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LEGAL NEWS *ALERT*: YOUR CLIENTS HAVE OFFSHORE ACCOUNTS OR INVESTMENTS – KEEPING THEM OUT OF THE CROSSHAIRS OF THE IRS

Business and business leaders loathe uncertainty. Even bad news can be dealt with if the dealings are predictable, particularly when the stick of bad news is padded by the carrot of somewhat less-bad news. Operating under the assumption that providing a measure of predictability to the outcome will stimulate holders of unreported offshore accounts to come forward, on March 26, 2009, the Internal Revenue Service (the "IRS") announced the details of a program such persons to greatly reduce their exposure to significant civil penalties and, in many cases, to eliminate the prospects of criminal prosecution.

In the wake of the admission by UBS, one of the leading Swiss financial institutions, that over 50,000 UBS Swiss accounts are held by U.S. citizens, the IRS has increased the pressure on tax avoidance schemes involving offshore financial holdings. The total number of offshore accounts at all non-U.S. financial institutions is difficult to even speculate.

Unpredictability and potential criminal action have caused many U.S. holders of undisclosed offshore financial accounts or assets to keep such accounts hidden from the IRS. Multiple steep penalties that may, in the aggregate, exceed the highest value of the offshore holdings and potential criminal penalties have posed too great a risk. For example, IRS investigators who discover during the course of an audit an undeclared offshore account or income from offshore assets may impose penalties of up to 50% of the balance of each undeclared account for each year that it remained undisclosed, as well as interest on any unpaid tax. Such penalties can add up quickly.

The newly announced Penalty Framework for Voluntary Disclosure Requests is designed to interject a measure of predictability and limitation on penalties, and for those who qualify a complete elimination of criminal penalty. The Penalty Framework applies to all voluntary disclosures involving offshore issues, but will remain available only until September 23, 2009. After that date, the unpredictability and potential for criminal punishment returns.

After a preliminary determination by IRS Criminal Investigation that a taxpayer is eligible for voluntary disclosure, all voluntary disclosure requests will be sent to the Philadelphia Offshore Identification Unit (the "POIU") for civil processing, which is authorized to enter into closing agreements relative to offshore matters. The POIU will:

- Assess tax and interest looking back to the earlier of the date of account establishment or acquisition, or six (6) years;
- Oversee the taxpayer's filing of all missing or amended returns and Reports of Foreign Bank and Financial Account forms;
- Assess an accuracy-related or delinquency penalties for all subject disclosure years (NOTE: the traditional reasonable-cause exception will not be available for offshore disclosures);
- Assess a penalty equal to 20% of the value of the unreported foreign holdings in the disclosure year with the highest aggregate account/asset value (NOTE: this 20% penalty is in place of all otherwise applicable penalties, other than accuracy-related and delinquency penalties); *provided, however*, that a 5% penalty may be imposed in place of 20% penalty in cases in which: (a) the taxpayer did not open or cause to be opened any accounts and did not form or cause to be formed any entities, (b) there was no deposit or withdrawal activity during the period that the account or entity was controlled by the taxpayer, and (c) the taxpayer has paid all applicable U.S. taxes on the corpus of the funds in the account or entity, and only interest and earnings remain subject to U.S. taxation.

The IRS offered similar disclosure incentives in 2003 as part of the 2003 Offshore Voluntary Compliance Initiative. While the IRS collected in excess of $170 Million from approximately 1,300 participants, the program was not as successful as the IRS had hoped. Reference the 50,000 accounts disclosed by UBS, not to mention accounts with other financial institutions. Based on recent developments with UBS and the focus of the April, 2009, G-20 meeting in London on eliminating tax havens and bank secrecy, however, the IRS is more optimistic about increased participation this time. There are several advantages of participating in this voluntary disclosure program. First, those who do participate should be able to repatriate their funds to the United States immediately and without additional concern. Second, the newly announced penalty

structure is far less harsh than those that could be imposed outside of the current initiative, or that will apply after the initiative closes. Third, voluntary disclosure is likely to completely eliminate the specter of criminal prosecution. Finally, the IRS is confident that the atmosphere of bank secrecy has changed and that those persons who choose not to participate will be identified after September 23, 2009, and will be exposed to the full gamut of penalties and criminal prosecution.

Taxpayers with previously unreported or underreported foreign holdings should consider voluntary disclosure as a valuable risk definition and risk mitigation strategy. Carlton Fields is uniquely positioned to advise taxpayers with respect to both the tax and potential criminal implications of such a strategy, and to help taxpayers define the risk of not entering a voluntary disclosure action. Our attorneys experienced in both tax and white collar crime defense function as a team to pursue the most favorable results on both fronts. For additional information, please contact one of the attorneys below.

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