

(I.) INTRODUCTION

UBS: 52,000 Accounts for U.S. Taxpayers -

1. Undisclosed Accounts
2. Undeclared Income
3. As of 2004: (\$14.8B in Assets)

32,000 Accounts (cash)

20,000 Accounts (securities)

To Date:

1. UBS paid a \$780M fine, subject to a deferred prosecution agreement
2. Disclosed 323 U.S. Taxpayers (to IRS) who wired funds from American accounts to Switzerland

Federal District Judge in Miami (July, 2008)

Authorized the IRS to serve a “John Doe” summons to UBS

seeking the identities of U.S. Taxpayers who failed to report

income on undeclared foreign accounts (“Form 1099” income)



Government Accountability Office

Underreporting of Income by businesses & individuals led to a  
“tax gap” of \$345B in 2001 –

Unreported Income aka

“Rich people who cheat on their taxes”

(II.) The Mickey Cohen Case (Origins of Unreported Income)

Mickey Cohen –

Dapper former boxer

LA “Muscle” for Bugsy Siegel –

LA’s most high-profile Mobster of the 1940’s & 1950’s

1951 trial –

LA officials lobbied federal government

All the way to Pres. Truman

Use legal strategy “nailed Al Capone”

A Tax Case: Unreported Income

Federal Grand Jury collected evidence –

Mickey Cohen:

1. Paid \$49,329 Decorator (Brentwood home)
2. Spent \$800 on shoes
3. \$600 tips -

Explanation: Cohen lived like that “in style” on \$300,000 in “loans”, not income (from Bookies)

Cohen’s Defense

“If it’s against the law to borrow dough, . . . I’m guilty”

Government: Evidence Discovery

1. Documents salvaged from a backyard incinerator (“Mickey would take his papers out there to burn”)
2. Undercover cop (on Mickey’s home security team) would stamp out the fire, sneak the charred documents to the police, sent to the Feds –

Documents proved unreported income

Mickey Cohen got a 5-year jail term for tax evasion -

(III.) UBS Undeclared Foreign Accounts (Unreported Income)

U.S. Taxpayer who has foreign accounts with more than \$10,000 must file a Foreign Bank & Financial Account Report (“FBAR”) with the Treasury by June 30 annually

(FBAR rules established in 1970 Bank Secrecy Act – Since 2003 IRS enforces these rules)

In 2007, the Treasury received 322,000 FBAR’s –

IRS estimates 1 million plus Americans have offshore accounts – (over 700,000 – accounts unreported)

Criminal penalties for undeclared foreign accounts (unreported income) up to 24 years in jail (plus perjury)

1. Perjury (filing false income tax returns, failure to disclose offshore accounts, i.e. Form 1040/ Schedule B)
2. Failure to Report Income (3 Felonies, 1 Misdemeanor, up to 14 years in jail) -

3. Willful Failure to Report Offshore Accounts – (\$10,000 or more) –

Felony up to 10 years in jail –

Annual penalty – 50% Account Balance

(Account wiped out in 2 years)

(IV.) U.S. Congress

Edward Kleinbard, Chief of Staff, Joint Committee on Taxation

(3/31/09):

“The Global recession and the UBS scandal have created a Katrina-type movement. There is a push to improve tax enforcement and deter tax havens –

1. Since 1990, annual cross border capital flows have increased to \$8.2 trillion.
2. Offshore Tax Havens cost: \$100B per year lost U.S. tax revenue

## U.S. Congress combat offshore tax havens

### 1. Proposed Senate Bill 506: Stop Tax Haven Abuse Act

(2006)

Blacklist 34 countries, impose new reporting obligations on banks when a U.S. customer establishes a foreign bank account.

### 2. 2009 Updates

- SB 506

#### 3/4/09 Senator Levin recommended:

- i. Establish a special enforcement unit to handle UBS criminal prosecutions
- ii. Finalize a regulation to allow the U.S. to engage in automatic exchanges of information with foreign countries, specifically for tax enforcement
- iii. Require 3<sup>rd</sup> party disclosures of offshore transactions
- iv. Extend the statute of limitations for assessing taxes (for offshore cases) from 3 years to 6 years

(V.) The IRS

(1) IRS Budget

Fiscal 2010: \$12.1 Billion Budget for the IRS

5.2% increase over 2009 Budget (\$11.5B) –

Double Budget for Enforcement of Tax Laws (2009: \$400M

2010: \$890M)

(3/31/09) House Ways & Means Subcommittee

(Select Revenue Measures)

IRS Commissioner Douglas Shulman:

