



Business Crimes

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Avoiding Criminal Tax Prosecution of the Client with Foreign Accounts

An Analysis of the IRS Offshore Voluntary Compliance Initiative

By Justin A. Thornton

Your client Jane Doe, the distraught business executive who hopes you can assist her in avoiding a criminal tax prosecution arising from her offshore bank accounts, calls you to inquire about the status of her case. While vacationing in the Caribbean several years ago, she opened accounts for herself and her company at a bank located on Grand Cayman Island. The bank issued her credit and debit cards linked to the offshore accounts, thereby enabling her convenient access to her offshore funds from the United States. In recent years, Jane's personal income tax returns, as well as those of her company, have failed to disclose the offshore accounts or to report the interest earned on them. Nor did she or her company file the required forms reporting those foreign financial accounts. Although Jane had not received any contact from the Internal Revenue Service prior to her engaging your services, she had heard news reports that the IRS had been gathering information about thousands of U.S. taxpayers with credit and debit cards issued by banks in the Caribbean, and she had feared that it was just a matter of time before the IRS would come calling.

Fortunately for Jane and her company, at the time she retained you in late December 2002 the IRS had recently announced significant changes to its voluntary disclosure program. See *Business Crimes Bulletin*, January 2003. A month later, the IRS announced its Offshore Voluntary Compliance Initiative (OVCI), which incorporated its newly revised voluntary disclosure policy and offered taxpayers such as Jane a possible golden opportunity to avoid criminal prosecution as well as significant civil penalties in exchange for their filing amended tax returns and cooperating with the IRS in its enforcement program against promoters of offshore tax shelters. Jane followed your advice to request participation in the OVCI program before the announced deadline of April 15, 2003. Subsequently, the IRS notified her of its preliminary determination of her eligibility.

What are the risks that your client still faces? What are the benefits? Have you rendered the correct advice? To serve your client properly, you must understand the seriousness of the situation, analyze the possible responses to IRS inquiries, and decide upon the best strategy to pursue in light of IRS and Department of Justice enforcement priorities, practices, procedures, and policies.

PRELUDE TO OVCI

Three years ago, the IRS began issuing "John Doe" summonses to American Express, MasterCard, and VISA to obtain the names, addresses, telephone numbers, Social Security numbers, and other pertinent information relating to holders of debit and credit card accounts with banks located in 30 countries, 20 of which the U.S. government considered to be tax havens (eg, Antigua, the Bahamas, Barbuda, the Cayman Islands, Isle of Man, Hong Kong, Liechtenstein, and Switzerland). (See *Business Crimes Bulletin*, September 2002 and January 2003). As its investigation continued, the IRS learned that there were hundreds of thousands of U.S. taxpayers with offshore debit and credit cards, and that only a small percentage of them reported their foreign accounts as required by law. Having identified such significant sources of unreported income, the IRS, with limited resources for enforcing tax compliance, decided to offer such taxpayers a limited opportunity to "get right" with their taxes.

A 3-MONTH WINDOW OF GOLDEN OPPORTUNITY

On January 14, 2003, the IRS announced OVCI. With a non-extendable deadline of April 15, 2003, for taxpayers to apply for acceptance into the OVCI, the initiative was aimed at bringing back into compliance those taxpayers who used offshore financial arrangements to hide income. Eligible taxpayers could avoid criminal prosecution and certain civil tax penalties (including the onerous 75% civil fraud penalty), but would still be liable for back taxes, interest, and some lesser civil penalties. In exchange, eligible taxpayers would be required to provide full details on any and all promoters of their offshore financial arrangements. See IR-2003-5.

Further, civil penalties for failure to file a timely Form TDF 90-22.1 ("Report of Foreign Bank and Financial Accounts"),

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commonly known as an FBAR, would not be imposed against eligible taxpayers that participate in the OVCI. Until earlier this year, FinCEN (the Financial Crimes Enforcement Network of the Treasury Department) had enforcement authority over FBARs, which are required to be filed annually by June 30th by U.S. citizens, residents, domestic corporations, partnerships, estates, and trusts with a "financial interest" or "signature or other authority over" a foreign financial account in which the balance exceeded \$10,000 anytime during the prior year. *See* 31 U.S.C. §5314 and 31 C.F.R. §103.24. The civil penalties for failure to report a foreign account or to include all required information on an FBAR are substantial, ranging from \$25,000 to \$100,000. *See* 31 U.S.C. §5321(a)(5)(B)(ii). It also should be noted that on April 10, 2003, the IRS and FinCEN announced the latter agency's delegation of its enforcement authority for FBAR reporting to the IRS. *See* IR-2003-48.

For those who missed the April 15th OVCI deadline, the opportunity at least to avoid a criminal prosecution still might be available pursuant to the newly-revised IRS Voluntary Disclosure policy, announced December 11, 2002. *See Business Crimes Bulletin*, January 2003; IR-2003-58; and, IR-2002-135.

WHO WAS ELIGIBLE?

