

## Outside Counsel

# Disclosure of Financial Accounts Outside the United States

The U.S. government is continuing to expand its efforts to increase compliance by U.S. persons with regard to disclosures of financial accounts outside of the United States. As a result, U.S. persons with previously undisclosed financial accounts (and/or income) outside of the United States should be aware that the government has made it a priority to enforce laws requiring disclosure of such accounts and reporting of such income.

A looming Aug. 31, 2011, deadline by which to complete a voluntary disclosure of such accounts and/or income to the Internal Revenue Service (IRS) is discussed below, and should be taken seriously by U.S. taxpayers whose compliance with disclosure, reporting and/or tax payment obligations has been imperfect. Failure to participate in the formal voluntary disclosure program leaves such persons vulnerable to both civil and criminal penalties.

### Federal Mandate

As permitted by the Bank Secrecy Act, the Secretary of the Treasury has delegated to the Director of the Financial Crimes Enforcement Network (FinCEN) the authority to issue regulations regarding reports for foreign financial accounts. Pursuant to these regulations, in general, U.S. persons must file annual Reports of Foreign Bank and Financial Accounts, Form TD F 90-22.1 (FBAR), for any year during which those persons maintained (or had signatory authority over) one or more foreign financial accounts with an aggregate value of \$10,000 or more at any time during the calendar year. The FBAR is due on June 30 of the year following the year in which any such accounts were maintained. (Unlike tax filing deadlines, it is the date of receipt not the date of mailing that governs timely filing and extensions of time to file are not generally available).

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According to the preamble accompanying the most recent amendments of the FBAR regulations, FinCEN has been delegated authority, among other things, “to issue regulations requiring persons to keep records and file reports that are determined to have a high degree of usefulness in criminal, tax, regulatory, and counterterrorism matters.” A June 1, 2011, presentation by an Internal Revenue Service Senior Policy Analyst indicated that even an infant who is a U.S. person is required to file an FBAR, if financial accounts with an aggregate value of \$10,000 or more are held in the name of that infant outside of the United States, even if that infant has no U.S. tax filing obligations.

The IRS, FinCEN, the Department of Justice and Congress have all engaged in efforts to further increase compliance.

Although the IRS indicated that the presentation should not be considered “official guidance,” it is clear from this presentation as well as from other indicia (discussed further below) that the U.S. government is continuing to expand its efforts to increase compliance by U.S. persons with regard to disclosures of financial accounts outside of the U.S. and the correlative income reporting/payment obligations.

### Voluntary Disclosure

The efforts to increase compliance with (and indeed, awareness of) such disclosure obligations came to public attention largely through the combination of the U.S. Department of Justice’s highly publicized deferred prosecution agreement with a Swiss Bank (which included a release of some client names) coupled with the 2009 Offshore Voluntary Disclosure Program (2009 OVDP). The 2009 OVDP offered U.S. persons who had unreported income and bank accounts outside of the U.S. (between 2003 and 2008) an opportunity to disclose those accounts and report that income without fear of criminal prosecution and with assurance that civil penalties would be limited.

The limited civil penalties were a unique feature of that voluntary disclosure program, insofar as the benefit of a voluntary disclosure has generally been to eliminate the risk of criminal penalties. Approximately 15,000 persons came forward in connection with that program, which concluded on Oct. 15, 2009.

The IRS, FinCEN, the Department of Justice and Congress have all engaged in efforts to further increase compliance. Among other things, the IRS has announced a second Offshore Voluntary Disclosure Initiative (the 2011 OVDI) with an Aug. 31, 2011, deadline for completing the disclosure (including providing all required documentation, including amended federal income tax returns and FBARs).

The 2011 OVDI, like the 2009 OVDP, offers many U.S. persons the opportunity to file or amend prior year tax returns and FBARs without risk of prosecution and with specified civil penalties. Although specified, the penalties may not be less than would be imposed outside the 2011 OVDI because, within the 2011 OVDI (according to the 2011 OVDI “Frequently Asked Questions and Answers” or FAQs), the IRS will not evaluate “issues relating to reasonable cause, willfulness, mitigation factors or other circumstances that

may reduce liability.” Accordingly, some taxpayers (particularly those with extremely limited exposure to criminal prosecution) may prefer other alternatives, such as participating in the 2011 OVDI and then opting out.

One option, the so-called “quiet” or “silent” disclosure (filing amended tax returns and FBARs and paying tax due but not participating in the 2011 OVDI), while theoretically still permitted by the Internal Revenue Manual, has been actively discouraged by the IRS and the Department of Justice in connection with cases involving foreign financial accounts. In fact, in a May 19, 2011, press release accompanying a recent prosecution, the Department of Justice intimated that it was prosecuting a taxpayer who had done a “silent” disclosure in part because that taxpayer had failed to take advantage of the 2009 OVDP.

