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Caveat Interests In Foreign Accounts

The Editor interviews ***Lawrence S. Horn****, Chair of the Sills Cummis & Gross Business Crimes and Taxation Litigation Practice Groups.*

Editor: Please describe your practice at Sills Cummis & Gross. What is your background with the Justice Department?

Horn: I was an Assistant United States Attorney in the District of New Jersey Attorney's office for seven years in the mid-1970s. An Assistant U.S. Attorney is a federal prosecutor. During my last three years in that position, the U.S. Attorney, at the request of the Internal Revenue Service, centralized all the criminal tax cases in the office. I was chosen to be that one point person. The idea was that, when the IRS and their special agents or their group managers had questions, there was one person they could call to get prompt responses on their cases. In those next three years I either personally prosecuted or was personally involved in the decision to prosecute or not prosecute every criminal tax case in New Jersey and, as a result, became quite proficient in handling criminal tax cases. When I left the U.S. Attorney's Office in 1979, I had a specialty that was immediately useful in private practice. I joined a small firm specializing in the defense of criminal tax matters. In the middle of 1981, that firm merged with a larger firm - now Sills Cummis & Gross P.C.

While I was in the U.S. Attorney's Office, I did not have a master's degree in taxation, but I became friendly with a lawyer by the name of Richard Sapinski in the Office of District Counsel of the IRS who did. He worked with me on a number of the criminal tax cases I handled at the U.S. Attorney's Office. In 1987, I recruited him to join me at Sills Cummis & Gross, and together we now head the firm's "Tax Controversy" practice. We have two other IRS specialists in the group. One is another alumnus of the IRS Counsel's office, Robert Stern, who joined us two years ago. The other is Steve Max, who is a retired special agent of the IRS. We have a unique tax practice. It is a "tax controversy" practice, which focuses on the consequences that occur after a return is filed, or after a return is not filed. Although my firm has a traditional tax department, we differ in that we do not do tax planning or assist in developing tax return positions for clients. Instead, we handle civil and criminal tax cases with the Internal Revenue Service and the Department of Justice after either begins an audit or investigation of the taxpayer either as a result of what the IRS may believe to be a false filing or, in some cases, a failure to file entirely.

Lawrence S. Horn

Editor: Please describe the filing requirements for those holding assets overseas. What is the primary purpose of FBAR? What are the thresholds for filing? What penalties are involved?

Horn: Every U.S. citizen or permanent resident is required to report income from all sources, whether foreign or domestic, on her U.S. income tax return every year. If a U.S. citizen or permanent resident has bank accounts overseas, and those bank accounts generate income, whether it is interest, dividends or capital gains, she is required to report the income on Schedule B or, in the case of capital gains, Schedule D of her return. In addition to that requirement, there is a form that has to be filed with the Treasury Department (not with the IRS), on or before June 30 of every year, which is a Foreign Bank Account Report (FBAR). People who have more than $10,000 in the aggregate in one or more accounts overseas must file this form each June 30. It applies even if the accounts do not generate income. It applies whether an individual is the owner of the account or just has signatory authority over the account or power of attorney over the account. If the total value of all foreign accounts amounts is over $10,000 at any point during the year, the owner(s) and all signatories must file this FBAR form.

There are both civil and criminal penalties for non-filing. The civil penalty for failure to file the FBAR or failing to disclose an account on an FBAR that is filed could be as high as 50 percent of the account value if the violation is "willful" (meaning it was done intentionally). The maximum penalty is an annual penalty, so it can be imposed for each year, which is quite draconian. There was a case filed in Florida a few months ago where the government sought the 50 percent penalty for six years – 300 percent! You can also be prosecuted for failing to file FBARs. It is also a felony not to file an FBAR (or to file a false one) while it is only a misdemeanor for failure to file an income tax return. In addition, if you do not report all of your income on the federal income tax return, you can also be prosecuted for false filing or tax evasion. If someone is prosecuted, whether or not he goes to jail, the IRS will come back and assess a 75 percent civil fraud penalty on the understatement of tax.

Editor: Who is treated as having an "interest" in a foreign asset account?

Horn: Even if you do not technically own the account, if you are the beneficial

Please email the interviewee at lhorn@sillscummis.com with questions about this interview.

owner and use a foreign person as a "straw man" to be the nominal owner or if you have a power of attorney or signatory authority over the account, you will be considered to have an interest. In addition, merely having signatory power but no real ownership (such as a trustee or a "straw man" for someone else) also triggers the FBAR filing requirement. Either ownership (actual or nominal) or signatory authority is sufficient; both are not required.

