the tax return (with extensions) has passed;

3. Either:

- Taxpayer did not file tax return or;

- Tax liability on the filed return is understated, and;

- Tax collection is jeopardized.

Treas. Reg. Sections 301.6861 – 1(a)

IRS general levy requirements (IRC § 6330, 6331) do not apply if the IRS finds that tax collection is in jeopardy.

Under IRC § 6330(f), the IRS is entitled to levy on taxpayer's property, without prior notice to Taxpayer.

To justify a jeopardy levy, the IRS must be able to show:

1. The Taxpayer is (or appears to be) designing to quickly depart from the U.S.;

2. The Taxpayer is (or appears to be) designing to quickly place their assets beyond the reach of the IRS by:

a. Removing assets from the U.S.;

b. Concealing assets;

c. Dissipating assets;

d. Transferring assets to third parties; or

3. The Taxpayer is in danger of becoming insolvent (bankruptcy or receivership, alone is not sufficient evidence to establish financial insolvency for jeopardy purposes).

The IRS procedures for a jeopardy levy, (as stated in the Internal Revenue Manual):

1. IRS chief counsel must personally give prior written approval to a jeopardy levy (IRC § 7429(a));

2. Thereafter, the IRS must provide Taxpayer with a written statement, within five days, of the information upon which the IRS relied in making its jeopardy levy (IRC § 7429(a)(1)(B));

3. IRM 5.11, Notice of Levy Handbook section 3.5(5) instructs the IRS to try to give Taxpayer notice in person, or certified mail (last known address);

IRS notice should include:

a. Reason for jeopardy levy;

b. Taxpayer's rights to administrative and judicial review (IRC § 7429);

c. Notice of Taxpayer's rights to administrative and judicial review within a reasonable period of time (under IRC § 6330).

The jeopardy assessment may be made either:

Before or after a notice of tax deficiency is issued, and;

Also, either before or after a Tax Court petition is filed (IRC § 6861(a), Treas. Reg. Section 301.6861 – 1(a).

IRS notice and demand for payment gives the Taxpayer ten days to pay the tax in full or post a bond to stay collection (Treas. Reg. Section 301.6861 – 1(d).

If tax collection is determined to be in jeopardy, the IRS may immediately levy on Taxpayer's assets (without 30 day notice of intent to levy) (IRC § 6331(d)(3)), subject to IRS chief counsel personally approving the levy in writing (IRC § 7429(a)(1)(A)).

The IRS must send a formal notice of deficiency within 60 days after making the jeopardy assessment (IRC § 6861(b)). Upon receipt of notice of deficiency, the Taxpayer may file a Tax Court petition for redetermination of the deficiency amount (IRC § 6213(a)).

Under IRC § 6213(a), the Tax Court petition stops additional IRS assessments until the Tax Court decision is finalized. However, upon receipt of the notice of deficiency, payment (of the tax assessed), or a bond is required, within ten days, to stay collection (IRC § 6863(a)).

Under a jeopardy assessment, any amount collected by the IRS, in excess of the amount determined by the Tax Court, (as the final assessment), is refunded (IRC § 6861(f)).

Chapter 56 - Offer in Compromise

The IRS may compromise the tax liability in most civil or criminal cases before referral to the Department of Justice for prosecution or defense. The Attorney General or a delegate may compromise any case after the referral. However, the IRS may not compromise certain criminal liabilities arising under internal revenue laws relating to narcotics, opium, or marijuana. Interest and penalties, as well as tax, may be compromised (Code Sec. 7122; Reg. § 301.7122-1).

Offers-incompromise are submitted on Form 656 accompanied by a financial statement on Form 433-A for an individual or Form 433-B for businesses (if based on inability to pay) (Reg. § 601.203(b)). A taxpayer who faces severe or unusual economic hardship may also apply for an offer-in-compromise by submitting Form 656. If the IRS accepts an offer-in-compromise, the payment is allocated among tax, penalties, and interest as stated in the collateral agreement with the IRS.

If no allocation is specified in the agreement and the amounts paid exceed the total tax and penalties owed, the payments will be applied to tax, penalties, and interest in that order, beginning with the earliest year. If the IRS agrees to an amount that does not exceed the combined tax and penalties, and there is no agreement regarding allocation of the payment, no amount will be allocated to interest.

