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White Collar Crime

Is It Too Late for Voluntary Disclosure?

New regulations tighten the net on U.S. persons with foreign financial accounts

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The recent press coverage of the IRS' enforcement efforts to obtain information from Swiss banking giant UBS about accounts it maintained for U.S. taxpayers and the criminal prosecutions that the Tax Division of the Justice Department has initiated since April 2009 against U.S. foreign account holders have shined the spotlight on the existence of what was previously a little-known and seemingly innocuous U.S. Treasury Department Form — the "Report of Foreign Bank and Financial Accounts" form or "FBAR."

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Formally known as Form TDF 90-22.1, the FBAR has, in fact, been around for many years and had its origin, along with the better-known domestic "Currency Transaction Report" or "CTR" banks are required to file if a person deposits or withdraws cash in over $10,000 amounts, in the Currency and Foreign Transactions Reporting Act (otherwise known as the Bank Secrecy Act or BSA) enacted in 1970. Congress' stated purpose in enacting the BSA was to combat the use of tax havens by U.S. taxpayers to hide income, evade taxes and facilitate other illegal activities.

Until recently, when the Justice Department initiated prosecutions of U.S. taxpayers in New York, New Jersey, South Florida and several other places, most lawyers (whether tax planners or criminal defense lawyers) were unaware that the failure to file the FBAR form (or filing an incomplete one) was a separate federal crime subjecting the violator to up to five years in prison and a fine of up to $250,000 (or both).

Where the failure to file the FBAR was in conjunction with the violation of other laws (commercial bribery, public corruption, etc.), the violator is exposed to up to 10 years in prison and a fine of up to $500,000 (or both).

As illustrated by Senator Levin's well-publicized 2008 hearings on the extent of noncompliance by U.S. taxpayers with foreign account reporting and the recent enactment of the "Foreign Account Tax Compliance Act" ("FATCA") provisions imposing a 30 percent withholding tax on U.S. source payments to foreign banks that do not disclose their U.S. based account holders as part of the HIRE Act (P.L. 111-147), there is little or no governmental or public sympathy for U.S. taxpayers who have undisclosed foreign accounts and who have not yet taken advantage of the Commissioner's Voluntary Disclosure Program Initiative.

In the wake of last month's Swiss Parliament vote to disclose the records of 4,450 UBS accounts directly or indirectly controlled by U.S. citizens to the IRS, reports indicate that the IRS is now turning its focus to other banks with large "private client banking" businesses in both Switzerland and in the Far East. Within the last two weeks, German tax authorities raided the offices of Credit Suisse (rumored to also be under investigation by the U.S. Department of Justice). In addition, a number of U.S. clients of HSBC in India have received 'target' letters from the Department of Justice.

Federal prosecutors have found that prosecuting FBAR violations is more efficient and quicker than prosecuting an underlying tax evasion case, as it only requires proof of the existence of a foreign

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financial account with over $10,000 in it at some point during the year in question, nonfiling (or false filing) of the FBAR form and willful intent (generally proved circumstantially by showing a pattern of such non-filing or false filings).

Against this backdrop, the IRS recently announced new proposed regulations which clarify (and tighten) the definitions in the existing FBAR rules to make it even more difficult for those U.S. taxpayers who still have not come forward to use artificial structures created for them by advisors both here and abroad to avoid disclosure of their offshore holdings.

The new expanded FBAR rules, along with the existing requirements imposed on U.S. owners of foreign corporations and trusts and the new FATCA rules, represent a substantial tightening of the net by which IRS hopes to ensnare and bring to justice those U.S. taxpayers who still are trying to remain in the shadows with respect to their foreign accounts.

Summary of the New FBAR Requirements: Any "U.S. person" (defined as a citizen or permanent resident of the U.S. and any corporation, partnership, trust or LLC formed under the laws of the U.S., any state, the District of Columbia or any U.S. territory or possession, whether or not the entity is 'disregarded' under 26 CFR 301.7701-2 or 3), is required to file an annual FBAR on or before June 30th of the following year, disclosing: (1) a financial interest in or (2) "signature or other authority" over a foreign financial account.