Taxpayers seeking to participate had to send an application to the OVCI unit in Philadelphia by the deadline of April 15, 2003, with identifying data about themselves and any entity that was the source of funds they caused to be transferred offshore, and information about the origin of their involvement with offshore financial arrangements. Eligibility for participation in the

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OVCI required that the taxpayer must not, at the time of the application, have been: 1) under IRS audit or criminal investigation; 2) known by the IRS to be in non-compliance; 3) a promoter of abusive offshore tax shelters; or, 4) the recipient of illegal sources of income. *See* Rev. Proc. 2003-11.

WHAT HAPPENS NEXT?

Within 30 calendar days of receipt of the taxpayer's application, the IRS sent a form letter that notified the applicant of its preliminary determination of eligibility to participate in the OVCI. *See* Letter 3651 (SC) (Rev. 1-2003). Taxpayers who received such letters have 150 calendar days to file complete and accurate delinquent or amended income tax returns, other required information returns, and FBARs; provide additional detailed information about their offshore arrangements; and, pay all taxes, interest, and applicable civil penalties, or "make other financial arrangements acceptable to the Service" (which would require the completion and submission of a complete financial statement to the OVCI unit). While the OVCI requires the taxpayer to file returns for only the 3 years 1999 through 2001, returns filed for earlier years (up to a maximum of 6 years) also will be subject to the same penalty relief under the OVCI. *See* Rev. Proc. 2003-11. Most taxpayers participating in the OVCI now are in the process of complying with those requirements before their deadline expires in early October 2003.

OVCI APPLICANTS

On July 30, 2003, the IRS announced that 1299 taxpayers participated in the OVCI, resulting in the collection by that time of more than \$75 million in taxes and the identification of more than 400 offshore tax shelter promoters, 214 of

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whom previously were unknown to the IRS. The amount of taxes collected is expected to increase as most OVCI participants continue to amend their returns and pay back taxes before the October deadline. IRS estimated the cost of the OVCI program at \$2 million through July. The applications came from almost every state and 48 foreign countries. The diverse applicants included lawyers, dentists, business executives, and estate heirs, filing returns as individuals, domestic and foreign corporations, and trusts and estates. *See IR-2003-95.*

CAN APPLICANTS STILL BE REJECTED?

You bet. The IRS's initial acceptance letter states: "there may be facts about your case such as described in Revenue Procedure 2003-11, sections 2), 3), and 4) that are not known to us at this time which would disqualify you from the initiative." Citing other pertinent provisions of the OVCI, the letter also states that acceptance ultimately depends on the applicant's compliance with all the OVCI requirements noted above. Taxpayers know they are accepted only after the IRS executes the "Closing Agreement on Final Determination Covering Specific Matters." *See Rev. Proc. 2003-11, section 7.*

REJECTED OVCI APPLICANTS

In its initial announcement, the IRS

was silent as to the potential use it might make of admissions made by taxpayers in their requests to participate in the initiative if they were denied eligibility. Following inquiries by private practitioners, the IRS addressed that issue on March 17, 2003, when it posted on its Web site "Additional FAQs" about the OVCI, and stated: "Information about a taxpayer requesting participation in OVCI is admissible in subsequent criminal proceedings." The number of potential applicants who were deterred by that chilling position cannot, of course, be quantified. However, the IRS did go on to state its belief that, with respect to the taxpayer's original request for participation, "there is little risk the information will be helpful to the IRS in building a case against the taxpayer." *See www.irs.gov.* Such is not the case, however, with those applicants determined to be preliminarily eligible but later are rejected after submitting much more detailed and incriminating information to the IRS during the 150-day compliance period. Should that occur, those rejected simply have provided the government with a GPS road map for potential indictment, conviction, and incarceration.

CONCLUSION

As then-acting IRS Commissioner Robert E. Wenzel stated on May 1, 2003: "We are gaining a substantial amount of insight and information for our agents to use as we continue to build and expand our offshore

investigations. This will provide us with a valuable map to track offshore cheating. The IRS intends to take full advantage of these leads." *See IR-2003-58.* On July 30, 2003, as IRS Deputy Commissioner for Services and Enforcement, Mr. Wenzel stated: "We have a multi-pronged approach on offshore tax evasion, and we will continue to aggressively pursue this issue. Our continuing efforts send a strong signal to offshore tax evaders and others considering hiding their money overseas." *See IR-2003-95.* Indeed, recent IRS statistics reveal a significant increase in open criminal tax investigations and prosecution referrals involving the promoters of, and participants in, abusive offshore trust schemes. Numerous convictions have been obtained in recent months against individuals, including lawyers and accountants, associated with Anderson's Ark and Associates (AAA), the Institute of Global Prosperity (IGP), and other such organizations engaged in the promotion of offshore tax shelters. *See www.treas.gov/irs/ci.* In its increased attempts to promote voluntary compliance with the tax laws, the IRS has been loudly proclaiming, in essence, "pay the tax or face the max." While the decibel level of those IRS pronouncements has been high, will the bite follow the bark?