A $150 user fee is required for many offers-in-compromise (Reg. § 300.3). Taxpayers must normally pay the user fee at the time a request to compromise is submitted. No user fee is imposed with respect to offers (1) that are based solely on doubt as to liability or (2) that are made by low-income taxpayers (i.e., taxpayers whose total monthly income falls at or below income levels based on the U.S. Department of Health and Human Services poverty guidelines). If an offer is accepted to promote effective tax administration or is accepted based on doubt as to collectibility and a determination that collecting more than the amount offered would create economic hardship, the fee will be applied to the amount of the offer or, upon the taxpayer's request, refunded to the taxpayer. The fee will not be refunded if an offer is withdrawn, rejected or returned as nonprocessible. The IRS treats offers received by taxpayers in bankruptcy as non- processible, even though two district courts have held that the IRS must consider such offers (R.H. Macher, DC Va., 2004-1 USTC ¶50,114 (Nonacq.); W.K. Holmes, DC Ga., 2005-1 USTC ¶50,230). However, one district court and one bankruptcy court have held in favor of the IRS on this issue (1900 M Restaurant Associates, Inc., DC D.C., 2005-1 USTC ¶50,116; W. Uzialko, BC-DC Pa., 2006-1 USTC ¶50,297).

Detailed IRS procedures for the submission and processing of offers-in-compromise are reflected in Rev. Proc. 2003-71.

Taxpayers are required to make nonrefundable partial payments with the submission of any offer-in-compromise (Code Sec. 7122(c)). Taxpayers who submit a lump-sum offer (any offer that will be paid in five or fewer installments) must include a payment of 20 percent of the amount offered. Taxpayers who submit a periodic payment offer must include payment of the first proposed installment with the offer and continue making payments under the terms proposed while the offer is being evaluated. Offers that are submitted to the IRS without the required partial payments will be returned to the taxpayer as nonprocessible. However, the IRS is authorized to issue regulations waiving the payment requirement for offers based solely on doubt as to liability or filed by low-income taxpayers. Pending the issuance of regulations, the IRS has announced that it will waive the payment requirement for such offers (Notice 2006-68).

The required partial payments are applied to the taxpayer's unpaid liability and are not refundable. However, taxpayers may specify the liability to which they want their payments applied. Additionally, the user fee (see above) is applied to the taxpayer's outstanding tax liability. Any offer that is not rejected within 24 months of the date it is submitted is deemed to be accepted. However, any period during which the tax liability to be compromised is in dispute in any judicial proceeding is not taken into account in determining the expiration of the 24-month period (Code Sec. 7122 (f)).

The IRS may not levy against property while a taxpayer has a pending offer in compromise or installment agreement (Code Sec. 6331(k)). If the offer in compromise or installment agreement is ultimately rejected, the levy prohibition remains in effect for 30 days after the rejection and during the pendency of any appeal of the rejection, providing the appeal is filed within 30 days of the rejection. No levy may be made while the installment agreement is in effect. If the installment agreement is terminated by the IRS, no levy may be made for 30 days after the termination and during the pendency of any appeal.

Chapter 57 - Attorney-Client Privilege

For U.S. taxpayers (U.S. citizens, long-term residents, "green card holders", "Substantial Presence Test" residents) reliance upon legal advice of competent counsel may be a defense against criminal and civil tax penalties. In the attorney-client relationship, a privilege may be asserted to maintain as confidential, the advice received by the client (and the facts disclosed by the client to the attorney).

The attorney-client relationship, and the privilege, does not extend to the client's accountants, unless the accountant was retained by the attorney, (and not by the client).

If retained by an attorney, client accountants may receive the benefits of Attorney-Client privilege. In United States v. Kovel, 296 F.2d 918 (2d Cir. 1961), the Attorney-Client privilege was extended to accountants retained to assist the attorney in understanding taxpayer's financial records.