- i. The audit coverage rate rose from 0.58% in Fiscal Year 2001 to 1.07% in Fiscal Year 2008 (nearly a 100% increase in 7 years).
- ii. IRS has increased the number of audits in offshore banking (since 11/08)
- iii. Increased hiring of international tax experts
- iv. Offered a 6-month amnesty program (thru 10/09) for offshore account holders who reveal their unreported assets, including:

1. Payment of back taxes
2. Interest (up to 6 years)
3. Penalty either 20% accuracy-related (IRC §6662) or 25% delinquency penalty (IRC §6651) (for up to 6 years)
4. Additional 20% penalty – of the amount in foreign bank account (in the year with the highest account value -)

(2) IRS Audits (2007)

**b**

1. Taxpayers with income over \$1M up 84% (17,015 2006  
31,382 2007)
2. Income over \$200,000 up 29.2% (87,885 2006  
113,105 2007)
3. Overall Individual Audits increased 7% (1,293,681 2006  
1,384,563 2007)

Business Audits (2007)

**b**

1. S-Corporations up 26%	(13,984 2006
	17,681 2007)
2. Partnerships up 25%	( 9,777 2006
	12,195 2007)
3. Businesses up 14%	(52,223 2006
	59,516 2007)

IRS Audits (2008)

In Fiscal Year 2008, the IRS conducted 1.4 million examinations of individual tax returns, an 8% increase over Fiscal Year 2006.

■

(2007 - 105,549

2008 130,751)

Their audit coverage rate rose from 2.68% (2007) to 2.94% (2008) (still under 3%).

IRS Criminal Prosecution

1. Indicted 2,547 Taxpayers in FY 2008 (2,323 in FY 2007)
2. FY 2008 IRS cases for offshore issues resulted in 61 criminal convictions, average jail time of 32 months –
3. For the first 4 months of FY 2009, 20 convictions, and average jail term of 84 months – (nearly triple 2008 jail term)

(VI.) UBS/US Taxpayers (Foreign Source Income)

UBS acted as a Qualified Intermediary (i.e., a foreign financial institution subject to U.S. Tax Reporting and Tax Withholding). UBS as a withholding agent is liable for any tax required to be withheld (IRC §1461) but is not required to withhold if payee is a U.S. Person (Form W-9) or an exempt foreign payee (Form W-8).

U.S. Taxpayers, with foreign source income (e.g., Swiss Bank Interest), subject to Form 1099 tax reporting for UBS income received (i.e., UBS reports the income on Form 1099, issued after receipt of IRS Form W-9 to identify Taxpayer), and payment of tax (on Taxpayer Form 1040 tax return). UBS as the tax withholding agent is not required to withhold any amount if the payee is a U.S. person (identified by Form W-9).

For foreign Taxpayers with U.S. source income, UBS acts as a withholding agent (Treas Reg Sec. 1.441-7), who must withhold tax unless in receipt of Form W-9 (US Taxpayer) or Form W-8 (a foreign person not subject to U.S. tax withholding), or subject to reduced rate of withholding (Form W-8 BEN: Treaty Exemption, or reduced treaty tax rate), or in receipt of Form W-8 ECI, (effectively-connected U.S. taxable income to be declared by recipient or beneficial owner by filing U.S. tax return).

IRS Form W-9: Payor of income to U.S. Taxpayer files Form W-9 with IRS to report income. The Payee (U.S. Taxpayer) provides Taxpayer ID number to Payor (Requestor) to report U.S. taxable income.

Form W-9:

- Certifies Taxpayer ID#
- Certifies Taxpayer not subject to back-up withholding (i.e., pay 28% tax to IRS)
- Claim exemption from withholding by a U.S. “exempt” payee (i.e., exempt from tax under U.S. Tax Treaty)



- [REDACTED]
- [REDACTED]
- [REDACTED]

V [REDACTED]

1 [REDACTED]

2 [REDACTED]

3 [REDACTED]

(VIII.) UBS/Qualified Intermediary

2001 IRS establish Qualified Intermediary program –

Attract foreign investors to U.S. securities;

7000+ foreign banks participate in QI program

Foreign banks, in the QI program, hold more than \$35B offshore in accounts for U.S. individual investors, partnerships, trusts, family foundations and corporations, but withheld taxes of only 5% of that amount in 2003 (not required 30% tax withheld) –

Until 10/13/08 IRS allowed the banks to promise:

1. Identify U.S. Taxpayer clients –
2. Withhold U.S. taxes on U.S. securities in their account (30% tax withheld)
3. Send tax dollars owed to the IRS

