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INSIGHTS

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EDITORS' NOTE

In this month's edition of *Insights*, we focus on the following topics:

- **Expatriation the Transatlantic Way: Overview of the French and the U.S. Regimes.** Our feature piece is written by our guest writer, Nicolas Melot, and our resident attorney, Fanny Karaman. The article compares the existing exit tax rules of France and the United States.

- **F.B.A.R. and O.V.D.P Updates.** In light of the June 30th deadline for the 2013 reporting year, we discuss recent develops concerning Form 114, *Report of Foreign Bank and Financial Accounts* ("F.B.A.R.") as well as penalties and assessment and collection procedures and processes. We also highlight recent changes to the offshore voluntary disclosure programs, as well as recent events with respect to banks under investigation.

- **Tax 101: Taxation of Foreign Trusts.** Our Tax 101 piece focuses on foreign trusts. We discuss the taxation of foreign trusts and reporting obligations of the trust, the trustee, and the beneficiaries.

- **Corporate Matters: Breaking Up Shouldn't Be So Hard to Do.** Simon Prisk focuses on break up provisions in the business agreement and what one should look for when entering a business relationship or other form of contractual obligation.

- **F.A.T.C.A. 24/7.** This month's monthly F.A.T.C.A. column focuses on the first published list of registered F.F.I.'s list and highlights the various new countries added to the I.G.A. list.

- **Updates and Tidbits.** We discuss various recent developments on tax policy, international tax issues, B.E.P.S., and highlight two recent examples of tax evasion and its unfortunate consequences.

We hope you enjoy this issue.

-The Editors

EXPATRIATION THE TRANSATLANTIC WAY: OVERVIEW OF THE FRENCH AND THE U.S. REGIMES

Authors
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Tags
Expatriation Tax
Exit Tax
France

Over the past years, both France and the United States recorded a growing number of individuals expatriating as a tax planning device.

In order to discourage the tax exiles, the French government introduced an exit tax in the late 90's.[1] It called for the immediate taxation of unrealized capital gains on shares that represent at least 25% of the share capital of a company held by the expatriating individual. In comparison to U.S. rules, an individual was caught by the French expatriation tax upon the relinquishment of tax residence rather than citizenship. Thus, the threshold for the tax was much lower than in the U.S. The law was intended to limit the temporary exile of entrepreneurs willing to sell their shares in more favorable tax conditions than under French tax law. Belgium could be seen, for French taxpayers, as a "tax vacation" destination; by becoming a Belgian resident, a French taxpayer could sell French shares without paying any tax either in France or in Belgium.

However, the Court of Justice of the European Union (formerly European Court of Justice) invalidated the French exit tax regime because it violated the principle of freedom of establishment (article 43 of the treaty establishing the European Community).[2] Pursuant to this decision, article 167 bis of the French Tax Code was abolished as of January 1, 2005.

The 2008 crisis affected the economies of many States, including France, and resulted in increased tax burdens for resident individuals. In 2007 for instance, gains realized by individuals on the sale of securities were taxed at the rate of 16% plus an 11% social contribution, resulting in an overall tax burden of 27%. Today, the same gains are taxed at the French progressive income tax of up to 45% plus an exceptional contribution on high income of 4% after possible allowances based on the holding period for certain securities. The gains are also subject to an added 15.5% social contribution, resulting in a potential tax of more than 60% on some or most of the gain realized.

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1 Late Section 167, 1 bis and Section 167 bis of the French Tax Code (Section 24 of the Financial Law for 1999).

2 European Court of Justice, Lasteyrie du Saillant, March 11, 2004, case C-9/02, 5e ch.

As a result, many French tax residents were incentivized, again, to take “tax vacations” in countries offering a "less confiscatory" tax system. This, in turn, led to the rebirth of the French exit tax in the form of the Amended Finance Law for 2011.[3]

Like France, the U.S. is no longer a tax paradise. It, also, introduced an exit tax. Prior to 2008, expatriate individuals were subject to U.S. tax on certain income that was deemed to arise from U.S. sources for a period of ten years following the date “H.E.A.R.T. Act”) modified the then existing expatriation regime. The current regime applies to individuals expatriating on or after June 17, 2008 for both income tax and succession tax purposes. Note that mere relinquishment of tax residence is not sufficient to trigger application of the expatriation tax in the U.S., other than for non-citizens who hold green cards for eight or more years within a 15-year period. Because the U.S. imposes tax on citizens residing outside the country, relinquishment of U.S. citizenship is the trigger for the tax.

This article aims to compare the French and American exit tax regimes by giving an overview of their respective scopes and effects. The U.S. succession tax is not covered by this article. That is a special inheritance tax paid by the recipients of gifts and bequests from an expatriate that is covered by the expatriation tax.

“In France, the exit tax regime was introduced to limit the tax benefit derived by individuals looking to avoid tax on certain capital gains. The scope is consequently limited to these assets.”

THE SCOPE OF THE FRENCH AND U.S. EXIT TAX REGIMES

The scope of the French and U.S. exit taxes are quite different. In France, the exit tax regime was introduced to limit the tax benefit derived by individuals looking to avoid tax on certain capital gains. The scope is consequently limited to these assets. In the United States the objective is broader, and therefore, the scope is wider.

In France

As previously mentioned, the first Amended Finance Act for 2011 dated July 29, 2011 reintroduced the exit tax regime in France. The exit tax is codified under article 167 bis of the French Tax Code. The 2013 Amending Finance Act broadened the scope of this tax regime.[4]

This new exit tax on unrealized capital gains[5] applies retroactively to March 3, 2011 and covers individuals who transferred tax residence after that date.

Under the 2011 regime, the exit tax applied only to taxpayers who were French tax residents during at least six of the ten years preceding the transfer of residence to outside of France. The exit tax applied to the following unrealized or deferred gains:

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3 Law n°2011-900 of July 29th, 2011.

4 Section 42 of the 2013 Amending Finance Act, n° 2013-1279, dated December 29, 2013. Indeed, on December 31, 2013, there were only 251 exit tax returns.

5 Valued on the day preceding the date of departure.

- Unrealized capital gains relating to securities that represent at least 1% of the share capital of a company, or to direct or indirect shareholding with a value of more than €1.3 million, corresponding to the wealth tax threshold;

- Previously realized capital gains on shares for which taxation was deferred under French tax law, such as the realized but untaxed gain when a taxpayer contributes shares to a company; and

- Amounts payable under an "earn-out" provision.

The 2013 Amending Finance Law introduces a number of changes to the French exit tax regime:

- The 1% shareholding threshold is replaced with a 50% threshold in order to only target majority shareholding;

- Alternatively, a shareholding that has a value in excess of €800,000;

- Certain investment funds[6] that were outside the scope of the exit tax are now taxable on the same basis as other securities.

Several investments remain outside the scope of the exit tax. Most prominently, the exit tax does not apply to shares of real estate companies. These are companies in which 50% or more of the assets directly or indirectly consist of real estate not used in the company's principal trade or business.

Pre-expatriation planning is thus available to French expatriates.

In the U.S.

Section 877A of the Internal Revenue Code of 1986 (the "Code"), as currently in effect, applies to certain U.S. citizens relinquishing citizenship and certain long-term residents who cease to be green card holders.[7] These two categories of individuals are referred to as "Expatriates."[8] For this purpose, a "long-term resident" is an individual who held a green card for at least eight years out of a 15 taxable-year period ending with the year of the expatriation.[9]

Persons becoming Expatriates are subject to the exit tax if they meet the following requirements:[10]

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6 The French "Organisme de placement collectif en valeurs mobilières."

7 Within the meaning of Section 7701(b)(6) of the Code.

8 Section 877A(g)(2) of the Code.

9 Any taxable year during which a U.S. green card holder is treated as a resident of another country (pursuant to the tie-breaker rules contained in an applicable income tax treaty with the U.S.) generally is not considered a year in which the individual holds a green card for purposes of the above computation. Section 877(e)(2) of the Code.

10 Section 877A(g)(1) of the Code.

- The average net income tax liability of the Expatriate during the five taxable-year period ending prior to the date of expatriation exceeds a certain amount that increases with inflation. Currently, that amount is $157,000[11] (the "Income Tax Liability Test"). This test looks to income taxes owed in the U.S. after taking into account the foreign tax credit and certain other credits;

- The Expatriate's net worth at the expatriation date is equal to at least $2,000,000 (the "Net Worth Test"); or

- The Expatriate did not file Form 8854 ("Initial and Annual Expatriation Statement") declaring under penalties of perjury that the Expatriate complied with all U.S. income tax laws during the five taxable years preceding the year of the expatriation (the "Certification Test").

For purposes of the exit tax, Expatriates meeting the above requirements are "covered expatriates." For U.S. citizens, the expatriation date is the date on which the individual gives up U.S. citizenship. For long-term residents of the U.S., the expatriation date is the date on which they cease to be green card holders.

Several exceptions exist for the Income Tax Liability Test and the Net Worth Test. Under one of the exceptions, neither test is met if, at birth, the Expatriate was a citizen of the U.S. and of another country, continues to be a citizen and resident of that other country, and has been a resident of the U.S. for not more than ten taxable years out of the 15 taxable-year period ending with the year of expatriation.

Another exception applies to a U.S. citizen who relinquishes U.S. citizenship before the age of 18½ years, provided that individual was not a resident of the U.S. for more than ten taxable years prior to the date of expatriation.

Here again, pre-expatriation planning is available to U.S. Expatriates.

THE CONSEQUENCES OF THE FRENCH AND THE U.S. EXIT TAX REGIMES

In France

When the French exit tax is applicable, the built-in capital gains on securities are immediately taxed. The basis of the tax assessment is the difference between the fair market value of the securities at the date of the exit and the purchase price by the taxpayer.