The IRS Restructuring & Reform Act of 1998 extended Attorney-Client privilege to communications with federally authorized practitioners with respect to tax advice. (IRC § 7525)

IRC § 7525 applies to:

1. Any non-criminal matter before the IRS, or in Federal Court brought by or against the U.S.

2. IRC § 7525(b) provides the privilege will not apply to representation of a corporation involved in the promotion or the direct or indirect participation of any such corporation in any tax shelter.

3. The IRC § 7525 privilege does not extend to criminal tax investigations.

A federally authorized tax practitioner is any individual who is authorized under federal law to practice before the IRS. This includes attorneys, CPAs, and enrolled agents. IRC § 7525(a).

Tax advice is advice given by an individual on a matter for which he is authorized to practice before the IRS. IRC § 7525(a). In general, the privilege, like the common-law privilege, applies to the content of the advice, not the identity of the person seeking the advice.

For communications made on or after October 22, 2004, the privilege does not apply to written communications concerning tax shelters. Thus, the privilege does not apply to any written communication between a tax practitioner and any person, director, officer, employee, agent, or representative of a person, or any other person holding a capital or profits interest in a person, in connection with the promotion of the direct or indirect participation of the person in any tax shelter. IRC § 7525(b).

A tax shelter is a partnership or other entity, an investment plan or arrangement, or any other plan or arrangement, if a significant purpose of the partnership, entity, plan, or arrangement is the avoidance or evasion of federal income tax. IRC § 6662(d)(2)(C). (This exception was limited to communications concerning corporate tax shelters, IRC § 7525(b), prior to amendment by Pub. L. 108-357, American Jobs Creation Act of 2004, Section 813.)

The IRS's position is that the Attorney-Client privilege also does not apply to tax accrual workpapers (tax accrual and other financial audit workpapers relating to the tax reserve for deferred tax liabilities and to footnotes disclosing contingent tax liabilities appearing on audited financial statements).

These workpapers are not generated in connection with seeking legal or tax advice, but are developed to evaluate a taxpayer's deferred or contingent tax liabilities in connection with a taxpayer's disclosure to third parties of the taxpayer's financial condition. IRS Announcement 2002-63, 2002-2 C.B. 72.

The crime-fraud exception may be asserted to defeat the claim of tax practitioner privilege for communications that were made for the purpose of getting advice for the commission of crime or fraud. This prevents a party from seeking advice to commit a crime or fraud and then claiming that the communication is privileged.

To assert the crime-fraud exception, (1) there must be a prima facie showing of a crime or fraud, and (2) the communications in question must be in furtherance of the misconduct. U.S. v. BDO Seidman, 368 F.Supp. 2d 858 (N.D. Ill. 2005).

If the IRS shows sufficient evidence that the communication was made in furtherance of a crime or fraud, then the taxpayer may respond by providing an explanation that would rebut the IRS's evidence. The crime-fraud exception will apply only if the court finds the taxpayer's explanation unsatisfactory. U.S. v. BDO Seidman, No. 02 C 4822 (N.D. Ill. May 17, 2005), aff'd on this issue and vacated and remanded on other grounds, No. 05-3260 & 05-3518 (7th Cir. July 2, 2007).

Chapter 58 - Medicare Tax on Investment Income

Medicare Tax on Investment Income

On March 25, 2010, Congress passed the Healthcare and Education Reconciliation Act of 2010 (H.R. 4872).

The Reconciliation Act amends various provisions of the Patient Protection and Affordable Care Act (P.L. 111-148) which was enacted March 23, 2010.

The Reconciliation Act adds provisions that were not included in the Patient Protection Act including a Medicare Tax Investment Income.

The Reconciliation Act added a new IRC Section 1411 that imposes a new 3.8% Medicare tax on investment income. The new tax on individuals is equal to 3.8% of the lesser of:

1. The individual's net investment income for the year, or

2. The amount the individual's modified adjusted gross income exceeds the threshold amount ($200,000 individual).

For estates and trusts, the tax equals 3.8% of the lesser of:

1. Undistributed net investment income, or

2. Adjusted gross income (over $11,200, the dollar amount of the highest trust and estate tax bracket).

For married couples, the threshold amount is $250,000 for a joint return and $125,000 for married, filing separately. For all other individuals the threshold amount is $200,000 (i.e., if the individual's modified adjusted gross income exceeds $200,000, a 3.8% tax is imposed on the lesser of the individual's net investment income (for the tax year) or the adjusted gross income amount, i.e., $200,000).

