# PRACTITIONERS' CORNER

## Bringing a Foreign Bank Account Into Tax Compliance

by Asher Rubinstein

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Twice in the last three years, the IRS has offered taxpayers with undisclosed foreign assets an opportunity to voluntarily disclose those unreported assets, pay back taxes and penalties, and avoid more severe penalties and criminal prosecution. These voluntary disclosure opportunities were well timed with the success achieved by the U.S. Department of Justice and the IRS in obtaining once-secret Swiss banking details from UBS and criminal prosecutions of U.S. taxpayers who did not report and pay tax on foreign income.

The two disclosure programs together resulted in about 30,000 taxpayers coming forward and reporting offshore assets at numerous financial institutions in foreign countries around the world. The programs also yielded an extensive database of information for U.S. law enforcement agencies about offshore banking — the financial institutions and the people, such as bankers, trustees, and lawyers, who facilitated noncompliant offshore banking. Armed with this information, the U.S. has looked beyond UBS and Swiss banks and is now investigating other banks, including ones in Israel, India, and Liechtenstein, for their roles in facilitating U.S. tax fraud by providing noncompliant bank services.

At the same time, other countries, most notably Germany and the United Kingdom, joined in the pressure against foreign bank secrecy. Switzerland and other "tax havens" have been made to sign tax information exchange agreements and have agreed to new standards of financial transparency. The cumulative result of this multipronged offensive has been the elimination of foreign bank secrecy vis-à-vis governmental tax authorities.

Still, there are U.S. taxpayers who have chosen not to participate in the IRS voluntary disclosure programs and have not brought their foreign assets into tax compliance, notwithstanding the growing risk of discovery. Those taxpayers must confront the challenges of continuing to maintain a noncompliant foreign account, the probability of discovery, and the massive and crippling fines and potential criminal tax fraud consequences that would ensue. While the two voluntary disclosure programs have ended, there still exists a means of bringing a foreign account into tax compliance while avoiding criminal prosecution.

### U.S. Offensive Against Bank Secrecy

In 2009 U.S. prosecutors achieved a staggering victory against UBS, forcing the largest Swiss bank to settle criminal and civil charges that it aided and abetted tax fraud by assisting Americans to hide funds from U.S. taxation. UBS also was compelled to disclose to the IRS the identities of thousands of Americans with formerly "secret" Swiss accounts. This was a stunning breach of hitherto ironclad Swiss bank secrecy. To date, dozens of Americans with accounts at UBS and other foreign banks have been prosecuted, and 150 grand jury investigations have been opened against taxpayers with foreign accounts. Most of the criminal charges have resulted in guilty pleas, with punishment ranging from probation to jail terms, and significant monetary penalties totaling half the balance in the foreign account.

Since its victory against UBS, the U.S. has been relentless in its offensive against foreign bank secrecy, pursuing other banks in Switzerland and banks in other countries.

In June 2011 Credit Suisse revealed that it is the target of a criminal tax investigation by the DOJ. In February and again in June 2011, Credit Suisse bankers were criminally indicted in the U.S. on charges of assisting Americans to hide income from the IRS. The DOJ released a statement saying that "the conspiracy dates back to 1953 and involved two generations of U.S. tax evaders including U.S. customers who inherited secret accounts."[1] The allegations also included a charge that a Credit Suisse banker suggested that noncompliant funds be transferred from Switzerland to a bank in Israel to avoid detection by the IRS. Tracing noncompliant funds from Swiss banks to Israeli banks is indicative of the expanding global scrutiny and effectiveness of the investigations. In September 2011 Credit Suisse paid €150 million ($206 million) to end an investigation by the German government regarding Credit Suisse bankers assisting Germans in avoiding taxation. In April 2011 Bank Julius Baer likewise settled a German tax fraud investigation with a payment of €50 million.

HSBC is also facing similar allegations and in 2011 became the subject of a John Doe summons in U.S. federal court to reveal the identities of U.S. account holders with undeclared accounts in India. A John Doe summons is an important, effective weapon for prosecutors to uncover once-secret banking information from foreign financial institutions. A John Doe summons seeks information relevant to a large class of unidentified account holders, rather than a narrow request for accounts of specific, known people suspected of tax fraud. UBS settled civil and criminal tax fraud charges by the DOJ, and Swiss bank secrecy ultimately ended, as a result of the John Doe summons served against UBS in 2008. It was once thought that without actual names of account holders and account numbers, prosecutors could not obtain information from foreign banks. The success of the John Doe summons against UBS proved otherwise. Now a broad class of account holders, not identified specifically other than "Americans with accounts at HSBC," is vulnerable to discovery and prosecution by the government.