The capital gains so calculated are subjected to the progressive French individual income tax rates, allowances, and social contributions discussed above.[12]

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[11] Rev. Proc. 2013-35

[12] The taxable basis of the exit tax is calculated based on the new capital gains regime, taking into account new allowances provided by the Article 150-0 D of

FRENCH INCOME TAX SCALE IN 2014	
Until €6,011	0%
From €6,011 to €11,991	5.5%
From €11,991 to €26,631	14%
From €26,631 to €71,397	30%
From €71,397 to €151,200	41%
Beyond €151,200	45%

However, an automatic tax deferral will be granted to taxpayers who transfer their tax residence to another European Union ("E.U.") member state or to a European Economic Area ("E.E.A.") member state that has entered into an administrative assistance agreement with France to combat fraud and tax evasion, and a mutual assistance agreement for the collection of taxes.

For transfers to other countries, tax deferral may be granted upon a specific request by a taxpayer who offers guarantees for payment of the deferred tax[13] and designates a tax representative in France.

Deferral without guarantees may be granted if the individual demonstrates that the transfer of tax residence is due to a professional purpose such as a business transfer by a multinational employer. Deferral may also be available for transfers to a state that is not part of the E.E.A., if certain conditions are met.

If not paid at the date of the transfer, the tax will be due to the French Tax Authorities in case of transfer, repurchase, repayment or cancellation of the securities.[14] The taxable event is the date of departure and not the date of sale. This is aimed at allowing France to tax the gain even if the individual has moved to a country that has in effect a tax treaty with France that allocates the right to tax capital gains from the sale of securities to the country of residence. In order to prevent double taxation, the taxpayer may benefit in France from a tax credit for the tax paid in the residence state on an actual gain.

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the French tax code (*e.g.*, by taking into account a 50% rebate after a two-year holding period and 65% after eight years). The rebate can go up to 85% under certain condition.

13 This guarantee is calculated on 30% of the amount of unrealized capital gains.

14 The Law clarifies the rules for offsetting capital losses from sales of securities subject to the exit tax (post-departure) against capital gains on other securities. Lastly, the Law clarifies how the contribution of shares realized after the transfer of tax residence should be treated, by providing that contributions realized pursuant to Article 150-0 B ter of the French tax code do not have the same consequences as "sales," which put an end to the deferral of payment of the exit tax. The deferral of payment of the exit tax applies until the date of sale of shares received in exchange for the contribution or of the contributed shares within three years of the contribution, except reinvestment within the deadlines provided by Article 150-0 B ter of the French tax code.

The exit tax on unrealized capital gains may be waived or refunded in several cases:

- No triggering event occurs in the 15 years following the departure of the taxpayer. Prior to the 2013 Amending Finance Law, the triggering period was eight years, with the waiver or refund applied to only the income tax.

- The taxpayer moves his/her residence back to France within the 15 year period;

- The taxpayer dies;

- The taxpayer gifts the shares.

Regarding gifts, the initial bill required the taxpayer to demonstrate intent to donate as the principal purpose for the gift. The 2013 Amending Finance Law eliminated the purpose requirement which was ruled as contrary to E.U. law by the French Administrative Supreme Court on July 12, 2013, n°359994 for taxpayers who become residents of the E.U. or of the E.E.A. Taxpayers moving to other countries remain obligated to prove that the "main" reason for the gift was not the avoidance of the exit tax.

Tax planning is consequently still available "through expatriation followed by gifts." However, the country of expatriation should be well chosen in order for the gift not to be taxed in France.

In the U.S.

Under Section 877A of the Code, all of the property of a covered expatriate is treated as subject to a deemed fair market value sale occurring on the day immediately preceding the date of expatriation. Any deemed realized gain or loss must be taken into account in the taxable year of the deemed sale, after reduction of an amount of $663,000.[15] Particular attention must be paid when a domestic trust becomes a foreign trust due to the expatriation of the taxpayer. In that case, the application of the mark-to-market rule of Section 684 of the Code trumps the application of Section 877A, and the Expatriate cannot benefit from the $663,000 *de minimis* exemption.[16] If the Expatriate is a long-term resident of the U.S., gain is computed by taking into account a stepped-up basis as of the residency. Certain items of property are excluded from the deemed mark-to-market sale rule, generally dealing with deferred compensation and interests in trusts.[17]

An Expatriate can elect to defer the payment of the exit tax. This election is made on a property-by-property basis. It must be secured by an acceptable arrangement

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[15] Section 877A(3) of the Code, as adjusted for inflation for tax year 2013.

[16] Sections 877A(h)(3) and 684 of the Code.

[17] Certain deferred compensation items (see Section 877A(d) of the Code), certain specified tax deferred accounts (see Section 877A(e) of the Code) and certain distributions of property from a nongrantor trust to a covered expatriate (see section 877A(f) of the Code).

with the I.R.S.[18] and is irrevocable.[19] In addition, the taxpayer making the election must waive all claims to the benefits of an income tax treaty that may reduce his or her liability to the exit tax.[20]

The payment of the tax is deferred until the occurrence of the earliest of the following events:

- The due date of the return for the taxable year in which the actual sale of the property occurs or if the property is disposed of in a nonrecognition transaction (*e.g.*, a gift), until such other date as provided by the I.R.S.;
- The due date of the return for the taxable year of the individual's death; or
- The time that the security provided by the individual fails to meet the appropriate requirements.[21]

"Although the deferred payment of the tax is allowed, underpayment interest runs on the amount of tax deferred. The interest runs from the original due date for the payment of the exit tax."

Although the deferred payment of the tax is allowed, underpayment interest runs on the amount of tax deferred. The interest runs from the original due date for the payment of the exit tax.[22]

Absent the issuance of income tax regulations under Section 877A of the Code, the I.R.S. published Notice 2009-35. Under this notice, an Expatriate is required to file Form 8854 along with a dual-status return in the tax year of Expatriation. A dual-status return requires the filing of Form 1040NR ("U.S. Nonresident Alien Income Tax Return") to which is attached Form 1040 ("U.S. Individual Income Tax Return") in regard to the portion of the tax year that preceded the date of expatriation. In the case of an expatriation date on January 1 of a given year, no dual-status tax return must be filed. In subsequent years, the covered expatriate must file Form 1040NR in the event that effectively connected income or U.S. source fixed or determinable, annual or periodic income is realized. For covered expatriates electing for the deferral of tax, Form 8854 must be filed every year up until the year of the payment of the entire exit tax and interest.

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18 Section 877A(b)(4) of the Code.
19 Section 877A(b)(6) of the Code.
20 Section 877A(b)(5) of the Code.
21 Section 877A(b)(1) and Section 877A(b)(3) of the Code.
22 Section 877A(b)(7) of the Code.

A COMPARATIVE TABLE OF THE FRENCH AND THE U.S. EXIT TAX REGIMES

Comparative Table		
	France	**U.S.**
Triggering Event	Transfer of tax residence	Giving up citizenship / ceasing to be a green card holder
Properties Subject to Exit Tax	Corporate Securities	All property
Exceptions / Tax deferral	Tax Deferral: - Taxpayers who transfer tax residence to another E.U. member state or to a cooperating E.E.A. member state. - For transfers to other countries: upon a specific request by the taxpayer if guarantees are offered for the tax deferred and a tax representative in France is designated. - Upon the taxpayer's request if justifies demonstration is made that tax residency was transfer for business reasons.	Exceptions: - Certain dual birth citizens and certain citizens prior to age 18½. Tax Deferral: - Upon election - On a property-by-property basis - Irrevocable - Security requirement must be met - Waiver of treaty benefits - Reporting and filing requirements must be respected - Interest applies despite deferral
Highest Applicable National Tax Rate	45% (income tax) + 4% (exceptional contribution tax on high income) + 15.5% (social contributions) = 64.5%	20% in the case of capital gains or 39.6% absent capital gains + Additional Potential 3.8% Net Investment Income Tax (+ applicable state and local taxes)

CONCLUSION

For both U.S. and French purposes, the exit tax constitutes an important element in determining whether or not to expatriate. In both countries, the advice of competent tax counsel should be sought prior to expatriation in order to manage the consequences of this tax.

F.B.A.R. PENALTY: RECENT CASES

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U.S. v. ZWERNER: WILLFUL NON-FILINGS RESULT IN MONSTROUS CIVIL PENALTIES

United States v. Zwerner[23] illustrates the potential for monstrous civil penalties resulting from willful failure to file F.B.A.R.'s. It further confirms the point that, if evidence of willfulness exists even in a sympathetic case, the I.R.S. may assert willful penalties in the case of "silent" or "quiet" disclosures, which the I.R.S. and its officials have consistently warned in official and non-official statements.[24]

The facts of the case in brief are as follows:

From 2004 through 2007, Carl Zwerner, currently an 87-year-old Florida resident, was the beneficial owner of an unreported financial interest in a Swiss bank account that he owned indirectly through two successive entities. He did not report the income on the accounts for the period of 2004 through 2007, according to the complaint filed by the United States, but in his answer to the complaint, Zwerner, while admitting that he filed a delinquent F.B.A.R. for 2007, denied filing an amended return for that year, stating that his financial interest in the foreign account was reported on his timely-filed 1040 for that year. The complaint also alleged that, for 2006 and 2007, he represented to his accountant that he had no interest or signature authority over a financial account in a foreign country. Zwerner denied those allegations.

According to the answer to the complaint, Zwerner made, what he thought to be, a voluntary disclosure. However, he was poorly represented. His attorneys advised him that a voluntary disclosure occurred, and that he should file amended returns and delinquent F.B.A.R.'s based on the advice of his then "counsel," and he was subsequently audited in 2010. His defense appeared to be reasonable reliance on what he thought to be competent attorneys and for the fact that, under past and then-existing programs, the penalties would be substantially reduced if not eliminated, to the extent that an actual voluntary disclosure would have been made.