Net investment income (defined): income from interest, dividends, capital gains, annuities, royalties and passive rental income (other than such income derived in the ordinary course of a trade or business), but does not include: municipal bond interest, 401(k), IRA, and pension payments

The definition of net income includes:

1. Income from passive activities, or

2. From a trade or business of trading in financial instruments or commodities.

This tax provision takes effect for tax years beginning after December 31, 2012 (i.e., commences January 1, 2013, first tax year, 2013).

The net investment tax is determined using Form 8960. The tax is an addition to the regular income tax liability, it is taken into account for purposes of calculating estimated tax payments and underpayment penalties. (IRC Sec. 6654(a)(f).

Conclusion

The IRS estimates up to 10milion U.S. taxpayers have undisclosed offshore accounts. Effective July 1, 2014 the Foreign Account Tax Compliance Act ("FATCA") is requiring an estimated 100,000 banks in 80 countries to disclose the names and identities of their US taxpayer accounts. After hundreds of years of tax evasion, Swiss banks, whose trillions of dollars in assets from all over the world, are now being exposed for being the world center of tax and money laundering.

Currently, more than 12 of the largest Swiss banks with trillions of dollars in assets are at the center of U.S. Dept. of Justice criminal inquiry. 106 smaller Swiss Banks have agreed to non-prosecution agreements with the US government and will provide taxpayer information on these US taxpayers who hid assets in these Swiss Banks.

In the words of Irish poet, Seamus Heaney, from his translation, Sophocles "The Curse at Troy": "But the once in a lifetime the longed for tidal waive of justice can rise up and hope and history rhyme."

About the Author – Gary S. Wolfe, Esq.

Gary S. Wolfe received his Juris Doctorate from Loyola Law School in 1982, where he was President of the Tax Law Society.

From 1982 through the present, Gary has been in private practice in Beverly Hills and Los Angeles.

Gary is an international tax attorney representing clients for IRS audits, international tax planning, and asset protection.

Previously, Gary was the managing partner of a tax and business law firm, which represented Fortune 500 companies (IBM, ITT) and financial institutions (Sterling Bank, First Charter Bank.) Gary now provides case management for international litigation.

In 1997, Gary completed the Team Beverly Hills civic leadership training.

From 1997-1999 Gary was Vice-President and Member of the Board of Trustees of The Greystone Foundation, Beverly Hills, California.

From 1995-2001, Gary was the Chief Financial Officer and a Member of the Board of Directors of the Le Faubourg Honore Homeowners Association, Beverly Hills, California.

Since 2004, Gary has been conducting private seminars throughout California on the IRS, International Tax and Asset Protection.

Since 2004, Gary has been researching the IRS and International Tax (and other issues).

As of December 2014, Gary has written 13 articles and 11 books, and has been interviewed in 4 articles:

Articles by Gary S. Wolfe

EB-5 Investor Green Cards By Mark Ivener and Gary Wolfe

Offshore Investment (December 2014/January 2015 Edition)

EB-5 Investors & the Perils of U.S. Estate and Gift Taxes with Mark Ivener

EB-5 Investors Magazine (Winter/2014 Edition)

Self-Study Article: A Primer on Passive Foreign Investment Companies and Comparison to Controlled Foreign Corporations with Allen Walburn

California Tax Lawyer (Fall 2013)

EB-5 Investor Visa And U.S. Tax Issues with Mark Ivener

ABA/The Practical Tax Lawyer (Fall 2013)

U.S. Based Hedge Funds and Offshore Reinsurance with Allen Walburn

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International Tax Evasion and Money Laundering

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International Tax Planning for U.S. Exports (IC-DISC) with Ryan L Losi

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FBARs and Offshore Hedge Funds

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IRS Issues Guidance on Ponzi Schemes

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Articles (Interviewed)

1. Learning From Gandolfini's Estate Plan 'Disaster' by Anthony Greco

Private Wealth Magazine (July 2013)

2. IRS Closes In On Secret Caribbean Accounts by Eric Reiner

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4. The Best Tax Haven Getaways by Christina Valhouli

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Books by Gary S. Wolfe

Tax Planning for U.S. California Wine Exports (2015)

The IRS and Defrauded Investors: Theft Tax Loss (2015)

Offshore Tax Evasion: The IRS and Swiss Banks (2015)

Expatriation: The IRS & U.S. Taxes (2014)

EB-5 Visas: International Investors & U.S. Taxes (2014)with Ryan Losi, CPA and Mark Ivener, Esq.

