FINANCIER WORLDWIDE corporatefinanceintelligence

The United States strikes again – the new Swiss bank program

November 2013 Issue

November 2013 | SPOTLIGHT | TAX

Financier Worldwide Magazine

BY

Caroline D. Ciraolo

Rosenberg Martin Greenberg, LLP

The United States has taken another giant leap forward in its aggressive pursuit of individuals and entities who attempt to evade, or help others evade, US tax reporting and payment obligations through the use of foreign accounts, structures, and financial arrangements. On 29 August 2013, the US Department of Justice (DoJ) and the Swiss Federal Department of Finance issued a joint statement announcing a program under which Swiss banks that are not under criminal investigation, and have reason to believe they may have committed tax-related offences under Title 18 or 26 of the United States Code, or monetary offences under 31 U.S.C. §§ 5314 and 5322 in connection with undeclared 'U.S. Related Accounts' during the 'Applicable Period', as those terms are defined by the program, may request a Non-Prosecution Agreement (NPA). These banks are referred to as 'Category 2' banks and under the terms of the program, are required to: (i) pay substantial penalties; (ii) make a complete disclosure of their cross-border activities; (iii) provide detailed information on an account-by-account basis for accounts in which US taxpayers have a direct or indirect interest; (iv) cooperate in treaty requests for account information; (v) provide detailed information as to other banks that transferred funds into secret accounts or that accepted funds when secret accounts were closed;

and (vi) agree to close accounts of account holders who fail to come into compliance with US reporting obligations.

To obtain an NPA, the bank must agree to a penalty in an amount equal to 20 percent of the maximum aggregate dollar value of all non-disclosed US accounts that were held by the bank on 1 August 2008. The penalty increases to 30 percent for secret accounts opened after 1 August and before 28 February 2009 and to 50 percent for secret accounts opened thereafter.

Swiss banks eligible for and seeking to participate in the program must send a letter of intent to the DoJ on or before 31 December 2013. The letter must explain the bank's plan to comply with the program requirements within 120 days of the date of the letter, identify the independent examiner, confirm that the bank will maintain all records required, and waive any defence based on limitations for the period from 29 August 2013 to the issuance of the NPA or Deferred Prosecution Agreement (DPA). During this application period, the DoJ agrees not to authorise any new criminal investigations of Swiss financial institutions.

For those Swiss banks that have not committed US tax or monetary violations (Category 3 banks), and seek confirmation of that status, the program offers the opportunity to submit an internal, independent investigation report and other information required (such as waivers of limitations), no earlier than 31 July 2014 and no later than 31 October 2014. Swiss banks that are deemed-compliant under FATCA (Category 4 banks), can enter the program under similar requirements. Category 3 and 4 banks will be eligible to receive Non-Target letters.

Swiss banks must be careful in selecting the proper category through which to apply. If a bank enters the program under Category 3, and later discovers that it should have applied as a Category 2 bank, the DoJ will consider whether the bank should be properly classified as a timely Category 2 applicant. No such relief will be granted if the request is made after 31 October 2014, if a formal criminal investigation has been authorised, or if the US has received information concerning wrongful conduct by the bank.

The DoJ is actively investigating the Swiss-based activities of 14 financial institutions, including Credit Suisse, Julius Baer, and Rahn & Bodmer, Co., and has expanded its reach to targets in India, Hong Kong, Luxembourg, Israel and the Caribbean. Those banks are not eligible for the program; nonetheless, any cooperation agreement to avoid prosecution will require the same disclosures.

Options for US taxpayers

Time is running out for those individuals with undeclared offshore accounts to come forward and into compliance. The anticipated disclosures by the Swiss banks will expose thousands and result in civil tax audits, substantial civil penalties and criminal prosecutions.

To date, 30 banking professionals and 68 US accountholders have been prosecuted for violations associated with their offshore activities. Those wishing to avoid criminal prosecution and what could be draconian civil penalties should consider the Internal Revenue Service's (IRS) offshore voluntary disclosure options.