Pursuant to an audit, Zwerner apparently admitted that he was aware of his reporting obligations in a statement addressed to the I.R.S. in hopes – or promise –

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[23] *United States v. Zwerner*, S.D. Fla., No. 1:13-cv-22082, 5/28/14.

[24] *See*, *e.g.*, O.V.D.P. FAQ #15, encouraging participation in the O.V.D.P. and stating that "[t]hose taxpayers making 'quiet' disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years."

of reduced penalties.[25] Citing this admission, the I.R.S. assessed a penalty for willful failure to file an F.B.A.R. in an amount of 50% of the highest balance of the unreported account for every year of this four-year period. The penalties were as follows:

- 2004 - $723,762, assessed on June 21, 2011;
- 2005 - $745,209, assessed on August 10, 2011;
- 2006 - $772,838, assessed on August 10, 2011; and
- 2007 - $845,527, assessed on August 10, 2011.

Zwerner refused to pay the fines. The U.S. filed a complaint to collect on June 11, 2013. The total sum of the amount of the fines, plus interest and additional amounts, owed to the United States as of the date of filing was $3,488,609.33. Zwerner responded in an answer to the complaint with multiple defenses, including a defense based on the Eighth Amendment to the Constitution, which prohibits excessive fines.

"On May 28, 2014, a U.S. District Court jury ruled against the taxpayer finding three willful violations of failing to file an F.B.A.R."

On May 28, 2014, a U.S. District Court jury ruled against the taxpayer *finding three willful violations* of failing to file an F.B.A.R.

The consequences to the 87-year old taxpayer were chilling: he faced civil penalties amounting to 150% of the highest balance on the unreported account plus interest and additional amounts. This by far exceeded the value of the defendant's unreported account. Attorneys representing Zwerner stated they would present an Eighth Amendment challenge to the fines. In *U.S. v. Bajakajian*,[26] the Supreme Court ruled that forfeiture of $357,114 transported out of the country in violation of statute requiring reporting of transport of more than $10,000 would constitute an excessive fine. The Supreme Court stated:

> The forfeiture of respondent's entire $357,144 would be grossly disproportional to the gravity of his offense. His crime was solely a reporting offense. It was permissible to transport the currency out of the country so long as he reported it. And because §982(a)(1) orders currency forfeited for a "willful" reporting violation, the essence of the crime is a willful failure to report. Furthermore, the District Court found his violation to be unrelated to any other illegal activities. Whatever his other vices, respondent does not fit into the class of persons for whom the statute was principally designed: money launderers, drug traffickers, and tax evaders. And the maximum penalties that could have been imposed under the Sentencing Guidelines, a 6-month sentence and a $5,000 fine, confirm a minimal level of culpability and are dwarfed by the $357,144 forfeiture sought by the Government. The harm that respondent caused was also minimal. The failure to report affected

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[25] The answer alleges that the I.R.S. agent coerced an admission through an empty promise of reduced penalties.

[26] 524 U.S. 321 (1998).

> only the Government, and in a relatively minor way. There was no fraud on the Government and no loss to the public fisc. Had his crime gone undetected, the Government would have been deprived only of the information that $357,144 had left the country. Thus, there is no articulable correlation between the $357,144 and any Government injury.

Ultimately, the I.R.S. and the defendant settled, leaving the Eighth Amendment challenge for another day.

Under the terms of the settlement, Zwerner agreed to pay to the U.S. two of the 50% FBAR penalties assessed against him relating to 2004 and 2005 in the amounts of $723,762 and $745,209 respectfully, plus interest thereon of $21,336.11 and $20,947.52 respectively, plus statutory penalties on the FBAR penalty assessments for 2004 and 2005 of $128,016.64 and $125,685.11 respectively.

The end result in Zwerner is bitter sweet for taxpayers. Facing four willful F.B.A.R. penalties, through litigating, Zwerner reduced it to two. However, two F.B.A.R. penalties, plus interest and penalties for late payment, is devastating to the taxpayer as the penalties exceed the balance of the unreported account. Further, although the U.S. settled, indicating doubt as to the strength of their position on the Eighth Amendment challenge, they can use this, and other cases, to incentivize taxpayers into compliance through voluntary disclosures as the Eighth Amendment issue remains unsettled.

U.S. v. HOM: NON-WILLFUL PENALTIES ON VARIOUS POKER RELATED ACCOUNTS

U.S. v. Hom[27] held that a taxpayer's accounts at an online financial company and at two online poker companies were F.B.A.R. reportable assets. As the assets were not reported on a timely filed F.B.A.R., the court upheld non-willful penalties that were assessed by the I.R.S.

The facts of the case can be summarized as follows:

During 2006, pro se defendant John Hom (“D”) gambled online through internet accounts with PokerStars.com and PartyPoker.com. In 2007, D continued to gamble online through his PokerStars account. Both poker websites allowed defendant to deposit money or make withdrawals.

D used his account at FirePay.com, an online financial organization that receives, holds, and pays funds on behalf of its customers, to fund his online PokerStars and PartyPoker accounts. He deposited money into his FirePay account via his domestic Wells Fargo bank account or other online financial institutions, such as Western Union. In 2006, FirePay ceased allowing United States customers to transfer funds from their FirePay accounts to offshore internet gambling sites, so D

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[27] 113 AFTR 2d 2014-XXXX, (DC CA), 06/04/2014.

used Western Union and other online financial institutions to transfer money from his Wells Fargo bank account to his online poker accounts. D admitted that at some points in both 2006 and 2007, the aggregate amount of funds in his FirePay, PokerStars, and PartyPoker accounts exceeded $10,000 in United States currency.

After the I.R.S. detected discrepancies in D's federal income tax returns for 2006 and 2007, the I.R.S. opened an F.B.A.R. examination. D did not file his 2006 or 2007 F.B.A.R.'s until June 26, 2010. Moreover, the 2006 submitted F.B.A.R. did not include his FirePay account.

On September 20, 2011, the I.R.S. assessed D with civil penalties for his non-willful failure to submit F.B.A.R.'s regarding his interest in his FirePay, PokerStars, and PartyPoker accounts. The I.R.S. assessed a $30,000 penalty for 2006, which included a $10,000 penalty for each of the three accounts, and a $10,000 penalty for 2007 based solely on defendant's PokerStars account.

The critical issue was whether D had an interest in a "bank, securities, or other financial account" for F.B.A.R. purposes. The Court stated as follows:

> While our court of appeals has not yet answered what constitutes "other financial account[s]" under 31 C.F.R. 103.24, the Court of Appeals for the Fourth Circuit found that an account with a financial agency is a financial account under Section 5314 … Under Section 5312(a)(1), a "person acting for a person" as a "financial institution" or a person who is "acting in a similar way related to money" is considered a "financial agency." Section 5312(a)(2) lists 26 different types of entities that may qualify as a "financial institution." Based on the breadth of the definition, our court of appeals has held that "the term "financial institution" is to be given a broad definition." . . . The government claims that FirePay, PokerStars, and PartyPoker are all financial institutions because they function as "commercial bank[s]." … The Fourth Circuit in Clines found that "[b]y holding funds for third parties and disbursing them at their direction, [the organization at issue]functioned as a bank [under Section 5314]." …

"Thus the court further held that '[a]s FirePay, PokerStars, and PartyPoker functioned as banks, defendant's online accounts with them are reportable.'"

Thus, the court further held that "[a]s FirePay, PokerStars, and PartyPoker functioned as banks, defendant's online accounts with them are reportable."

D also argued that even if he is liable, the amount of penalty assessed was too high because it might contravene the Internal Revenue Manual ("I.R.M."). However, the court stated:

> Our court of appeals, however, has foreclosed that argument by holding that "[t]he Internal Revenue Manual does not have the force of law and does not confer rights on taxpayers." Fargo v. Comm'r of Internal Revenue, 447 F.3d 706, 713 [97 AFTR 2d 2006-2381] (9th Cir. 2006). Thus, defendant's argument fails.

The case is interesting for a number of reasons, which include the following:

- D did not argue that the penalty should be on a per form basis and the court allowed assessment of the penalty on a per account basis.

- D was liable for $40,000 for non-willful violations for playing poker by simply failing to report his poker related accounts. It is unclear from the case what aggravating circumstances existed for the agent not to give an F.B.A.R. warning letter.

- The court states that the I.R.M. does not confer rights to the taxpayer. The I.R.M. provides mitigation guidelines in order to provide uniform consistency among examinations and also gives substantial discretion to the examiner to lower the penalty amount. It is not clear whether the examiner followed the I.R.M. or not; the court simply states that the I.R.M. does not provide rights to the taxpayer.

F.B.A.R. ASSESSMENT AND COLLECTIONS PROCESSES: A PRIMER

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Tags
Tax Controversy
F.B.A.R.

With the June 30th deadline fast approaching and the recent cases addressing F.B.A.R. penalties, we thought it would be useful to provide a primer on F.B.A.R. assessment and collections processes.

BACKGROUND

In general, a U.S. person having a financial interest in, or signature authority over, foreign financial accounts must file an F.B.A.R. if the value of the foreign financial accounts, taken in the aggregate and at any time during the calendar year, exceeds $10,000.

The F.B.A.R. must be filed electronically by June 30 of the calendar year following the year to be reported. No extension of time to file is available for F.B.A.R. purposes.

Failure to file this form, or filing a delinquent form, may result in significant civil and/or criminal penalties:

- A non-willful violation of the F.B.A.R. filing obligation can lead to a maximum penalty of $10,000. If reasonable cause can be shown and the balance in the account is properly reported, the penalty can be waived.[28]
- In the case of a willful violation of the filing obligation, the maximum penalty imposed is the greater of $100,000 or 50% of the balance in the account in the year of the violation.[29]
- Criminal penalties apply only when the failure to report the foreign account is willful. Depending on the context and the scope of the willful violation, the criminal penalties can go as high as a combination of a fine of $500,000 and imprisonment for up to ten years.[30]

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28 31 United States Code ("U.S.C.") §5321(a)(5)(A), (B).
29 31 U.S.C. §5321(a)(5)(A), (C).
30 31 U.S.C. §§5322(a); 5322(b); 18 U.S.C. §1001.