Given the sizable presence of HSBC and Credit Suisse in the U.S. — branches in the U.S., employees in the U.S., assets in the U.S., and a lucrative banking license in the U.S. — these banks are clearly within the jurisdiction of U.S. courts. HSBC and Credit Suisse, like UBS before them, will likely cooperate and, sooner or later, provide the requested banking data to U.S. authorities.

In addition to targeting large banks like UBS, Credit Suisse, and HSBC, the IRS and the DOJ are also moving against smaller banks. In September 2011 the DOJ revealed that Swiss banks Julius Baer, Wegelin & Co. Privatbankiers, Basler Kantonalbank, and Zuercher Kantonalbank are also the targets of criminal investigations for facilitating tax fraud. Over the border, Liechtensteinische Landesbank is a similar target. The DOJ's criminal tax division is also investigating three Israeli banks: Bank Hapoalim, Bank Leumi, and Mizrahi-Tefahot. As noted above, these banks are under particular scrutiny for offering bank services to American clients fleeing from UBS accounts and attempting to keep one step ahead of American authorities as UBS prepared to reveal client identities and banking data. It has been reported that these additional foreign banks will soon be the targets of U.S. grand jury criminal subpoenas and John Doe civil summonses, and that the threshold for revealing the banking data will be accounts valued as low as $50,000. This is a much lower threshold than the 2009 agreement with UBS, which covered accounts with a value of more than €1 million.

## Legitimate Reasons for Offshore Accounts

It is not illegal to have a foreign bank account. Americans can legally invest in foreign markets, own foreign real estate, own foreign businesses, settle and fund offshore trusts and foundations, and deposit their assets into foreign bank and brokerage accounts, provided that they disclose their foreign accounts to the U.S. government and pay U.S. tax on foreign income.

In fact, there are many legitimate and compelling reasons to have a foreign financial account. Investment diversification into foreign currencies, foreign equities, funds, and financial products is not only common, it may be financially wise. Many people concerned about the viability or safety of the U.S. financial system and the U.S. dollar have diversified their wealth outside the U.S. Business expansion into new markets or new sources of production is routine. Maintaining foreign accounts and entities such as foreign corporations, foundations, or trusts may be useful for international business and prudent investment planning. Sophisticated people understand the need for foreign options and foreign diversification. Among those options is the use of foreign laws to protect hard-earned assets. Many people understand that their retirement plans in the U.S. may provide for their later years, but that a protected nest egg in a stable foreign country provides a greater level of assurance for wealth preservation. Also, the litigious nature of the U.S. has compelled many people to protect and preserve their assets in foreign jurisdictions where the likelihood of creditor success is significantly low. Even with the eradication of bank secrecy by the IRS, confidentiality from one's private creditors and other financial challengers remains. These are all legitimate reasons to bank offshore, but, as noted, the foreign accounts must be disclosed to the IRS and taxes paid on any gains.

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[1]U.S. Department of Justice, Press Release, "Swiss International Bank's Former Head of North America Offshore Banking, Others Charged With Conspiracy," July 21, 2011, *available at* http://www.justice.gov/opa/pr/2011/July/11-tax-957.html.

## Difficulties in Continuing to Bank Offshore

Even with the legitimacy of tax-compliant offshore banking, in response to the U.S. offensive, many foreign banks are simply telling Americans to bank elsewhere. American taxpayers wishing to maintain foreign accounts now must find financial institutions willing to accept their accounts. There are foreign banks that still welcome American clients, but only if the clients sign waivers and provide evidence of IRS compliance, including Forms W-9. Of course, Americans must locate credible, reliable banks in safe, stable foreign jurisdictions. The ongoing concerns are stability and compliance, not tax secrecy.

