Offshore Tax Evasion: The IRS and Swiss Banks

by
Gary S. Wolfe

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Chapter 1 – Introduction

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 2 - 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 3 - 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 4 – 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 5 - 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, Fla, 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 6 – IRS: U.S. – Switzerland Joint Statement

On August 29, 2013 the United States and Switzerland issued a joint statement regarding tax evasion investigations.

United States and Switzerland Issue Joint Statement Regarding Tax Evasion Investigations

The Department of Justice today announced a program that will encourage Swiss banks to cooperate in the department's ongoing investigations of the use of foreign bank accounts to commit tax evasion. The department also released a joint statement with the Swiss Federal Department of Finance, stating that Switzerland will encourage its banks to participate in the program.

"This program will significantly enhance the Justice Department's ongoing efforts to aggressively pursue those who attempt to evade the law by hiding their assets outside of the United States," said Attorney General Eric Holder. "In addition to strengthening our partnership with the Swiss government, the program's requirement that Swiss banks provide detailed account information will improve our ability to bring tax dollars back to the U.S. treasury from across the globe."

"This program will provide us with additional information to prosecute those who used secret offshore bank accounts and those here and abroad who established and facilitated the use of such accounts," said Deputy Attorney General James M. Cole. "Now is the time for all U.S. taxpayers who hid behind Swiss bank secrecy laws or have undeclared offshore accounts in other foreign countries to come forward and resolve their outstanding tax issues with the United States."

Under the program, which is available only to banks that are not currently under criminal investigation by the department for their offshore activities, participating Swiss banks will be required to:

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

Banks meeting all of the above requirements will be eligible for non-prosecution agreements. Banks currently under criminal investigation related to their Swiss banking activities, and all individuals, are expressly excluded from the program.

The program holds banks to a higher degree of responsibility for opening secret accounts after it became publicly known that the department was actively investigating offshore tax evasion in Switzerland. Under the penalty provisions of the program, banks seeking a non-prosecution agreement must agree to a penalty in an amount equal to 20 percent of the maximum aggregate dollar value of all non-disclosed U.S. accounts that were held by the bank on Aug.1, 2008. The penalty amount will increase to 30 percent for secret accounts that were opened after that date but before the end of February 2009 and to 50 percent for secret accounts opened later than that.

The program will significantly assist the department's efforts to investigate and prosecute U.S. taxpayers who, when faced with the risk of detection, chose to move funds away from banks under investigation to banks that they believed might be better havens for tax secrecy. A key component of the program requires cooperating banks to provide information that will enable the United States to follow the money to other Swiss banks and to banks located in other countries.

The program also provides a path to resolution for Swiss banks that were not engaged in wrongful acts with U.S. taxpayers but nonetheless want a resolution of their status. Most banks in this category will be asked to provide an internal investigation report prepared by an independent examiner, as well as any additional information requested by the department. A smaller group of banks will be allowed to show that they met certain criteria for deemed-compliance under the Foreign Account Tax Compliance Act (FATCA). Banks in these two groups will be eligible to receive non-target letters.

The program is intended to enable every Swiss bank that is not already under criminal investigation to find a path to resolution. It also creates significant risks for individuals and banks that continue to fail to cooperate, including for those Swiss banks that facilitated U.S. tax evasion but fail to cooperate now, for all U.S. taxpayers who think that they can continue to hide income and assets in offshore banks, and for those advisors and others who facilitated these crimes.

Since 2009, the department has charged more than 30 banking professionals and 68 U.S. accountholders with violations arising from their offshore banking activities. Fifty-four U.S. taxpayers and four bankers and financial advisors have pled guilty, and five taxpayers have been convicted at trial. One Swiss bank entered into a deferred prosecution agreement, and a second Swiss bank was indicted and pleaded guilty. Currently, the department is actively investigating the Swiss-based activities of 14 financial institutions. The department's enforcement activities are global and have also included public actions concerning activities in India, Luxembourg, Israel and the Caribbean.

The program does not address current or future investigations and pending cases concerning bank employees, financial advisors and other individuals. The department will address each of these cases only with the individual's counsel, in a manner that gives consideration to the particular facts and circumstances of each case. In those cases in which indictments are pending, any resolution will also require addressing outstanding issues with the court. Counsel for banks currently under investigation, individuals who have been indicted, or bank employees who are concerned about whether they have potential criminal liability should contact the department's Tax Division or the prosecutors handling their case if they wish to seek resolution.