ASSESSING THE PENALTY

Pursuant to a Memorandum of Agreement between the Internal Revenue Service ("I.R.S.") and the Financial Crimes Enforcement Network ("FinCEN"), FinCEN delegated the authority to assess the F.B.A.R. penalty to the I.R.S.[31] Thus, the issue may arise during a standard income tax audit.

STATUTE OF LIMITATIONS

The statute of limitation ("S.O.L") to assess a civil F.B.A.R. penalty is six years from the due date of the F.B.A.R. or from the date of the I.R.S.' request for records.

The S.O.L. to file a suit for the collection of an assessed civil F.B.A.R. penalty is two years from the date of assessment or the date any judgment becomes final in any criminal action with respect to which the penalty is assessed.[32]

Absent any action brought within this two-year period, the Government may offset payments in order to collect the F.B.A.R. penalty. According to the I.R.M., the S.O.L. for this latter option is 10 years from the date of assessment or the date any judgment becomes final in any criminal action with respect to which the penalty is assessed.[33] However, many, including tax practitioners and certain I.R.S. officials, have noted that there is no S.O.L. with respect to the collection of debt under 31 U.S.C. §3716(e)(1).

The collection methods available include (a) administrative offsets, (b) tax refund offsets, (c) federal salary offsets, (d) non-federal employee wage garnishments, (e) debt referrals to private collection contractors, debt collection center, as well as the reporting of delinquencies to credit reporting agencies.

The S.O.L. for criminal penalties is five years from the date the offense is committed.[34]

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31 31 Code of Federal Regulations ("C.F.R.") §1010.810(g).
32 31 U.S.C. §5321 (b)(2).
33 31.U.S.C. §3711(g)(A)-(H).
34 18 U.S.C. §3282.

The following diagram illustrates the S.O.L. timeframe for civil penalties:

Assessment of Civil Penalty

Collection Action
(if assessed on last day possible)

|----------|----------|

6 years 2 years

Possibility to Offset Payments

|----------|

Potentially Unlimited

THE PROCESS

If the potential violation is discovered in a Title 26 examination (*i.e.*, in a federal income tax context), the examiner must first have the Territory Manager sign a Related Statute Memorandum (R.S.M.). This allows the examiner to be able to use the F.B.A.R. related information discovered in the Title 26 examination in compliance with Section 6103 of the Internal Revenue Code of 1986 as currently in effect (the "Code"). No R.S.M. is necessary if the potential violation is discovered under a Bank Secrecy Act examination.

After conduct of the examination, the examiner explains his or her conclusion in a Summary Memorandum.

- If no violation was discovered, the examination is closed;
- If a violation was discovered but no penalty is asserted, a warning letter is issued and the examination is closed;
- If the examiner concludes that a violation occurred and assesses penalties, an internal procedure must be followed, including a potential referral to Criminal Investigation, the rendering of legal advice by the appropriate SB/SE Counsel Area F.B.A.R. Coordinator and the issuance of a 30-day letter to the filer (if recommended by Counsel).
    - If the taxpayer agrees to the civil penalties, the penalties are paid and the case is closed.
    - F.B.A.R. penalties are eligible for Fast Track Settlement only if the F.B.A.R. 30 day letter, Letter 3709 has not been issued to the taxpayer.

- If the taxpayer disagrees to the assessment of the civil penalties, the taxpayer has 45 days to appeal. The case is then forwarded to Appeals [35] in a pre-assessment procedure.
- If the taxpayer does not appeal, the penalties are assessed and the collection process can begin (in this scenario, post-assessment Appeals is still available to the taxpayer).[36]
- Post-assessment Appeal will be handled on priority basis. These cases need to be completed within 120 days from the date the Appeals office is assigned to the case.[37]
- Post-assessment F.B.A.R. cases in excess of $100,000 (excluding interest) cannot be compromised by Appeals without approval of the Department of Justice ("D.O.J.").[38]
- Alternative Dispute Resolution (A.D.R.) rights or Post Appeals Mediation (P.A.M.) rights are not available to taxpayer in a post-assessment Appeals procedure.[39]

"Penalties may be mitigated under the I.R.M. It is unclear, however, whether the procedures under the I.R.M. are being followed by all examiners, and, even if so, whether those rules are being applied consistently . . . "

Penalties may be mitigated under the I.R.M. It is unclear, however, whether the procedures under the I.R.M. are being followed by all examiners, and, even if so, whether those rules are being applied consistently, which is one of the stated intents behind those procedures. As noted above, courts have held that the I.R.M. does not provide substantive rights to the taxpayer.

ENFORCEMENT

The Federal Debt Collection Procedure Act also known as F.D.C.P.A.[40] provides three remedies for enforcing civil judgments: (1) execution, (2) garnishment and (3) installment payment orders.

Judgment for F.B.A.R. penalties must be collected under F.D.C.P.A., 28 U.S.C. 3001-3308. Here, the courts can issue any other writs under 28 U.S.C. §1651 to support these remedies. In order to enforce a judgment under any of these remedies, the government must prepare a notice to the debtor for service by the clerk of the court. The notice advises the debtor that property has been seized, identifies debt owed, prescribes potential exemptions, explains procedure and time (20 days) to request a hearing, and gives notice of intent to sell the property. In

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35 Unless less than 180 days remain on the assessment S.O.L. and the taxpayer does not agree to an S.O.L. extension. In that case, the penalty will be assessed and the post-assessment Appeals procedure is available to the taxpayer.

36 31 CFR 5.4; 31 CFR. Part 900.

37 I.R.M.8.11.6 (October 28, 2013).

38 32 U.S.C. §3711(a)(2) and 31 CFR §902.1(a), (b).

39 I.R.M.8.11.6 (October 28, 2013).

40 31 U.S.C. §3711(g)(9).

addition, the government may use other collection tools, such as sale of property, sale of stocks, bonds, notes and securities.[41]

JURISDICTIONAL ISSUES

According to the Tax Court, the Tax Court is a court of limited jurisdiction and can only exercise jurisdiction to the extent expressly provided by Congress.[42] In addition, the provision under which F.B.A.R. penalties are asserted is under Title 31 and therefore it does not fall within the Tax Court's jurisdiction.[43]

The taxpayer may be able to file a complaint in either in District Court or the Court of Federal Claims to challenge the assessed penalty under the Tucker Act (and the Little Tucker Act), as many tax practitioners have noted, or wait until the U.S. attempts to collect the debt.[44]

A taxpayer has six years to bring his civil action,[45] but there is no right to a jury trial for an action to recover money from the Federal Government in a non-tax refund setting.[46] However, when the Government counterclaims for the unpaid balance, the plaintiff has the right to trial by jury.[47]

BANKRUPTCY

At least one court has held that F.B.A.R. penalties are not dischargeable in bankruptcy.[48] The court based its rationale on the fact that the F.B.A.R. penalty is not a tax or tax penalty, which is an exception to nondischargeability of fines. The Court stated:

> A debt may be discharged if the debt is for one of two kinds of "tax penalties." Defendant argues that his debt is dischargeable under this exclusion. In order to be a tax penalty, the FBAR penalty would have to be linked in some way to an underlying tax. For Defendant's argument to have any viability, the FBAR itself would have to be a tax. The FBAR is a document, not a tax.

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41 28 U.S.C. §§2001(a); 2001 (b).
42 *Breman v. Commissioner*, 66 T.C. 61 (1976).
43 *Williams v. Commissioner,* 131 T.C. No 6.
44 28 U.S.C. §1491; 28 U.S.C. §1346; 28 U.S.C. §1345. *See*, *e.g.*, Horowitz, *Litigating the FBAR Penalty in District Court and the Court of Federal Claims* (2014), available at: http://taylorlaw.com/wp-content/uploads/2014/03/Article-Litigating-the-FBAR-March2014.pdf.
45 28 U.S.C. §§2401; 2501.
46 28 U.S.C. §§2401; 1346.
47 *Tull v. United States*, 481 U.S. 412 (1987).
48 *Simonelli*, 102 AFTR 2d 2008-6577 (D. Conn. Sept. 30, 2008).

F.B.A.R. UPDATE: WHAT YOU NEED TO KNOW

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NOTWITHSTANDING OFFICIAL COMMENTS, BITCOIN EXCHANGE ACCOUNTS SHOULD BE REPORTED ON F.B.A.R.'S

As noted in our previous issue, the I.R.S. clarified the tax treatment of Bitcoin, ruling that Bitcoin will not be treated as foreign currency but will be treated as property for U.S. Federal income tax purposes. As a result, the I.R.S. ruling may allow for capital gains treatment on the sale of Bitcoin. However, the ruling did not address whether Bitcoin is subject to Form 114 reporting.

This month, pursuant to a recent I.R.S. webinar, an I.R.S. official stated that Bitcoins are not required to be reported on this year's Form 114. However, the official noted that the issue is under scrutiny, and caveated that the view could be changed in the future.

Notwithstanding the official's comments, whether Bitcoin is a reportable asset will depend on the nature and manner it is held.

- If Bitcoin is treated as property (not currency), the situation is analogous to a U.S. person who directly holds non-U.S. real property or any other valuable asset, which is not a foreign financial account.

- If Bitcoin is held through an entity (*e.g.*, a (non-grantor) trust), the situation is analogous to the "look-through" rule, in which case reporting is required only with respect to the entities foreign financial accounts if and to the extent the indirect holder has control of the entity (using a greater than 50% test).