It is not clear that that taxpayer would have been eligible to participate in the 2009 OVDP and among the allegations are that the tax returns he filed as part of his “silent” disclosure understated the income and the tax due. If that allegation is true, then the “silent” disclosure itself would have been inadequate. However, instead of stating that the disclosure was inadequate, the information filed in that case states that “[a] silent disclosure does not constitute a voluntary disclosure.” Representatives of the Department of Justice have indicated that international tax evasion is a priority and that additional prosecutions—of taxpayers, advisers and/or financial institutions—should be anticipated.

#### Voluntary Disclosure Now

For many (if not all) U.S. persons with previously undisclosed financial accounts (and/or income) outside of the U.S., voluntary disclosure in some form is imperative in light of the U.S. government’s focus on these accounts. On June 2, 2011, the IRS issued updated 2011 OVDI FAQs, addressing some of the concerns taxpayers and practitioners had expressed. Among other things, the updated 2011 OVDI FAQs provide additional relief to those U.S. persons who for each year of their voluntary disclosure (a) resided outside of the U.S., (b) complied with all tax reporting and payment requirements in their country of residence, and (c) had \$10,000 or less of U.S. source income. These amendments, like the new FBAR regulations which were issued in February 2011, and the correlative amendments to the FBAR instructions, which were issued (along with the new FBAR form) in March 2011, increase taxpayers’ ability to comply with the disclosure obligations, both present and past.

When announcing the 2011 OVDI, IRS Commissioner Douglas H. Shulman stated, “The situation will just get worse in the months ahead for those hiding assets and income offshore. This new disclosure initiative is the last, best chance for people to get back into the system.”

Consistent with the statement of the IRS commissioner, the Department of Justice has commenced investigations and prosecutions of multiple persons (including non-compliant U.S. persons and bankers who assisted non-compliant U.S. persons) who are alleged to have been involved in hiding foreign assets and/or evading U.S. tax. Indictments in July included allegations that certain Swiss bankers and financial advisers had continued to assist clients in attempting to hide their assets after announcement of the 2009 OVDP and also discouraged their clients from participating in the 2009 OVDP.

One message of the most recent round of indictments is that continued efforts to conceal assets and income offshore will not be tolerated by the Department of Justice or the IRS. U.S. persons should heed that warning and recognize that although increased reporting requirements will make continued concealment less likely, compliance has been facilitated.

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#### Disclosure Requirements

FinCEN has issued new FBAR forms and new FBAR instructions, and revised FBAR regulations. Congress (as a part of the Hiring Incentives to Restore Employment Act) has enacted many of the additional reporting requirements initially included in the Foreign Account Tax Compliance Act of 2009 (FATCA).

As described in IRS Notice 2011-34, FATCA “expands the information reporting requirements imposed on foreign financial institutions... (FFIs) with respect to certain United States accounts... and imposes withholding, documentation and reporting requirements with respect to certain payments made to certain foreign entities.” Among the new requirements will be an additional reporting requirement for individual taxpayers with \$50,000 or more of specified foreign financial assets (some of which are not presently required to be disclosed on the FBAR) as well as additional (and substantial) obligations of FFIs to disclose the existence of U.S. account holders. Additional guidance is anticipated with regard to FATCA.

#### Clarity and Compliance

Although many practitioners believe there is still room for improvement, the new FBAR regulations do address some concerns and provide some clarification. For example, the new regulations clarify who is required to file an FBAR based on signatory or other authority (i.e., those who can control disposition of funds through direct communication with a financial institution) and who is not (i.e., those who participate in the decision to allocate assets or have the ability to instruct or supervise others with signature authority), which financial accounts are considered foreign (i.e., certain foreign mutual funds and similar pooled funds) and which are not (i.e., accounts maintained with a financial institution located in the U.S. even if those accounts hold securities of a foreign company), who has a financial interest in an account (i.e., persons with a present beneficial interest in a trust) and who does not (i.e., beneficiaries of discretionary trust).

One of the most helpful clarifications is that when a U.S. customer of an omnibus account held in the name of a global custodian “does not have any legal rights in the omnibus account and can only access their holdings outside of the United States through the U.S. global custodian bank” then “the U.S. customer would not have to file an FBAR with respect to assets held in the omnibus account and maintained by the global custodian.”

Finally, the fact that disclosure of financial interests outside the U.S. remains a priority is evidenced by the decision by FinCEN not to eliminate the requirement that those with signatory or other authority be required to file FBARs. The preamble accompanying the most recent amendments of the FBAR regulations notes that “Law enforcement representatives disagreed with commenters that the signature authority requirement results in duplication of information.... By adopting an independent reporting requirement for individuals with signature authority, the final rule maintains the check and balance that has existed since 1972, making it more difficult for the account and the individuals having access to that account to escape detection.”

Insofar as it is clear that the U.S. government will continue to view disclosure of financial interests outside of the United States as a priority, the recent guidance with regard to disclosure requirements is beneficial. The more clarity that can be afforded taxpayers attempting to comply with the disclosure and reporting requirements, the more likely that the compliance objectives of both the U.S. government and U.S. persons will be satisfied.