The department notes that the joint statement with the Swiss Federal Department of Finance provides that if personal data are provided, they should only be used for purposes of law enforcement, which may include regulatory action, in the United States or as otherwise permitted by U.S. law. Additionally, the department has assured its Swiss counterparts that it understands that simply because the names of individuals are included in the information that it receives from a bank does not necessarily mean that any particular individual is or is not culpable of wrongdoing. The support that Switzerland has shown for this program may also help those banks already under investigation take some of the steps necessary to reach a resolution.

"Banks that come forward under the program that we have announced today have the opportunity to reach a resolution with the United States," said Assistant Attorney General for the Tax Division Kathryn Keneally. "The program will give us yet more information to pursue U.S. taxpayers who are continuing to hide their assets in offshore accounts, and creates significant risks for those Swiss banks that fail to come forward. We recognize and express our appreciation for Switzerland's support of the program."

"The program the Department of Justice announced today is another positive step forward in the U.S. government's continuing efforts to combat offshore tax evasion," said Danny Werfel, Acting Commissioner of the Internal Revenue Service. "On behalf of the IRS, I extend my appreciation to both the Justice Department and the Swiss government for developing a way forward that provides the United States with information that will be critical to the enforcement of our tax laws and will bring closure for Swiss banks that meet the requirements of the program."

Chapter 7 - IRS: Swiss Banking Deal

In January 2014, Kathy Keneally, U.S. Assistant Attorney General, advised that 106 Swiss banks have agreed to non-prosecution agreements with the U.S. government and will provide data on those U.S. taxpayers who hid assets in these Swiss banks. These Swiss banks are sending letters to these U.S. customers advising them to enter the IRS Voluntary Disclosure program.

In my book, "Offshore Tax Evasion: IRS Offshore Voluntary Disclosure Program," I advised against entering the IRS/OVDP for the following reasons:

1. No transactional or use immunity (i.e. Ty Warner case).

2. Waiver of 5th Amendment Right of Self-Incrimination, 4th amendment Right Against Unreasonable Searches, 8th Amendment Right Against Excessive Fines.

3. Waiver of Statute of Limitations Defenses.

Chapter 8 – 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 9 – 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 10 - 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 11 - International Tax Evasion: Tax Evasion & Money Laundering

"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 12 - 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 13 - 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 14 - 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 15 - 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 16 – 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 17 – 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 18 – 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 19 – 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.

<u>Specified Foreign Financial Assets</u>

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.

<u>Interests in Specified Foreign Financial Assets</u>

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.

<u>Statute of Limitations</u>

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 20 – U.S. Taxpayer 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 21 – 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 22 – Statute of Limitations

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 23 – Annual Filing Requirements and Reasonable Cause Exception

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 24 – Civil and 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.

(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 25 – Criminal Penalties – Willful Failure to File (Defenses)

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 26 – Offshore Entities: Foreign Grantor Trusts

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 27 - Foreign Non-Grantor Trusts

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 28 - IRC Reporting Requirements for Foreign Financial Assets

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:

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 29 - Foreign Trusts Treated as Having U.S. Beneficiaries

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 30 - Foreign Grantor Trusts: U.S. Tax Compliance
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:

1. <u>Money Laundering</u>: (Disguise of the nature or the origin of funds (18 U.S.C. Sec. 1956 and 1957);

2. <u>FBAR Issues</u>: (See below);

3. <u>Unreported Income Issues</u>: (See below);

4. <u>FATCA Issues</u>: (See below);

5. <u>Perjury</u>: (See below).

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.

		Civil Penalties	**Criminal Penalties**	**Legal Authority**
(I)	**<u>Non-Willful Violation</u>**	Up to $10,000 for each violation.	N/A	31 U.S.C.§ 5321(a)(5)(A)

(II)	**Negligent Violation**	Up to the greater of $100,000, or 35 percent of the greatest amount in the account.	N/A	31 U.S.C. §5321(a)(5)(C)
(III) **(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

1. Tax Evasion (Willful Evasion of Tax)
   (IRC Sec. 7201) up to five years in prison
   Fine: $100,000 (individual)
   $500,000 (corporation)

2. Obstruct (Impede Tax Collection)
   (IRC Sec. 7212) up to three years in prison
   Fine: $5,000

3. Conspiracy to Impede Tax Collection
   (18 USC 371) separate charge of impeding
   Up to five years in prison

4. Failure to File Tax Return
   (IRC Sec. 7203) up to one year in prison
   Fine: $25,000 (individual)

$100,000 (corporation)

5. File False Tax Return
   (IRC Sec. 7206(1)), up to three years in prison
   Fine: $250,000

6. "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.