- However, if and to the extent a U.S. person holds Bitcoin or shares of an entity that holds Bitcoin through, *e.g.*, an offshore custodial account or other financial account, the account will likely be an F.B.A.R. reportable asset.

An interesting question involves exchange accounts. Exchanges that convert Bitcoin in and out of other currencies function similarly to brokerages and offer a variety of financial services similar to banks or other financial institutions. Without official guidance that can be relied upon, we would advise our clients to disclose these accounts under a protective filing. *United States v. Hom*, discussed above, is noteworthy. The court ruled an online poker player was liable for penalties after concluding that online poker sites PokerStars.com and PartyPoker.com operated

as commercial banking financial institutions under the Bank Secrecy Act, and therefore, non-U.S. accounts held with them were F.B.A.R. reportable assets.

MUTUAL FUNDS IN BROKERAGE ACCOUNTS DON'T HAVE TO BE SEPARATELY REPORTED ON F.B.A.R.'S

Mutual funds held in brokerage accounts generally don't have to be separately reported on the FinCEN Form 114. Therefore, an I.R.S. official recently confirmed that the taxpayer would be reporting only on the brokerage account that holds the mutual fund. However, if the mutual funds and the brokerage accounts were separate, they would each require separate F.B.A.R.'s. This would also be true of other types of financial holdings in the brokerage account.

CHILD FILING REQUIREMENTS

Recent updates to the instructions to Form 114 (06/11/2014) provide that, in general, a child is responsible for filing his or her own F.B.A.R. report. If a child cannot file his or her own F.B.A.R. for any reason, such as age, the child's parent, guardian, or other legally responsible person must file it for the child. In addition, if the child cannot sign his or her F.B.A.R., a parent or guardian must electronically sign the child's F.B.A.R. and in item 45 Filer Title enter "Parent/Guardian filing for child."

O.V.D.P. UPDATE

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Tags
O.V.D.P.
Streamlined Procedures

I.R.S. ANNOUNCES MAJOR CHANGES TO O.V.D.P. AND STREAMLINED PROCEDURES

After more than two weeks of speculation,[49] on June 18, 2014, the I.R.S. announced major changes to its current offshore voluntary disclosure programs earlier today. The programs affected are the 2012 Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer U.S. Taxpayers (the "Streamlined Procedures") and the 2012 O.V.D.P.

In general, as will be discussed in more detail below, the changes to the programs relax the rules for non-willful filers and at the same time potentially increase penalties for willful non-compliance.

The changes to the O.V.D.P., as announced today, include the following:

- Additional information will be required from taxpayers applying to the program;
- The existing reduced penalty percentage for non-willful taxpayers will be eliminated;
- All account statements, as well as payment of the offshore penalty, must be submitted at the time of the O.V.D.P. application;
- Taxpayers will be able to submit important amounts of records electronically; and
- The offshore penalty will be increased from 27.5% to 50% if, prior to the taxpayer's pre-clearance submission, it becomes public that a financial institution where the taxpayer holds an account or another party facilitating the taxpayer's offshore arrangement is under investigation by the I.R.S. or the Department of Justice.

The changes to the Streamlined Procedures include the following:

- The availability of the program is extended to certain U.S. taxpayers residing in the U.S.;

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[49] *See* "Prepared Remarks if John A. Koskinen-Commissioner of Internal Revenue Service, Before the U.S. Council for International Business – OECD International Tax Conference, Washington D.C.", June 3, 2014.

- The requirement that the taxpayer have $1,500 or less of unpaid tax per year is eliminated;

- The Streamlined risk questionnaire is eliminated; and

- The taxpayer is now required to certify that previous failures to comply were due to non-willful conduct.

All penalties will be waived for eligible U.S. taxpayers living outside the United States. Eligible taxpayers living in the U.S. will only incur a 5% miscellaneous offshore penalty on the foreign financial assets that gave rise to the tax compliance issue.

It should be noted that taxpayers who, prior to July 1, 2014, submitted their intake letter and attachments, can benefit from the expanded Streamlined Filing Compliance Procedures if they are eligible for this program.

At first glance, the changes appear to officialize the prior avenue of silent disclosures that were made by many U.S. persons residing in the U.S. and abroad who believed the O.V.D.P. penalties were too harsh by providing an official path forward to come into compliance on a penalty free or penalty limited basis.

The open question is how the I.R.S. will treat silent disclosure filers currently under audit as a result of being discovered.

We will follow up shortly on the specifics, but you may review the details of the changes at www.irs.gov.

CREDIT SUISSE PLEADS GUILTY TO ASSISTING IN TAX EVASION BY U.S. TAXPAYERS

Credit Suisse AG pleaded guilty to conspiracy to aid and assist U.S. taxpayers with the filing of false income tax returns and other documents. Credit Suisse admitted to operating an illegal cross-border banking business that knowingly and willfully aided and assisted thousands of U.S. clients in opening and maintaining undeclared financial accounts and concealing their offshore assets and income from the I.R.S., thus evading U.S. taxes. The bank has agreed to pay $2.6 billion to the U.S. government, which will be divided among several agencies.

Although the agreement does not require that Credit Suisse provide names of its U.S. clients who had undisclosed accounts with the bank, which was required under the plea agreement made by UBS in 2009, Credit Suisse agreed to:

- Promptly disclose all evidence and information described in Section II.D.I. and II.D.2 of the U.S-Swiss bank voluntary disclosure program, which includes making a complete disclosure of its cross-border activities and providing all information (including the debits and credits on a monthly basis) with respect to its U.S. accounts other than the name of the individual;

- Provide testimony or information for admission into evidence of documents or physical evidence of any criminal or other proceeding as requested;

- Provide all necessary information for the U.S. to draft treaty requests to seek account records and other account information;

- Close accounts of account holders who fail to come into compliance with U.S. reporting obligations;

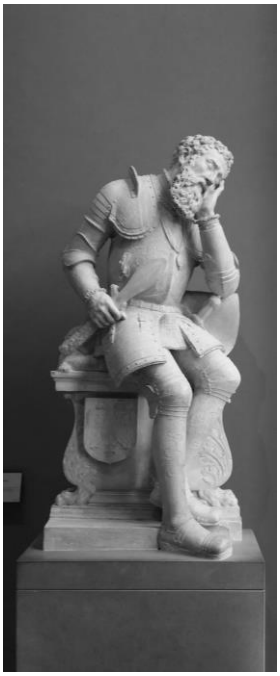
- Implement procedures to ensure compliance with U.S. laws including those under F.A.T.C.A. and relevant tax treaties in all its current and future dealing with U.S. customers.

As such, those with undeclared Credit Suisse accounts should promptly seek the advise of a competent professional.

ISRAEL'S BANK LEUMI AIMS TO AVOID GUILTY PLEA IN SETTLING U.S. TAX PROBE

Bank Leumi Le-Israel Ltd. recently said it is in advanced talks to settle a U.S. investigation into whether it helped Americans evade taxes in a deal that may not include a guilty plea. Israel's second-largest bank said it has set aside 950 million shekels ($275 million) to resolve the problem. Leumi would be the first Israeli bank to settle a tax probe with the Department of Justice. U.S. persons who have deposited funds with the bank may find that their income from those deposits may be disclosed to the U.S. once a final agreement is reached.

Thus, Leumi joins the list of banks which the U.S. Department of Justice has been pursuing with respect to offshore tax evasion. In 2009, UBS AG, the largest Swiss bank, avoided prosecution by paying $780 million and handing over the names of 4,700 U.S. account holders. As noted above, a guilty plea was just secured from Credit Suisse Group AG's main bank subsidiary, along with a $2.6 billion penalty. The Department of Justice has expanded its enforcement actions to banks outside of Switzerland in recognition of the fact that non-Swiss banks and other financial institutions have also played an active role in aiding U.S. persons in avoiding U.S. taxes. The Leumi case is evidence of one such situation, but it will not be the last with efforts expanding in Israel, India, and elsewhere around the world.



TAX 101:
TAXATION OF FOREIGN TRUSTS

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Tag
Foreign Trusts

INTRODUCTION: WHAT IS A FOREIGN TRUST?

In General

A trust is a relationship (generally a written agreement) created at the direction of an individual (the settlor), in which one or more persons (the trustees) hold the individual's property, subject to certain duties, to use and protect it for the benefit of others (the beneficiaries). In general, the term "trust" as used in the Internal Revenue Code (the "Code") refers to an arrangement created either by a will or by an *inter vivos* declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts.[50]

Trusts can be characterized as grantor trusts or ordinary trusts. Ordinary trusts can be characterized as simple trusts or complex trusts; U.S. tax laws have special definitions for these concepts. A simple trust is a trust that is required to distribute all of its annual income to the beneficiaries. Beneficiaries cannot be charitable. A complex trust is an ordinary trust which is not a simple trust, *i.e.*, a trust that may accumulate income, distribute corpus, or have charitable beneficiaries.[51] Ordinary trusts are "hybrid" entities, serving as a conduit for distributions of distributable net income ("D.N.I."), a concept defined in the Code,[52] to beneficiaries and receiving a deduction for D.N.I. distributions, while being taxed on other income (*e.g.*, accumulated income, income allocated to corpus).

A trust can be domestic or foreign. This article will focus on the U.S. tax consequences with respect to "foreign grantor trusts" ("F.G.T.") and "foreign nongrantor trusts" ("F.N.G.T.").

Foreign Trusts

A trust other than a domestic trust is considered a foreign trust. [53]

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50 Treas. Reg. §301.7701-4(a).

51 Simple trusts are governed by Code §651 and §652. Complex trusts are governed by §661 and §662.

52 Code §643.

53 Code §7701(a)(31)(B).

A trust will be considered domestic if: [54]

- A U.S. court can exercise primary supervision over trust administration (the "court test"); and
- One or more U.S. persons have the authority to control all substantial trust decisions (the "control test").[55]

U.S. TAXATION OF FOREIGN TRUSTS

Once a determination has been made that a trust is foreign, an analysis must be made as to whether the trust is a grantor trust or a nongrantor trust.