Editor: Do the foreign banks report all foreign transactions with U.S. persons?

Horn: In the past, they did not, but all that has changed. Congress has now enacted a law called FATCA - Foreign Account Tax Compliance Act. Now, if foreign banks want to utilize the benefits of the U.S. clearing system, they will have to be compliant with FATCA, which requires them to enter into agreements with the IRS to identify and disclose to the IRS their U.S. account holders. If they do not, they face mandatory 30 percent withholding on any U.S. transaction (whether or not any U.S. person is involved in the transaction). The major accounting firms are providing compliance programs for the foreign banks so that they can comply with these rules. The question now is not, do banks report the income from the foreign transactions to the IRS. What you see as a result of FATCA is more banks sending more information to the IRS whether or not the bank has any offices in the United States. This is a major victory in the IRS's efforts to combat what it sees as massive "offshore" tax evasion by U.S. persons.

Editor: Has the IRS's effort to force Swiss and other banks abroad to eliminate the shroud of secrecy paid dividends effectively in curtailing this practice? What about banks in the Far East?

Horn: The U.S. Treasury, as a result of the IRS's Offshore Voluntary Disclosure Program since 2009, has collected over $5 billion in tax, penalties and interest. I can't say that the IRS's efforts have eliminated this problem, but I will say that the IRS has made great advances in getting virtually every major bank in the world to cooperate with it in identifying U.S. account holders. There are still a number of bank investigations that the Justice Department is handling which I predict will lead to further disclosure of U.S. account holders at those banks as well as the payment by the banks of huge civil penalties.

About two weeks ago, a major bank in Lichtenstein entered into a deferred prosecution agreement and agreed to turn over names of U.S. account holders. There is also an investigation of at least one Israeli bank going on right now. Several other Israeli banks have been mentioned as well but have not publicly acknowledged being under investigation. The IRS is also believed to be focusing on banks in Hong Kong and other places in the Pacific Rim. They are "following the money."

Editor: Please describe the IRS's current Offshore Voluntary Disclosure Program. Why were the prior programs more lenient?

Horn: The reason why the first program in 2009 was more lenient than the second (the 2011 program) or the current one is that the IRS felt that it wasn't fair to the people who came forward during the first program to have the same deal offered to those who waited and only decided later to participate. The first program required the filing of amended returns and delinquent FBARs for six years. It had a 20 percent accuracy penalty on the tax that was not reported and a 20 percent FBAR penalty. In the second program, return filing went up to eight years and the FBAR penalties went up to 25 percent. Then in the latest program, which has no announced deadline, return filing is eight years, a 20 percent accuracy penalty and a 27.5 percent FBAR penalty of the highest balance over the eight-year period. These penalties are not negotiable within the program, but if someone has very compelling facts justifying lesser penalties, the program allows those people to opt out of the program penalty structure and ask for individual consideration. This typically involves a modified audit and more scrutiny, so it is not recommended for everyone.

Editor: Who is eligible to apply for the disclosure program?

Horn: Virtually anyone can apply for the program. There are only limited exclusions (people who have illegal income sources or are already under the IRS or other investigation). However, once the IRS has your name, either because the bank disclosed it under FATCA or as a result of a deferred prosecution agreement from the Justice Department with the bank or maybe a foreign banker who is looking to avoid future indictment, it is too late.

Editor: If someone does not participate in the Offshore Voluntary Disclosure Program and the IRS later finds that person, what penalties are likely to be levied for failure to file FBARs and other information returns once the IRS becomes aware of this failure?

Horn: The person risks being criminally prosecuted and penalized civilly in amounts that can easily exceed whatever monies were not disclosed (75 percent civil fraud penalties on any tax due *plus* FBAR penalties equal to 50 percent of the account balance *each year)*.

Editor: What should corporate counsel do to keep management and employees informed of their foreign accounts and/or their asset-reporting obligations?

Horn: Many U.S. multinational companies already insist that their U.S. employees posted overseas be compliant with their U.S. reporting obligations and have teamed up with U.S. law and accounting firms to assist their employees in becoming (and remaining) compliant. I believe that as time goes on this will become a standard practice at all major U. S. companies and at foreign-owned companies with U.S. operations as well, because some or all of their management may be foreign nationals who either have received U.S. green cards (and become U.S. residents) or have spent sufficient time in the U.S. to be deemed U.S. residents under a separate "substantial presence" test used by the IRS. More and more companies are becoming aware of these issues and addressing them. The stakes are now too high not to do it. All corporate counsel should be thinking about whether these issues affect any of their employees and should take action to bring the proper resources on board to address any such issues that are identified.