Since 23 March 2009, when the IRS announced the first Offshore Voluntary Disclosure Program (2009 OVDP), eligible taxpayers have had an opportunity to come forward, come clean and pay substantial civil penalties to avoid much larger potential civil penalties and possible prosecution. Under the 2009 OVDP, taxpayers were required to fully cooperate with the IRS, file amended or original tax returns for years 2003 through 2008, file original or amended Reports of Foreign Bank and Financial Accounts, TD F 90.22-1 (FBAR), and pay: (i) the tax on the unreported income; (ii) an accuracy-related penalty equal to 20 percent of the tax due; (iii) interest due on the tax and the accuracy related penalty; and (iv) a penalty equal to 20 percent (or 5 percent in very limited circumstances) of the highest aggregate balance of the undisclosed foreign accounts over the last six years in lieu of the FBAR and other civil penalties that might otherwise apply.

More than 15,000 taxpayers with accounts in more than 60 countries came into the 2009 OVDP. Much of this success was attributable to the relentless civil litigation pursued by the United States against Union Bank of Switzerland (UBS) AG, Switzerland's largest bank, to obtain the names of all US accountholders, and the prosecution of more than 30 individuals for offences related to offshore activities.

After the 15 October 2009 deadline, more than 3000 individuals came forward under the IRS traditional Voluntary Disclosure Practice (Internal Revenue Manual 9.5.11.9). These individuals were given no assurance of reduced civil penalties for their past non-compliance; they came forward solely to avoid prosecution and come into compliance.

On 8 February 2011, the IRS announced the Offshore Voluntary Disclosure Initiative (2011 OVDI), which imposed a higher offshore penalty (25 percent), a longer look-back period (eight years), and more rigid requirements. The 2011 OVDI's application deadline was 31 August 2011, later extended to 9 September 2011. With the announcement of the 2011 OVDI, then IRS Commissioner Douglas Shulman issued a stern warning: "As we continue to amass more information and pursue more people internationally, the risk to individuals hiding assets offshore is increasing."

On 9 January 2012, based on the success of the 2009 and 2011 programs (33,000 disclosures and $4.4bn collected by January 2012), the IRS reopened the offshore voluntary disclosure program. Under the 2012 OVDP, there is no deadline to apply but taxpayers may be excluded if their information is turned over to the IRS, and the IRS reserves the right to change the terms of the program at any time.

The 2012 program retains the requirement of eight years of amended returns, eight years of FBARs, submission of related disclosure forms, and payment of tax, accuracy-related penalties and interest. The offshore penalty increased to 27.5 percent of the taxpayer's undisclosed, noncompliant foreign income producing assets. The reduced offshore penalty percentages of 5 percent and 12.5 percent in certain situations remain intact. Taxpayers also retain the right to opt out from the civil penalty structure and submit to an examination of their returns in an effort to reduce or avoid penalties.

In June 2012, the IRS announced that collections from the offshore disclosure programs exceeded the $5bn mark, with an additional 1500 disclosures under the 2012 program. The Service warned taxpayers that its efforts to stop offshore tax evasion and ensure compliance would not subside, including continued criminal prosecutions and third-party reporting through the Foreign Account Tax Compliance Act (FATCA). Moreover, if a taxpayer challenges in a foreign court the disclosure of tax information by that government to the United States, the taxpayer is required to notify the DoJ of that appeal. Failure to do so makes the taxpayer ineligible for any offshore disclosure program.

The IRS also announced the Streamlined Filing Compliance Program (SFCP) for US citizens residing overseas who have not resided in the US or filed US income tax returns since 2009, unless those returns were filed pursuant to the offshore disclosure programs. Under the SFCP, a taxpayer simply needs to file their income tax returns and FBARs for the last three years and pay the tax and interest due. No penalties will be assessed. Eligibility for the SFCP and the degree to which the returns submitted will be reviewed by the IRS will depend on the complexity of the returns and the taxpayer's level of risk, as defined by the IRS. Taxpayers interested in the SFCP should consider engaging a tax professional to assist in confirming eligibility because an application for the SFCP precludes the taxpayer from later entering the 2012 OVDP.

Caroline D. Ciraolo is chair of the Tax Controversy Practice Group at Rosenberg Martin Greenberg, LLP. Ms Ciraolo can be contacted on +1 (410) 547 7852 or by email: cciraolo@rosenbergmartin.com.