Foreign Grantor Trust

A trust established by a nonresident alien person will be characterized as a grantor trust only if: [56]

- The trust is revocable so that the power to be revested absolutely in the title to the trust property is exercisable solely by the grantor without the approval or consent of any other person or with the consent of a related or subordinate party who is subservient to the grantor; or
- The amounts distributable during the life of the grantor are distributable only to the grantor and/or the spouse of the grantor.

If a nonresident alien that is treated as a grantor of an F.G.T. subsequently ceases to be so treated (*e.g.*, by amending the trust instrument removing the grantor's right to revest in himself title to the property transferred and/or by allowing beneficiaries other than the grantor and spouse to enjoy trust income), the grantor is treated as having made the original transfer to the foreign trust immediately before the trust ceases to be treated as owned by him.[57]

"A foreign grantor trust will generally become a foreign nongrantor trust upon the death of the grantor."

Note that if a foreign grantor trust has a U.S. beneficiary, the U.S. beneficiary will be treated as a grantor of a portion of the trust to the extent such beneficiary has made (directly or indirectly) transfers of property to the foreign grantor other than in a sale for full and adequate consideration.[58]

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54 Code §7701(a)(30)(E).

55 See examples of circumstances meeting the control test in Treas. Reg. §301.7701-7(d)(1)(v).

56 Code §672(f)(2).

57 Treas. Reg. §1.679-5(a)(1).

58 Code §672(f)(5). Any gift shall not be taken into account to the extent the gift would be excluded from tax under Code §2503(b).

A foreign grantor trust will generally become a foreign nongrantor trust upon the death of the grantor.[59]

When a trust is treated as an F.G.T., the property owned by the trust will be treated as owned by its foreign grantor. This will result in the income of the trust being taxed to the foreign grantor (*i.e.*, the person who made a gratuitous transfer of assets to the trust). The grantor will not be taxed by the U.S. on foreign sourced income, but certain U.S. sourced investment income will be subject to withholding tax and income effectively connected with a U.S. trade or business will be subject to U.S. income tax. Distributions to U.S. beneficiaries (other than the grantor) by an F.G.T. will generally be treated as nontaxable gifts but may be subject to U.S. tax reporting as explained below.

Special Rules with Respect to Foreign Trusts

- U.S. Grantor – Foreign Trust

  If a U.S. person transfers property directly or indirectly to a foreign trust and the trust has a U.S. beneficiary, the trust will generally be treated as a grantor trust.[60]

  If a foreign trust first has a U.S. beneficiary after it has been in existence for some time (*e.g.*, because an alien beneficiary becomes a U.S. resident), any U.S. person who transferred property to the trust will be treated as the owner of a portion of the trust attributable to such property for any year in which there is a U.S. beneficiary. As a result, such U.S. person will be taxed on (i) the income attributable to the transferred property for that year and (ii) the undistributed net income ("U.N.I.") at the close of the preceding taxable year that is attributable to the transferred property, if the only reason such U.S. person was not taxed on such income in the preceding taxable year was that there was no U.S. beneficiary at that time.[61]

- Foreign Grantor Becoming a U.S. Person

  If a nonresident alien becomes a U.S. resident within five years after directly or indirectly transferring property to a foreign trust, the transfer will be treated as if it occurred on the residency starting date.[62] The property deemed transferred to the foreign trust on the residency date includes the U.N.I. attributable to the property deemed transferred. The U.N.I. for

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59 If the trust was an irrevocable trust that allowed for distributions to be made only to the grantor or spouse during their lifetime, the trust would become a nongrantor upon the death of the grantor. However, if the trust deed allowed the spouse, upon death of the grantor, to appoint the trust assets to any person, including the spouse, the trust will still be treated as a foreign grantor trust, only the grantor will now be the spouse.

60 Code §679(a)(1).

61 Code §679(a)(1) and (b).

62 Code §679(a)(4). For a definition of the residency starting date for foreign nationals becoming U.S. residents under the different tests see Code §7701(b)(2)(A).

periods before the residency starting date is taken into account only for purposes of determining the amount of property deemed transferred.[63]

- Domestic Trusts Becoming Foreign Trusts

  If a U.S. citizen or resident transferred property to a domestic trust that subsequently becomes a foreign trust, the transferor (if then living) is deemed to transfer the portion of the trust that is attributable to the transferred property to a foreign trust.[64] Transfers to foreign trusts that are not taxed as grantor trusts are taxable transactions on which the transferor recognizes gain but not loss.[65]

Reporting Obligations with Respect to a Foreign Grantor Trust

An F.G.T. that does not make any distributions to U.S. beneficiaries does not have any reporting obligations for that taxable year. For the taxable year of a distribution to a U.S. beneficiary, a trustee of an F.G.T. is obligated to provide the beneficiary with a "Foreign Nongrantor Trust Beneficiary Statement."[66] Among other things, the statement provides a description of the property distributed and its fair market value, as well as a statement permitting the I.R.S. or the beneficiary to inspect a copy of the trust's permanent books of account, records, etc.

A U.S. person who receives a distribution from an F.G.T. must include Form 3520 (*Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*) with his or her tax return if the distribution is in excess of $100,000.[67]

Foreign Nongrantor Trust

Any foreign trust that does not meet the definition of a grantor trust is a foreign nongrantor trust. An F.N.G.T. is taxed as if it were a nonresident, non-citizen individual who is not present in the U.S. at any time.

The F.N.G.T. will not be taxed on foreign sourced income, but certain U.S. sourced investment income and income effectively connected with a U.S. trade or business will be subject to U.S. withholding tax or income tax. Note that the "net investment income tax" (known as the "Obamacare tax") does not apply to nonresident non-citizens, and therefore, does not apply to an F.N.G.T. However, certain distributions made to U.S. beneficiaries will be subject to this tax.[68]

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63 Code §679(a)(4)(B).
64 Code §679(a)(5).
65 Code §684. Treas. Reg. §1.684-1(a).
66 Although the trust is a grantor trust, it is appropriate for the trustee to provide a Foreign Nongrantor Trust Beneficiary Statement, as the purpose of the statement is to coordinate the U.S. income tax treatment of U.S. grantors and U.S. beneficiaries of grantor trust to ensure that at least one level of tax is paid.
67 Code §6048, §6677.
68 Treas. Reg. §1.1411-3(b)(1)(viii).

A U.S. beneficiary will be subject to tax on D.N.I. distributions received from the F.N.G.T., the character of which will reflect the character of income as received by the F.N.G.T. A foreign trust is required to include net capital gain income in D.N.I.[69]

If a F.N.G.T. accumulates its income and distributes the accumulation to U.S. beneficiaries in later years, those beneficiaries will be subject to the "throwback rules" if distributions are in excess of the current year D.N.I. The throwback rules generally seek to treat the beneficiary as having received the income in the year it was earned by the trust, using a relatively complex formula. A late payment interest is then applied. Furthermore, such throwback distributions will be taxed as ordinary income regardless of their characterization at the hands of the trust. Note that the throwback rules will not apply to amounts accumulated when the trust was a F.G.T.

Reporting Obligations with Respect to a Foreign Nongrantor Trust

As mentioned above, the trustee is required to provide the beneficiaries with a Foreign Nongrantor Trust Beneficiary Statement. In this case, the statement will also include the D.N.I. for the taxable year, the year(s to which an accumulation distribution is attributed, and the amounts allocable to each year.

Distributions to a U.S. beneficiary made from an F.N.G.T. are reported on Form 3520 regardless of the amount.

PLANNING SUGGESTIONS

Foreign persons have several planning opportunities:

Assuming all assets are non-U.S. situs assets (for estate tax purposes), establishing a foreign grantor trust (with a power to revoke) for the benefit of grantor's family members (including U.S. beneficiaries) may be advisable. It is important to domesticate or decant such trust upon the death of the foreign grantor to avoid the application of the throwback rules.

Another planning alternative is to establish a U.S. dynasty trust for the benefit of U.S. beneficiaries and descendants. In this case, the assets transferred to the trust may include U.S. stocks and securities (not subject to U.S. gift tax as intangible property).

Finally, if the grantor plans to immigrate into the U.S., establishing a U.S. (domestic) "drop off" trust prior to immigrating (*i.e.*, prior to establishing a U.S. domicile) may be advisable.[70]

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[69] Code §643(a)(6)(C). This differs from the treatment of a domestic trust's D.N.I., which does not include capital gains. Capital gains of a domestic trust are generally taxed to the trust.

[70] Note that under Code §679, the trust will be treated as a grantor trust.

CORPORATE MATTERS:
BREAKING UP SHOULDN'T BE SO HARD TO DO

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Tags
Corporate
Contract Law

We have found that clients typically have to be persuaded to think about what will happen if a commercial relationship does not work out. In this issue we will discuss break up provisions and what you should look for when entering a business relationship or other form of contractual obligation.

The problem of what happens if a relationship does not work out as planned can arise in many different legal contexts: (i) Landlord/Tenant – in some instances matters concerning lease renewal are not determined when the lease is signed, but rather, they are negotiated at the expiration of the term; (ii) Joint Venture/Partnerships – many joint ventures or partnership are set up in ways that make deadlock a distinct possibility; (iii) General Contracts – either party to a contract can breach the terms and conditions; (iv) Marriage Contracts – apparently 50% of these are breached by one of the parties (the cleanest resolution of these breaches one governed by a pre-nuptial agreement). When everyone is in a good mood the assets are divided, even when the last thing on anyone's mind is the division of assets.