Definition of a Foreign Financial Account

(a) A foreign "bank account" (defined as a savings, demand deposit, checking or other account maintained with a person engaged in the business of banking);

(b) a foreign "securities account" (defined as an account maintained with a person in the business of buying, selling, holding or trading stock or other securities); or

(c) an "other financial account" defined to mean an account with a person that is in the business of accepting deposits as a financial agency, an insurance policy with cash value or an annuity, an account with a broker for futures or options transactions in any commodity, and an account with a mutual fund or similar pooled fund (but excluding, for now, a hedge fund).

As can be easily seen, the new definition covers many more financial relationships than simply maintaining a bank account in a foreign country.

Definition of A Financial Interest

The regulations also broadly address what is considered a "financial interest" in an account to prevent people from easily avoiding direct ownership while still maintaining control. A "financial interest" exists if:

(a) The U.S. person owns legal title regardless of whether the account is maintained for his benefit or for the benefit of others;

(b) a U.S. person also has a "financial interest" in any account as to which a foreign person has legal title but is acting on behalf of the U.S. person (e.g., an attorney or trustee);

(c) a U.S. person has a "financial interest" in a foreign account owned of or record by: a corporation the U.S. person owns more than 50 percent of (by vote or value, directly or indirectly); a trust the U.S. person was the settlor of and deemed a 'grantor trust' for U.S. tax purposes; a trust in which the U.S. person has a beneficial interest of more than 50 percent of the assets or receives more than 50 percent of annual income; a trust established by a U.S. person for which a 'trust protector' is appointed who is subject to the U.S. person's direct or indirect direction; and any other indirect 'financial interest' structure created for the purpose of evading the FBAR filing requirements.

Definition of Signature Authority

The new regulations also require an FBAR filing by a U.S. person who holds only "signature authority" over a foreign account. "Signature authority" is broadly defined to mean the authority (whether exercised alone or with another) "to control the disposition of money, funds or other assets held in a financial account by the delivery of instructions (written or otherwise) directly to the person with whom the account is maintained.

The new regulations continue the exceptions to the filing requirement for signatory power over foreign accounts held by employees of banks or brokers regulated by federal banking and securities regulators and for similar accounts owned by publically traded companies registered with the S.E.C.

IRS Announcement 2010-23 temporarily extends the June 30 filing deadline for 2009 and prior years' FBAR filings by persons with signature authority but no financial interest in a foreign financial account until June 30, 2011, but makes clear that any new FBAR filing (even for a pre-2009 year) must use the new definitions and rules.

Is It Too Late for Voluntary Disclosure?

U.S. persons with foreign financial accounts who have not yet disclosed those accounts and are facing the dilemma of how to deal with the issue should remember that although the special IRS' Voluntary Disclosure Initiative for offshore accountholders ended last October, the IRS' regular Voluntary Disclosure Program may still be available to them. How long that option will remain available is unknown. Once the IRS moves against other foreign banks and receives information, the opportunity to avoid prosecution may be lost. This is because for a taxpayer to be eligible for the regular Voluntary Disclosure Program, typically the IRS must not have already received information about the taxpayer's noncompliance from a third party or must not have initiated a criminal or civil inquiry against a third party which is directly related to the specific liability of the particular taxpayer.

It remains to be seen whether and to what extent the IRS will now interpret these restrictions to preclude a voluntary disclosure by a U.S. taxpayer with an account at (for example) XYZ Bank in Hong Kong if the IRS has either entered into an agreement with XYZ Bank to remedy its own prior noncompliance with U.S. law by disclosing the names of its depositors or, as in the UBS case, the IRS issues a John Doe Summons to XYZ Bank. ■