

Swiss Bank Accounts Disclosures Place Taxpayers Between the Dog and the Fire Hydrant

A client confides in you about a Swiss investment account (or any offshore account or trust for that matter) created several years ago. Somehow it was neither disclosed on tax returns nor was any income reported. He recently read front page articles in the *New York Times*, *Wall Street Journal*, and other publications about the IRS obtaining Swiss bank and other offshore bank and financial records that most had thought were secret. He asks a simple question—what does this mean for me? The client will not like either the criminal or civil sections of the multi-part answer.

First, he is right. The Swiss have now turned over many names to the IRS. On February 18, 2009, one large Swiss institution entered into a deferred prosecution agreement with the U.S. Department of Justice, disclosed investor names and paid \$780,000,000 in fines, penalties restitution, and interest to the IRS.¹ The U.S. is seeking over 52,000 additional names regarding over \$20 billion of invested assets from one institution alone.² Criminal indictments are expected shortly from those in the first installment of revealed investors. Tax evasion is not a criminal offense in Switzerland. Other financial institutions in Switzerland, Liechtenstein, and numerous offshore banks in the Caribbean basin are also providing names and other information to the U.S. Treasury.

Second, for decades Schedule B of Form 1040 has contained two questions about foreign bank accounts and trusts. They are answered either “Yes” or “No.” There is no “Maybe, but...” entry. If there is a bank account and the answer is “yes,” then an additional filing is required—Foreign Bank Account Records, or “FBAR,” which are separate from income tax returns and due on June 30 every year. A foreign trust triggers a Form 3520 filing requirement.

On March 26, 2009, IRS Commissioner Shulman announced the comprehensive program discussed below under which qualifying taxpayers would not go to jail and have to make considerable transparent disclosures to the IRS, amend the last six years’ returns, and pay tax plus interest as well as certain penalties.

What are the Issues?

Criminal

Even white collar criminals like to sleep at night. Can they go to jail? Absolutely, it is a realistic possibility. On the criminal side, failure to properly report the existence of such foreign accounts and trusts can violate numerous felony provisions of the Internal Revenue Code. These start with a false statement under IRC 7206(1) merely for checking “no” to the above questions if the correct answer is “yes.” If there is unreported income from the accounts, then for each year that is a separate act of evasion, a five-year tax evasion felony under IRC 7201. If the income that funded the foreign account or trust was not reported years ago, that raises other issues. Despite it being a first offense, those situations typically involve very large dollar amounts and thus potentially harsh incarceration under the sentencing guidelines. The voluntary disclosure solution discussed below can preclude criminal prosecution, if the taxpayer both qualifies and takes prompt action.

Civil Tax & Penalties

Are there civil taxes and penalties too? The penalties, unless the taxpayer makes a “voluntary disclosure,” can readily exceed 100 percent of the balance in the accounts, and then there are the taxes and a fraud penalty on the income that went into the account as well as on unreported income the account generated. The penalty for failure to file a Form 3520

regarding a foreign trust is 35 percent per year. The penalty for willful failure to file the FBAR is 50 percent per annum. Also, if there is fraud or failure to file, then for civil tax purposes there is no—repeat, no—statute of limitations. The IRS can go back as many years as they find records and assert draconian penalties, plus compounded daily interest, on all of those years.

IRS Window of Opportunity for Most

For taxpayers not under criminal investigation, there is a window of opportunity to enter into a settlement program with the IRS. Those entering the program must a) file amended returns, including the newly disclosed assets for the last six years, b) pay tax and interest on the income, c) incur either a 20 percent accuracy related penalty under IRC 6662 or a 25 percent delinquency penalty under IRC 6651, d) pay a 20 percent penalty on the total balance on all such accounts using the highest account balance for the last six years, and e) provide full criminal and civil cooperation (including “dropping a dime” on others).

Taxpayers may say this is a steep price. What does the taxpayer receive? One, the IRS will not pursue criminal tax evasion charges against taxpayers who fulfill the terms of the settlement offer. If they have illegal source income, such as gambling or drugs, they may be open to other charges if they elect to pursue the settlement. Two, the IRS will not pursue other penalties against participating taxpayers. These include the FBAR penalties, which are annually up to 50 percent of the account balance and the 75 percent civil fraud penalty on unpaid tax. With no past filings or fraudulent filings, there is no statute of limitations. The FBAR penalties alone for undisclosed accounts going back a number of years can readily

aggregate several hundred percent of the account balances.

Why would the IRS do this? First, it will receive billions. Second, the accounts will be repatriated into the U.S. and the U.S. tax reporting system. Third, it makes its point. Fourth, there will be people who do not elect to surface, and the government can criminally prosecute many of them to fulfill the compliance by the highly publicized (bad) example function.

Every qualifying taxpayer must make a fully informed decision whether or not to pursue the settlement program after reviewing with informed counsel all relevant facts and circumstances. For those with legal source income, albeit skimmed or otherwise unreported, the decision will likely be to join the program. If they join the program, they must fulfill all of its myriad requirements. On March 26, the IRS also released memoranda that detail the long and complicated compliance journey for participating taxpayers. Those with illegal source income such as gambling or drugs, or those who have a second passport and no strong ties to the U.S., may decide not to participate.

For Those Who Bury Their Heads in the Sand...

The IRS announced that after this program expires this coming September, it will vigorously pursue those who do not elect to enter it. Remember that the IRS will receive the names of account holders from foreign banks. Given what happened on the IRS' 2004 settlement offers on common tax shelters, experienced tax practitioners expect the government to keep its word and most vigorously pursue those it discovers had such undisclosed accounts and who did not come in under the offshore account settlement. In addition to paying billions to the IRS, many of those who bury their heads in the sand will go to jail, and for considerable time under the federal sentencing guidelines.

NOTES

1. See "Swiss Bank To Give Up Depositors' Names to Prosecutors," *Wall Street Journal*, Feb. 19, 2009, and "A Swiss Bank is Set to Open Its Secret Files," *New York Times*, Feb. 19, 2009. Both articles were front page above the fold.

2. See "U.S. Wants More Client Names," *Wall Street Journal*, Feb. 20, 2009, page 1.



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