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New Developments in Unreported Foreign Bank Accounts: One Size No Longer Fits All

By: Lawrence S. Horn, Esq. and Richard J. Sapinski, Esq.

Significant events continue to unfold in the IRS enforcement effort directed at those who have undisclosed foreign bank accounts since our July 24, 2014, article in the *New Jersey Law Journal*. Every practitioner should be aware of these new developments as offshore enforcement remains a top tax enforcement priority for the IRS.

The IRS and the Department of Justice Tax Division have long known that not all taxpayers who had undisclosed foreign accounts participated in the 2009 Offshore Voluntary Disclosure Initiative (OVDI). They suspected that many such taxpayers moved to other banks both in and out of Switzerland, or withdrew the money and either "gifted" it to a non-U.S. relative or friend to hold for them, or used it to buy real estate or other non-FBAR reportable assets in an effort to keep hiding their noncompliance. In one way or another, every IRS or Tax Division action since 2009 has been aimed at "following the money."

On March 30, the Tax Division publically announced that BSI SA Lugano, one of Switzerland's 10 largest private banks, was the first of the Swiss banks to finalize a non-prosecution agreement with the Department of Justice under the department's "Swiss Bank Program" that was announced on August 29, 2013. That program was one of the tools aimed at forcing non-compliant taxpayers to come forward by forcing their bankers to identify them so the IRS could pursue them. BSI agreed to pay a $211 million penalty and to cooperate in any civil and criminal proceedings relating to current or former U.S. customers, and to assist in IRS/DOJ treaty requests to obtain customer account information and to demonstrate that it has "implemented controls to stop misconduct involving undeclared U.S. accounts after 2008."

One of the ways BSI reportedly facilitated the customers' efforts at avoiding disclosure was by issuing debit or credit cards linked to the undisclosed account but which did not have the cardholder's name on them and using coded messages (e.g., "Can you download some tunes for us?") when the client needed the card reloaded with funds. The Tax Division press release noted that "BSI and other banks in the Swiss Bank Program are also providing detailed information to the Department about transfers of money from Switzerland to other countries. The Tax Division and the IRS intend to follow that money to uncover additional tax evasion schemes."

In May, two more Swiss banks—Vadian Bank and Finter Bank Zurich—reached similar agreements with the Tax Division and agreed to pay multi-million dollar penalties. Vadian Bank, a bank with one branch and 26 employees, was a latecomer to the tax evasion game. Prior to the IRS summons to UBS in 2008, it did not seek out U.S. clients but, after UBS began closing the accounts of U.S. clients, Vadian hired a marketing firm and soon attracted 70 U.S. clients fleeing U.S. enforcement against bigger Swiss banks and $76 million in new deposits.

Like BSI, Vadian and Finter agreed to cooperate with the Tax Division and IRS in identifying its customers, and the Tax Division press release indicated it had already "provided extensive cooperation."

Since May 28, 25 additional Swiss banks, including Societe Generale Private Banking (Suisse), also reached non-prosecution agreements with the Tax Division, agreed to pay penalties and began disclosing depositor information.

When the Offshore Voluntary Disclosure Program (OVDP) was rolled out in 2009, the penalty protocol was simple and uniform: 20 percent accuracy penalty on the additional income tax and a one-time 20 percent FBAR penalty for the highest balance going back six years. The taxpayer's decision was also a simple one: disclose or not disclose.

In the 2011 and 2012 versions of OVDI, the FBAR penalties were increased to 25 percent and 27½ percent, respectively, and the look back period for income tax returns and FBARs became eight years but the decision remained a binary one.

In June 2014, things got much more complex. New Streamlined Filing Compliance Procedures (SFCP) were announced offering a maximum 5 percent penalty on a more limited class of foreign assets (but which forced Taxpayers to self-evaluate by Affidavit their level of non-compliance in order to decide if they should use the SFCP process or not). In addition, new more restrictive OVDI rules were announced. Under the new rules, after August 3, 2014, a taxpayer seeking to participate in OVDI who at any point in the eight-year OVDI period had an account at a bank which was publicly identified as either a target of an IRS/DOJ criminal tax investigation or as having reached a plea, non-prosecution or deferred prosecution agreement will face an FBAR penalty of 50 percent (not 27½ percent) on all foreign accounts and assets. BSI was the first of the banks in the Swiss Bank Program to be so named. Twenty-eight other banks followed by reaching agreements within five months of BSI. More will also surely follow.

What does this all mean? No longer does one size fit all. Depending on the facts of the case, the FBAR penalty for the eight-year period can be 5, 27 ½ or 50 percent. Depositors have been receiving letters from Swiss banks urging the customer to enter the OVDP or to prove their account has been properly disclosed.

Equally troubling to those who either had undisclosed accounts outside Switzerland or moved their Swiss accounts to banks in other foreign countries, in 2015, banks around the world started to implement "know your customer" procedures to enable them to comply with the provisions of FATCA (Foreign Account Tax Compliance Act). They are requiring their U.S. customers to sign W-9 forms or other documents which enable the foreign bank to disclose their names and account information going forward to the IRS or to close the client's account if the client refuses to do so.

Someday soon a client will likely bring you either a FATCA letter or a letter from a Swiss bank that they have received and sheepishly tell you they have one or more undisclosed foreign accounts. They will be scared and looking for you to tell them what to do. What should you advise them to do? The good news is that there is still time for your client to cure any non-compliance before the IRS identifies him/her. You should tell them that doing nothing is no longer an option. The issue is not whether to disclose, but how to make the disclosure. The "how" question is complex, but you should also stress the need to act quickly because if the IRS obtains the client's name before he or she takes remedial action, it is too late.

Continuing to be non-compliant could result in a criminal investigation or the "audit from hell."

Other Swiss banks are still negotiating to enter into Non-Prosecution Agreements similar to the ones BSI SA, and the other banks have signed. Banks are and will continue aggressively pushing their customers to enter the OVDP, or prove they have already done so, and request the customer to waive Swiss bank secrecy to allow the bank to put the customer's name on the "compliant" list rather than on the "recalcitrant" one, with the often not very subtle hint that these lists will be provided to the Tax Division. These banks have a powerful financial incentive to force their clients into disclosing their non-compliance to the IRS through the OVDI program, because the bank avoids paying any penalties on any account which has been disclosed by the customer to IRS in response to the bank's letter to the client. Otherwise, the bank pays a 20, 30 or 50 percent penalty on the highest account balance in the client's account depending on when the account was opened.

Offshore voluntary disclosure is no longer a simple cookie cutter where all one has to do is fill in the blanks. Obtaining and analyzing the foreign bank records, as well as conducting client interviews, is necessary at the start of the process in order to select the correct course of action.

Horn is a member of Sills Cummis & Gross in Newark, where he is chairman of the Business Crimes and Tax Litigation Practice Groups. Sapinski is a member of the firm and vice-chairman of the Tax Litigation Practice Group. *The views and opinions expressed here do not necessarily reflect those of the firm.*