U.S. Pre-Immigration Tax Planning (2014)

Tax Planning for U.S. and State Exports: IC-DISC (2013) with Ryan Losi, CPA and Allen Walburn, Esq.

Offshore Tax Evasion: IRS Offshore Voluntary Disclosure Program (2013)

Asset Protection 2013: The Gathering Storm (2013)

Offshore Tax Evasion: IRS Tax Compliance FATCA/FBAR (2013)

International Tax Evasion & Money Laundering (2013)

Offshore Tax Evasion: U.S. Tax & Foreign Entities (2013) with Allen B. Walburn, Esq.

For more information please see website, http://www.gswlaw.com.

About the Author – Steven Piascik

Steve Piascik is President and founder of PIASCIK, a boutique tax and financial planning CPA firm headquartered in Richmond, Virginia with offices in Beverly Hills, California. His background and experience in such key areas as international, state and local tax issues allow him to work effectively with a wide range of clients from start-ups to Fortune 500 andinternational companies.

As a specialist in complex accounting, tax consulting and tax compliance issues, he is responsible for his firm's client relationships, providing expert tax advice on high-level technical issues, IRS engagements and all areas of management of the firm.

Prior to founding his company, Steve was Senior Tax Manager in the Richmond office of KPMG LLP, one of the "Big Four" international accounting firms. He managed the firm's Central Virginia tax practice for high technology and emerging growth companies.

Over the course of his 24-year career, Steve has managed tax issues and consulted for several hundred clients including publicly traded and international companies, medical practices, high net worth individuals, real estate companies, retail, automotive, professional athletes, financial institutions and international companies.

His client list spans 56 countries and six continents. Some of Steve's memberships include: NFL Players Association Registered Representative, Richtech Board Member and Treasurer, Richmond 2015 Founding Board Member & Treasurer, St. Gertrude's Finance Committee Member, American Institute for Certified Public Accountants and Virginia Society of Certified

Public Accountants. He holds a BS in Business Administration/ Accounting from Bloomsburg University and a Masters in Taxation from Virginia Commonwealth University.

About the Author - Alan Jampol, Esq.

Alan Jampol is co-managing partner of Jampol Zimet LLP, an insurance defense firm he founded in 2001 along with partner Marc Zimet. He is a Super Lawyer© and is rated "AV Pre-eminent®" by Martindale-Hubbell. Alan is recognized as a top attorney in defense of professional liability claims against lawyers, insurance brokers and agents, real estate brokers, surveyors and appraisers and other professionals, as well as construction defect claims and other real estate matters, and defense of elder abuse claims against long term care facilities.

He also represents insurers (primarily Lloyd's syndicates) regarding coverage issues in these areas, and has acted as national supervising counsel for three nursing home insurance programs. Mr. Jampol also represents insurers in bad faith claims and serves as an arbitrator for the American Arbitration Association in commercial disputes.

Alan has forty years of experience in trying cases to juries, courts, and arbitrators with an enviable record of success. He lectures on arbitration, professional liability and nursing home elder abuse issues, including programs sponsored by the ABA and the DRI. He has several publications, including a chapter in the Agents of America book A Comprehensive Guide to Avoiding E&O Claims.

Alan is a graduate of University of California, Santa Barbara and the UCLA School of Law and is admitted to practice before all federal courts in California. He has in addition tried cases in several other states at the request of his insurer clients.

Alan is an active member of the American Bar Association (and its Section on Tort and Insurance Practice), the Los Angeles County Bar Association, the Association of Southern California Defense Counsel, the Defense Research Institute, the Professional Liability Underwriters Society, and the Claim and Litigation Management Alliance (CLM).