Another challenge will soon arise for offshore banking, in light of the Foreign Account Tax Compliance Act, which was signed into law in 2010 as part of the HIRE Act (P.L. 111-147). FATCA imposes additional reporting requirements on U.S. taxpayers with foreign holdings and also obligates foreign banks to report account information to the IRS. FATCA's reporting requirements were scheduled to begin in 2013, although some of the disclosure requirements will be phased in over 2014 and 2015. Americans with foreign assets will also be obligated to annually file a new Form 8938, "Statement of Specified Foreign Financial Assets." This new form is in addition to the FBAR form, "Report of Foreign Bank and Financial Accounts" (TD 90-22.1), currently due each year on foreign bank accounts valued in excess of $10,000.

These new requirements impose additional burdens on disclosing foreign accounts and assets. Nevertheless, if the foreign assets are properly reported and are tax-compliant, then there should be no fear of IRS scrutiny, and the benefits of the foreign account — international diversification, investment planning, and asset protection — are not only obtainable, but the tax compliance imparts an additional layer of confidence and security.

## What to Do

What if you still have a foreign account that is not tax compliant?

### Option A: Do Nothing

You could do nothing and hope that the IRS does not discover the account. Perhaps your account is at a bank that you believe to be "off the radar" or is in a quieter jurisdiction. Given the changing context of foreign banking and the recent erosion of offshore secrecy, sooner or later the IRS may find you and then it will be too late to come forward voluntarily and avoid criminal charges. Discovery is a distinct possibility given all of the tools at the disposal of the IRS and U.S. law enforcement agencies: TIEAs, mutual legal assistance treaties, qualified intermediary agreements with foreign banks, John Doe summonses, and the trove of information the IRS already has in its possession via the two voluntary disclosure programs, which yielded details about banks in 140 countries. Even if your foreign funds are at a bank that has, so far, managed to avoid detection and investigation, the ongoing question will be: How long can this bank avoid the same scrutiny now focused on virtually every other bank in every stable country? Moreover, even if you were to leave your funds where they are, those funds would essentially be paralyzed. The minute you attempt to access those funds, you could be sending red flags that could tip off law enforcement. For these reasons, the "take your chances" strategy is not recommended.

### Option B: Amend Past Tax Returns

Some U.S. taxpayers with undeclared foreign accounts are hoping to sneak through by amending their past tax returns quietly and paying back taxes on income earned in a foreign account. This is known as a "quiet disclosure."

The IRS has announced that it is aware of taxpayers attempting quiet disclosures and that this strategy will not work. The IRS is targeting amended tax returns reporting increases in income to determine if enforcement action is appropriate. Those amended returns are red flags. Even though tax returns are amended and back taxes paid, account holders still face penalties and criminal charges. In addition to charging and prosecuting people with undeclared foreign income, DOJ has also begun the prosecution of taxpayers whose quiet disclosures were discovered by the IRS.

There are other problems with quiet disclosures. They only address payment of back taxes and interest, not penalties. Also, they do not address the issue of the taxpayer's failure to report the foreign account, that is, filing the FBAR and IRS Form 1040 "check the box." If the foreign account was in the name of a foreign trust, then a Form 3520, "Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts," was probably due. If the foreign account was in the name of a foreign corporation, then a Form 5471, "Information Return of U.S. Persons With Respect To Certain Foreign Corporations," was probably due. Quiet disclosure does not correct these past non-reporting issues and will not avoid the massive penalties for failing to disclose timely.

### Option C: Preemptive Disclosure and Negotiation

If you currently have an interest in a noncompliant offshore account, you should consider voluntary disclosure of that interest before the IRS discovers it. Even though the 2009 and 2011 voluntary disclosure programs have both ended, the IRS still maintains a voluntary disclosure policy. That policy allows for taxpayers to come forward and disclose their noncompliant foreign assets. This must be done before the IRS already knows about the taxpayer's foreign assets. Also, the taxpayer cannot already be under audit or investigation, and the foreign assets cannot be connected to criminal activity. If these prerequisites are met, a voluntary disclosure offers reduced penalties and

a promise of no criminal prosecution. Although fines and penalties may be significant, they pale before the consequences of an IRS criminal prosecution. A preemptive disclosure is best made by qualified legal counsel experienced in offshore compliance and IRS negotiations.

In brief, if you are an American taxpayer with an offshore account that you thought was secret, you must bring it into compliance before the IRS discovers the account. Although the two voluntary disclosure programs have ended, an open IRS voluntary disclosure policy still exists. Given the elimination of offshore bank secrecy discussed above, you should expect that the IRS will soon learn about your offshore account. Once the IRS gets your name, it will be too late to take advantage of the voluntary disclosure policy. ◆