1. 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;

2. 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 31 - 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 32 - 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 indi- cation 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 33 - 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 34 - 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 35 – 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 36 – 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 37 - 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:

1. Experience;

2. Knowledge;

3. Sophistication;

4. Education;

5. Taxpayer reliance on a tax professional; and

6. 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 (5^{th} 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, 7^{th} 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;

1. Makes full disclosure;

2. To an independent tax professional;

3. Who is experienced in the area of law;

4. Receives, reviews and understands the advisor's tax opinion;

5. No "blind reliance" on the tax opinion; i.e. two tests: "You should know better", or "It's too good to be true".

6. The taxpayer must rely upon the opinion; and

7. 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 38 – 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 39 – 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 40 – 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 41 – 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 42 – 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 43 – 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 44 – 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 45 – 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).

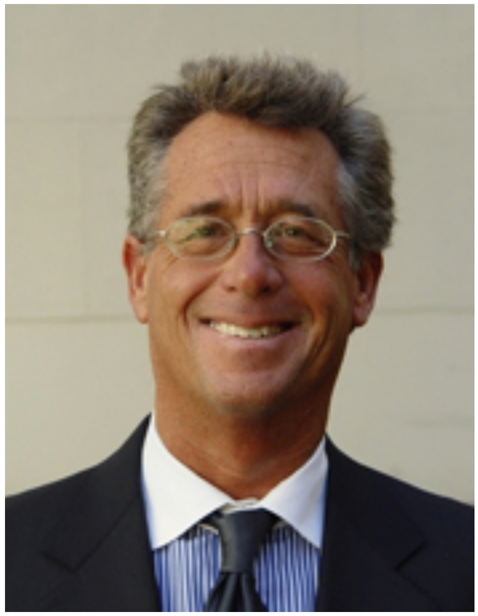
Chapter 46 – Conclusion

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 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 10 books:

Articles by or about 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
ABA/The Practical Tax Lawyer

International Tax Evasion and Money Laundering
ABA/The Practical Tax Lawyer (Summer 2013)

International Tax Planning for U.S. Exports (IC-DISC) with Ryan L Losi
ABA/The Practical Tax Lawyer (Summer 2013)

Learning From Gandolfini's Estate Plan 'Disaster' by Anthony Greco
Private Wealth Magazine (July 2013)

IRS Closes In On Secret Caribbean Accounts by Eric Reiner
Financial Advisor Magazine (June 2013)

Why Tax Evasion is a Bad Idea: UBS & Wegelin Bank
ABA/The Practical Tax Lawyer (Spring 2013)

U.S. Tax Planning for Passive Investments with David E. Richardson
ABA/The Practical Tax Lawyer (Winter 2013)

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IRS Issues Guidance on Ponzi Schemes
California Tax Lawyer (Summer 2009)

Karate Enables Lawyers to Focus on 'the Task at Hand' by Eron Ben-Yehuda
Daily Journal (May 2005)

The Best Tax Haven Getaways by Christina Valhouli
Forbes.com (April 2004)

Books by Gary S. Wolfe:

Expatriation: The IRS & U.S. Taxes

EB-5 Visas: International Investors & U.S. Taxes with Ryan Losi, CPA and Mark Ivener, Esq.

U.S. Pre-Immigration Tax Planning

Tax Planning for U.S. and State Exports: IC-DISC with Ryan Losi, CPA and Allen Walburn, Esq.

Offshore Tax Evasion: IRS Offshore Voluntary Disclosure Program

Asset Protection 2013: The Gathering Storm

Offshore Tax Evasion: IRS Tax Compliance FATCA/FBAR

International Tax Evasion & Money Laundering

Offshore Tax Evasion: U.S. Tax & Foreign Entities with Allen B. Walburn, Esq.

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