In many ways, the issue turns on whether you want a court or arbitrator to decide on a major dispute that has arisen in a business relationship. Delaware law, for example, provides for judicial dissolution upon application by a member or manager of a limited liability company in circumstances where it is not reasonably practicable to carry on the business in conformity with a limited liability company agreement.[71] A shareholder in a 50/50 Delaware corporation has a similar right,[72] although the standards are different. If the documents governing your relationship are silent or do not sufficiently cover dispute resolution, you could be left in the situation where a judge or arbitrator you don't know is deciding how to resolve a dispute between you and someone you do know – or at least you thought you did – and nobody should want that.

Obviously, due to the costs and time involved, it is a good idea to keep disputes out of court. When this cannot be completely achieved, we often advise clients to include an arbitration provision in governing documents where possible. If, as a last resort, an outside party is needed to resolve a dispute, arbitration is usually more cost efficient and timely. An expert in the field can be chosen and while it is still not entirely desirable to have someone else decide on the point, an arbitrator with

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[71] Delaware Limited Liability Company Act, DEL CODE ANN. tit. 6, §18-802.
[72] Delaware General Corporation Law, §273

industry experience may at least deliver a result that the parties can live with. The parties can choose an arbitrator at the outset or insert mechanisms in the agreement governing selection. If the parties cannot agree on an arbitrator, they may each choose one and have those two arbitrators select an impartial arbitrator.

The scope of the arbitration can also be limited in a number of ways. An example of this is known as "Baseball Arbitration," where the dispute may involve the determination of a "Fair Market Price" or "Fair Market Rent." The arbitration will be set up such that each party submits a written proposal, and, following a hearing, the arbitrator will choose one of the submitted proposals without modification.

Provisions can be included to limit possible areas of conflict. Transfer restrictions are an efficient way of doing this. A party that has made the decision to discontinue in a joint venture may decide to sell its interest. Depending on whom the purchaser is to be, this can lead to conflict. To avoid one party being in partnership with someone it considers undesirable or maybe even a competitor in another business, a selling party should be obligated to offer its co-venturer a "Right of First Refusal" on the interest being sold. If a party receives a bone fide offer to purchase its interest from an independent third party, his co-venturers should have the right to purchase the interest for the same consideration being offered. This enables a dissatisfied partner to leave the venture while enabling the remaining partners to potentially maintain their existing level of ownership. A similar method, not involving a proposed sale, is to insert predetermined actions in an agreement that will be considered "triggers," giving rise to the other party having a call option, at a predetermined price, on the interest of the party initiating the trigger. This, however, can be somewhat punitive and may result in the party initiating the trigger selling at a discounted price.

"Another method of resolving a deadlock that is a client favorite (more for its name than the result, as it favors deep pockets) is a Shotgun Buy/Sell."

Another method of resolving a deadlock that is a client favorite (more for its name than the result, as it favors deep pockets) is a Shotgun Buy/Sell. A party can initiate this buy/sell procedure in the event of a deadlock (deadlock events will be defined) by given notice of to the other party stating the amount the initiating party believes to be the value of the entity. The recipient of the notice at that point is either a buyer or a seller. The mechanics of the sale will be set out in the agreement. The harshness of this procedure can be tempered by having the entity valued by other means, whereby the recipient of the notice receives fair market value rather than a price determined by the partner initiating the procedure.

If this or any exit provision is included in the governing documents, the parties should consider and decide whether it is their intention that such remedy be exclusive and preclude a party from seeking judicial dissolution. There have been cases where the courts have judicially dissolved an entity notwithstanding the fact that the parties had specifically negotiated a buy/sell provision.[73] The court's reasoning was that the exit provision did not purport to be an exclusive remedy (*i.e.*, it did not require a dissatisfied member to break an impasse by using the exit provision rather than a suit for dissolution).

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[73] See *Haley v. Talcott 864 A.2d 86 (Del. Ch. 2004)*.

Where there is a deadlock, the buy/sell arrangement is probably the best solution. It allows one of the partners to continue the business, does not force the partners to continue the business notwithstanding the disagreement, and provides the departing partner with a fair value for his ownership interest.

It is also important for any exit provision to take into account other aspects of the business. For example, in the *Haley* case, the parties were 50/50 owners of the limited liability company and co-guarantors of the company's debt. The exit provision was silent as to the treatment of the debt if the buy/sell procedure was initiated. The court used this as another reason to bypass the exit provision and judicially dissolve the company.

In summary, whenever one is entering into a business venture consideration should be given to how to break a deadlock. If exit mechanisms are clearly worded and take into account all aspects of the parties' business, resorting, or being subject to, judicial dissolution with all its inherent costs and uncertainties can be avoided.

F.A.T.C.A. 24/7

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Tag
F.A.T.C.A.

I.R.S. PUBLISHES 1ST F.F.I. LIST

On June 2, implementation of the Foreign Account Tax Compliance Act ("F.A.T.C.A.") reached another milestone. On that date, the I.R.S. published its first list of foreign financial institutions ("F.F.I.'s") that have registered with the I.R.S. to show intent to comply with F.A.T.C.A. and have received a Global Intermediary Information Number ("G.I.I.N.") to document that compliance. The I.R.S. list is important since U.S. withholding agents who are being asked by F.F.I.'s not to remit the 30% withholding tax imposed under F.A.T.C.A. must first obtain a G.I.I.N. from the F.F.I. and then confirm on the I.R.S. published list that the G.I.I.N. is accurate and in full force.

More than 77,000 F.F.I.'s appear on this first list and include foreign affiliates of some of the U.S.'s largest financial institutions. Among those financial institutions are Bank of America, JPMorgan Chase, Merrill Lynch, and Franklin Templeton.

Withholding agents and others looking to search the website are given three options. First, the G.I.I.N. of an F.F.I. can be entered to see if it is accurate and has not been revoked. Second, the name of the F.F.I. can be entered. If the full name of the F.F.I. is not known, the website allows entry of part of the name and will then show all F.F.I.'s whose name includes the entry so that the desired F.F.I. can then be found. Third, the website allows entry of the country of the F.F.I. or its branch; this list will produce the most options, requiring the most review.

The website will now be updated each month to add the names of new F.F.I.'s that agree to participate in the F.A.T.C.A. program or are registered deemed compliant F.F.I.'s that fit within one of the exceptions to full compliance. The list will also be updated to remove the names of any F.F.I. whose F.A.T.C.A. compliant status may have been lost.

I.R.S. UPDATES F.A.T.C.A. FAQS

On May 29, the I.R.S. updated its F.A.T.C.A. FAQs by addressing the protocol for a taxpayer whose registration under F.A.T.C.A. is put into "registration under review" status. The I.R.S. said if a taxpayer's registration status is noted as being under review, the taxpayer should contact e-Help at 866-255-0652 and indicate that status. In addition, the taxpayer should provide the name of the financial institution and its F.A.T.C.A. identification and the name, telephone number, and e-mail address of either the F.A.T.C.A. responsible officer or a point of contact.

NEW I.G.A. COUNTRIES ADDED

The, Antigua and Barbuda, Belarus, Azerbaijan, Barbados, Georgia, Liechtenstein, New Zealand, Paraguay, Seychelles, Solvenia, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines, Turkey, Turkmenistan, Turks and Caicos Islands, United Arab Emirates, have entered into intergovernmental agreements ("I.G.A.'s") or I.G.A.'s in substance under F.A.T.C.A. The countries listed above, except Paraguay which signed a Model 2 I.G.A. in substance, agreed to Model 1 I.G.A.'s or Model 1 I.G.A.'s in substance.

At this time, the countries that are Model I partners by execution of an agreement or concluding an agreement in principle are:

Antigua and Barbuda
Belarus
Australia
Azerbaijan
Bahamas
Barbados
Belgium
Brazil
British Virgin Is.
Bulgaria
Canada
Cayman Islands
Colombia
Costa Rica
Croatia
Curacao
Czech Republic
Cyprus
Denmark
Estonia
Finland
France
Georgia
Germany
Gibraltar
Grenadines
Guernsey
Hungary
Honduras
India
Indonesia
Ireland
Isle of Man
Israel
Italy
Jamaica
Jersey
Kosovo
Kuwait
Latvia
Liechtenstein
Lithuania
Luxembourg
Malta
Mauritius
Mexico
The Netherlands
New Zealand
Norway
Panama
Peru
Poland
Portugal
Qatar
Seychelles
Singapore
Slovak Republic
Slovenia
St. Kitts and Nevis
St. Lucia
St. Vincent and the Grenadines
South Africa
South Korea
Spain
Sweden
Romania
The U.K.
Turkey
Turkmenistan
Turks & Caicos Is.
UAE

The countries that are Model II partners are: Armenia, Austria, Bermuda, Chile, Hong Kong, Japan, Switzerland, and Paraguay.

UPDATES AND OTHER TIDBITS

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Tags
Corporate Tax
Partnership Tax
Foreign Tax Credit

SUPPORT FOR PROPOSED BILLS LIMITING CORPORATE INVERSIONS WEAK GIVEN DESIRE FOR FULL INTERNATIONAL TAX OVERHAUL

The Stop Corporate Inversions Act was introduced in the Senate on May 20 by Senator Carl Levin. The bill represents an attempt to tighten U.S. tax rules preventing so-called "inversion" transactions, defined generally as those involving mergers with an offshore counterpart. Under current law, a U.S. company can move its headquarters abroad (even though management and operations remain in the U.S.) and take advantage of lower taxes, as long as at least 20% of its shares are held by the foreign company's shareholders after the merger. Under the bill, the foreign stock ownership for a non-taxable entity would increase to 50% foreign-owned stock. Furthermore, the new corporation would continue to be considered a domestic company for U.S. tax purposes if the management and control remains in the U.S. and at least 25% of its employees, sales, or assets are located in the U.S. The Senate bill would apply to inversions for a two year period commencing on May 8, 2014. A companion bill (H.R. 4679) was introduced in the House which would make the changes permanent. However, the bills face opposition on the Hill with lawmakers indicating that the issue could be better solved as part of a broader tax overhaul. House Republicans favored pushing corporate tax rates lower as opposed to tightening inversion requirements, believing that the lower rates would give corporations an incentive to stay in the U.S. and invest, rather than go overseas for a better corporate tax rate. Senate Finance Committee Chairman Ron Wyden (D-Ore.) stated that he would consider the issue at a later time during a hearing on overhauling the international tax laws but would not introduce anti-inversion legislation nor would he sign onto the Levin bill. We agree that any changes to the inversion rules should not be made in isolation but as part of an overall rationalization of the U.S. international tax system.