Swiss Bank: UBS world's largest private bank

Sold offshore Banking Services to U.S. Taxpayers to hide income  
(undeclared foreign accounts, tax not paid on annual income)

U.S. Taxpayers (i.e., U.S. Persons or foreign persons with U.S. source income): Offshore Accounts not illegal; Hiding income is illegal

After UBS bought Paine Webber, UBS entered into a Qualified Intermediary agreement w/the US which required US tax reporting/tax withheld for U.S. source income paid to either:

1. A “non-exempt” U.S. person (i.e., U.S. Taxpayer)
2. A foreign person (subject to US tax withholding – 30% tax withheld on “FDAP income”, e.g., interest, dividends, annuities)



1 [REDACTED]

2 [REDACTED]

3 [REDACTED]

4. [REDACTED]

(IX.) IRS Announcement 2008-98: Qualified Intermediary Rules

(10/13/08) New rules to stop rampant tax evasion

1. Stop American Investors who hide behind offshore shell companies and trusts set up by foreign banks (so as to claim no U.S. owners)
2. New rules go into effect 2010.
  - a. Foreign banks must now investigate, determine and report whether U.S. investors (or their legal entities) are the holders of the foreign accounts they open –
  - b. Private banks must alert the IRS to any potential fraud they detect, whether through their own internal controls, complaints from employees, or investigations by regulators.
  - c. The IRS:

- i. Will audit samples of individual bank accounts on a “no-names basis” to determine whether U.S. investors have control over foreign entities
- ii. Private banks must have external auditors to monitor their compliance
- iii. The auditors must identify the bank employees responsible for preventing tax abuses
- iv. The external auditor must report “red flags” to the IRS –
- v. Banks using foreign-based external auditors (including foreign branches of U.S. auditors) will have to work with an American auditor, who will accept joint responsibility for the audit (i.e., joint and several liability)



(X.) IRC §1441: Qualified Intermediary Agent

QI agrees to U.S. tax withholding and tax reporting for payments of U.S. source income to a foreign person (subject to 30% tax

withholding under FDAP rules unless withheld at a lower treaty rate)

or to a U.S. Person (request Form W-9 to identify U.S. Taxpayer, issue Form 1099 to report annual payments, and if required withhold 31% income tax under IRC §3406 [“back-up withholding”] –

QI responsibilities:

1. Obtain documentation to establish the identity and tax status of the beneficial owner of U.S. source income
2. Tax reporting for U.S. source income (on U.S. securities held in foreign bank accounts)
3. Withhold and remit taxes of U.S. non-resident aliens (and “back-up” tax withholding for US residents)

#### QI Benefits –

1. \*Anonymity\* (Privacy)

No Individual Income Disclosures –

2. Report only U.S. source securities income (i.e., no reporting required for non-U.S. source income)
  
3. “Pool Reporting” QI reports “pools of income” (“reporting pools”), on Form 1042-S, by 3/15 (next calendar year), (i.e., income that falls within a particular withholding rate, within a particular income code, exemption code and recipient code (determined on Form 1042-S)



4. Foreign Taxpayers (U.S. Source Income): 30% tax withholding:  
FDAP income (paid to a Foreign Taxpayer) subject to no tax withholding or to a lower rate of income tax withholding either:
  - a. IRC / Regulations
  - b. Tax Treaty

(XI.) US Taxpayers & Offshore Accounts Tax Reporting

U.S. Taxpayers are required to report offshore accounts:

1. IRS/Form 1040 (Schedule B) –  
Disclose Foreign Account
  
2. Include income on Form 1040

(Foreign Account)

3. File TD F 90-22.1

Report of Foreign Bank and Financial Account (“FBAR”)

(By 6/30 each year) separate filing –

Annual FBAR filing required:

Each U.S. person with a financial interest in, signature or other authority over any foreign financial accounts with an aggregate value exceeding \$10,000 at any time during the calendar year.