G.A.O. REPORT QUESTIONS FOREIGN EARNED INCOME EXCLUSION

Government Accountability Office ("G.A.O.") released a report on May 20, which considers retaining, modifying, or eliminating the foreign earned income exclusion ("F.E.I.E."). Questioning the merit of the F.E.I.E. the G.A.O. said it is unclear that the continued tax relief for the relatively small population of U.S. citizens living and working abroad positively benefits the overall well-being of the United States population. Perhaps more importantly, the report cites a Joint Committee on Taxation estimate that eliminating F.E.I.E. would increase federal revenue by $6.8 billion in 2014 and $89 billion from 2013 to 2023, although one could argue the net

economic effect of taxing all foreign earned income is uncertain. Currently, U.S. taxpayers working abroad may claim the exclusion under Section 911 to reduce taxable income up to an amount of $99,200 for 2014.[74]

I.R.S. CLARIFIES PROPOSED REGULATIONS ON PARTNERSHIP RECOURSE LIABILITIES

The I.R.S. has issued a correction to proposed regulations on partnership recourse liabilities,[75] which focus on the allocation of economic risk of loss among partners. The section clarifies that special rules applicable when an entity is structured to avoid related-person status will not be changed. Accordingly, under Treasury Reg. § 1.752-4(b)(2)(iv), which will be re-numbered as Treasury Reg. § 1.752-4(b)(4), a partner will continue to be treated as holding another entity's interest as a creditor or guarantor to the extent of the partner's or related person's ownership interest in the entity where the entity has lent to the partnership.

U.S. AND CANADA DEVELOPING "BEST PRACTICES" DOCUMENT

The I.R.S. and the Canada Revenue Agency ("C.R.A.") are developing a "best practices" document setting out agreed procedures for handling competent authority matters under the Canada-U.S. Tax Convention, a C.R.A. official said at the International Fiscal Association held in Toronto last month. The document will provide "very specific, practical things" that the U.S. and Canadian competent authorities will agree to, continually allowing improvement and efficiency between the parties. It will echo the parties' common understanding regarding the management of the U.S.-Canada mutual agreement procedure and advance pricing workload, including issues such as arrangements for negotiation meetings, exchange of documentation and coordination of interviews with taxpayer. The documents are treated as internal working documents and have not been publicly released. We welcome any potential improvements in the competent authority process, particularly given the significant number of cross-border U.S.-Canadian issues and related provisions of the U.S.-Canada Income Tax Treaty and Protocols that are specific to U.S.-Canada cross border transactions.

B.E.P.S. INTANGIBLE TRANSFER PRICING AND DEBT/EQUITY ISSUES ARE SEPARATE CONCERNS

In a comment of note, Branch Chief Christopher Bello, of the I.R.S. Office of Associate Chief Counsel (International) Branch 6, stated at a June 4th symposium that debt/equity characterization issues should be outside the scope of the O.E.C.D. project on transfer pricing of intangibles. Bello stated that if countries

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[74] Full text of the GAO report can be found at http://www.gao.gov/assets/670/663322.pdf.

[75] Proposed Regulations can be found at REG-136984-12, RIN 1545-BL21.

decide debt/equity characterization is an issue of concern to be dealt with internationally it could be targeted as a legitimate B.E.P.S. concern but that it did not need to be dealt with within the context of the arms-length principles of transfer pricing. We agree. The O.E.C.D. B.E.P.S. transfer pricing initiatives already have threshold issues on the table that could significantly change the transfer pricing landscape, such as positions with respect to allocation of income based on commercial risks and rewards of intangible property, country by country reporting, maintaining or perhaps re-defining the arms-length standard, etc. At this moment it is wise to allow taxpayers to choose how they finance their operations, by debt or equity, under existing rules.

B.E.P.S. INTANGIBLE TRANSFER PRICING CONT.

At the same June 4th symposium, the Treasury's Deputy Assistant Secretary for International Tax Affairs, Robert Stack, announced that according to the O.E.C.D. B.E.P.S. intangible property transfer pricing position, with respect to intangible-related returns, "capital gets a return once all the functions, assets and risks get an appropriate return." As far as the U.S. Treasury is concerned, this point is crucial to proper application of the arms-length standard, as defined by the U.S. government, and has apparently put the U.S. at odds with some trading partners, for whom it would effectively eliminate any intangible property profit at the source of the capital (think the Bermuda "cash box" paradigm, or as Mr. Stack described it, "two men and a dog"). The end result, according to Mr. Stack, will be an emphasis on functions and risks, recognizing that proper application of the arms-length standard can allocate profit to the source of the capital. We agree with the U.S. position in this regard and Mr. Stack's concern that the O.E.C.D. approach to intangible property transfer pricing and allocation of profits could get overly political. This would result from efforts by individual countries to allocate as much income as possible to their respective jurisdictions under the view of their own significance in contributing to the overall profitability of the intangible property. As to the Bermuda "cash box" paradigm, Mr. Stack indicated this might be dealt with under the auspices of the transfer pricing "special measures" consideration. This will have to be closely monitored as the "special measures" consideration has raised concerns in the worldwide taxpaying community.

TAXPAYER ADMITS TO CONCEALING $1 MILLION IN SWISS ACCOUNT FROM I.R.S.

In another example of the concerted I.R.S. and Justice Department joint enforcement of international reporting and compliance rules, a U.S. individual has pleaded guilty to willfully failing to file F.B.A.R.'s with the I.R.S. The individual had funds in a secret Swiss bank account that he maintained and controlled at Wegelin & Co., which is now defunct after pleading guilty in January 2013 to separate charges of assisting U.S. taxpayers in maintaining undeclared accounts.[76] The taxpayer opened the account when he was a Russian citizen. He emigrated to the

[76] 03 DTR K-5, 1/4/14.

U.S. in 1984 and obtained U.S. citizenship in 1986. No F.B.A.R.'s were ever filed for the account. According to prosecutors, the taxpayer received $168,000 in cash distributions from his undeclared account in 2010 just before he closed the account and transferred the balance to his wife. The highest value of his account, for F.B.A.R. reporting purposes, was in excess of $1.5 million according to prosecutors. As part of his plea, the taxpayer agreed to $268,000 in back taxes plus more than $750,000 in civil penalties. In addition, sentencing will take place on September 11, 2014.

EX-UBS BANKER PLEADS GUILTY TO AIDING AND ABETTING TAX EVASION

On May 27, 2014, Martin Lack, an ex-UBS AG banker pleaded guilty to aiding wealthy Americans in evading taxes, while avoiding prison in *United States v. Lack*, S.D. Fla., No. 0:11-cr 60184. Lack, a Swiss resident and citizen, worked at UBS until 2002 before he founded his own firm based in Zurich, Lack & Partner Asset Management AG. Lack was charged in an indictment with conspiring from 1993 to 2010 in assisting American clients hide assets from the I.R.S. through accounts first at UBS, then at his firm. The court sentenced Lack to five years of probation and fined him $7,500 in a Fort Lauderdale federal court. In 2011, he was indicted, surrendered to U.S. authorities on October 14, 2013 and pleaded guilty on February 26. Since his indictment, Lack has been cooperating with prosecutors. Lack told U.S. District Court Judge William Dimitrouleas, "I apologize for my conduct and was given an opportunity to make amends," which he states was done to the best of his ability. Mr. Lack assisted many Americans, over a period of 17 years, in evading U.S. taxes by maintaining secret overseas Swiss bank accounts. Not only did Lack persuade Americans to evade U.S. taxes, he "solicited Americans to open undeclared accounts at UBS and cantonal bank because Swiss bank secrecy would conceal their ownership of the accounts," said U.S. prosecutors. Lack is not the first nor will he be the last in this process, as the U.S. government aggressively pursues Americans who have evaded taxes and those who have assisted them. Since 2009, over three-dozen foreign bankers, lawyers, and advisers have been charged. In addition, more than 70 U.S. taxpayers have been accused, and 13 Swiss banks are under criminal investigation by the U.S. government. As a result, 43,000 U.S. taxpayers have avoided prosecution and the possibility of criminal charges by entering into the O.V.D.P., paying taxes owed and penalties. U.S. taxpayers willing to take the risk of evading taxes should think twice, as the I.R.S. continues to aggressively pursue tax evaders with punishments of heavy penalties, interests, and the possibility of jail time.

About Us

We provide a wide range of tax planning and legal services for foreign companies operating in the U.S., foreign financial institutions operating in the U.S. through branches, and U.S. companies and financial institutions operating abroad. The core practice of the firm includes tax planning for cross-border transactions. This involves corporate tax advice under Subchapter C of the Internal Revenue Code, advice on transfer pricing matters, and representation before the I.R.S.

The private client group of the firm also advises clients on matters related to domestic and international estate planning, charitable planned giving, trust and estate administration, and executive compensation.

The tax practice is supported by our corporate group, which provides legal representation in mergers, licenses, asset acquisitions, corporate reorganizations, acquisition of real property, and estate and trust matters. The firm advises corporate tax departments on management issues arising under the Sarbanes-Oxley Act. Our law firm has offices in New York City and Toronto, Canada. More information can be found at www.ruchelaw.com.

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