U.S. Taxpayers who hide income in undisclosed offshore accounts:

Face 24 years in jail:

1. May be subject to 3 felonies and a misdemeanor (up to 14 years in jail –)
2. Commit perjury by filing a false tax return (Form 1040 schedule B)
3. Do not disclose foreign bank and financial accounts (over \$10,000) are subject to additional felony (up to 10 years in jail) and subject to annual civil penalty greater of \$100,000 or 50% of account balance (i.e., in 2 years account “wiped out” by 100% penalty)



### Felonies

1. IRC §7201 Tax Evasion  
(Willful evasion of tax)  
Felony up to 5 years in jail
2. IRC §7212 – Obstruct Tax Collection  
Felony up to 3 years in jail
3. 18 U.S.C. 371 – Conspiracy to Impede Tax Collection  
Felony up to 5 years in jail
4. Failure to file “FBAR”: Felony up to 10 years in jail

### Misdemeanors

1. IRC §7203 Failure to File Tax Return  
up to 1 year in jail

### Penalties (up to 100%)

1. Civil Tax Fraud: 75% of Tax Due  
IRC §6651(f): Fraudulent failure to file tax return

IRC §6663(a): Fraudulent tax return filed –

2. Failure to Pay Tax: 25% of Tax Due

IRC §6651(a)(2): Tax Shown on Return

IRC §6651(a)(3): Tax Not Shown on Return –

(XII.) Olenicoff Case/Risks of Voluntary Disclosure

Igor Olenicoff (Forbes 400 Member)

Billionaire –

Hid \$200M offshore (at UBS), went to the IRS made a “voluntary disclosure” and requested a “deal”

The Deal: Plead guilty to a felony (filed false 2002 tax return)

(lied on 1998-2004 tax returns re: offshore accounts)

Paid \$52M in back taxes, interest, and civil fraud penalty (75% penalty)

Under the Olenicoff case, Taxpayer’s voluntary disclosure required a civil fraud penalty, a felony plea and ongoing material witness involvement in a federal probe of UBS –

The Olenicoff case highlights the risks of voluntary disclosure (until accepted) –

1. No tax compliance until the tax return is filed (which commences the statute of limitations (i.e., either criminal charges and/or civil penalties for failure to file tax returns) –
2. While a voluntary disclosure is pending, the IRS may request more information (i.e., discovery), commence an audit, criminally prosecute felonies/misdemeanors
3. A voluntary disclosure does not guarantee that there will be no federal criminal prosecution
4. A voluntary disclosure may be used as an evidentiary admission of Taxpayer's unreported income
5. A voluntary disclosure may waive Taxpayer's 5<sup>th</sup> Amendment right against self-incrimination –

(XIII.) IRS Criminal Prosecution

The IRS lacks the staff to pursue the massive criminal tax cases arising from UBS (and other foreign banks):

1. Cases are resource intensive  
(The IRS lacks the staff)

2. Justice Department Tax Division authorized 1284 criminal tax prosecutions of individual defendants in 2007  
(compared to 52,000 UBS US Taxpayers who may be guilty of multiple felonies, over 200,000 U.S. Taxpayers who fail to file FBAR forms annually for the over 1 million projected offshore accounts)

(XIV.) The IRS Audit Strategy

Preempt Pre-Audit Seizure

Avoid Jeopardy Assessments – (i.e. seizure). Do not repatriate offshore funds to the U.S. until all tax returns are filed, all taxes are paid, and the audit period statute of limitations expires.

U.S. Taxpayer Accounts Held in their Name

U.S. Taxpayer foreign source income (or unreported U.S. source income).

Accounts held in their individual names:

1. Amend Form 1040/Schedule B (for all years) and disclose a foreign bank account, declare all income
2. File TD F 90.22-1 (FBAR Forms) for current year, and include prior years (note pre 2008 FBAR filings request less details)

3. If no constructive receipt of income (i.e., a 3<sup>rd</sup> party controlled the income, U.S. Taxpayer could not access funds, declare the income as of the most recent tax year (once physically received)
4. Includes a tax return protective election filing and state if there is a reasonable cause for failure to report the income (e.g. illness, lost records, incomplete records, advisor failure to report income on Taxpayer's behalf as contractually obligated, in breach of fiduciary duty)

U.S. Taxpayer Accounts Held in the Name of Entities (e.g. Trusts, Corporations, Partnerships)

1. Dissolve Companies/Trusts
2. Receive funds in new accounts established offshore establisher f/b/o Taxpayer
3. Upon receipt of funds, report all income, as of the year of receipt, and pay tax on all income received (i.e., total income received for all years) by one lump sum tax payment -

4. If constructive receipt of income was prevented by 3<sup>rd</sup> party who controlled the income, and prevented unfettered access to the funds, file a protective election with the most recent tax year tax return, disclosing the income, and the reasons for no constructive receipt in prior years
5. File Form 1040/schedule B disclose new offshore accounts established f/b/o Taxpayer to receive the funds
6. File TD F 90.22-1 ("FBAR" Form) to disclose new offshore account established f/b/o Taxpayer to receive the funds