

Voluntary Disclosure Update for U.S. UBS Clients

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PRACTITIONERS' CORNER

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Because of recent developments, U.S. taxpayers who maintain undisclosed accounts with UBS AG in Switzerland will be required to close their accounts. Many taxpayers are seeking guidance to address U.S. legal and tax issues related to becoming U.S. tax compliant. One way to become compliant with U.S. law while also minimizing U.S. criminal and civil tax exposure is through the Internal Revenue Service's voluntary disclosure program.¹

Background

On July 1, 2008, the U.S. District Court for the Southern District of Florida issued an order approving the issuance of a summons to force UBS AG to disclose to the IRS detailed account information on U.S. taxpayers who allegedly use UBS offshore accounts to conceal assets and avoid U.S. tax reporting. Subject to some exceptions, however, Swiss bank secrecy laws prohibit a bank from disclosing confidential information about private individuals or companies to any third party. If any disclosure is made without consent of the account owner, the disclosing bank would be subject to criminal sanctions under Swiss law.

The competing obligations between Swiss bank secrecy laws and the pending IRS summons create a dilemma for UBS. To balance these obligations, UBS

recently began notifying its U.S. client base that UBS would discontinue providing banking services to its U.S. clients. Although UBS initially indicated that U.S. account owners would have a period of up to two years in which to wind down their accounts, UBS recently decided to accelerate the termination action. During the past few weeks, UBS notified many of its U.S. clients with an account balance of CHF 250,000 or less that their accounts would be terminated in 45 days (if not terminated earlier by the client). We understand that UBS accounts with a balance in excess of CHF 250,000 are also being notified that their accounts will be terminated, but apparently no specific termination period has been set for these larger accounts.

In view of the practical challenges of terminating larger accounts (which generally involve UBS proprietary "managed account" portfolios and "select stock" investments), we understand that UBS will suspend the account termination pending resolution of a U.S. voluntary disclosure proceeding (as discussed below). This policy approach gives U.S. taxpayers (who notify UBS of their intention to undergo a voluntary disclosure) the opportunity to become U.S. tax law compliant before terminating their accounts.²

Program Overview

Under the voluntary disclosure program, noncompliant U.S. taxpayers may initiate contact on a no-names

¹For a detailed description of the requirements for an IRS voluntary disclosure and considerations relevant to the ongoing UBS summons matter, see William M. Sharp Sr. and Larry R. Kemm, "The UBS Summons and IRS Voluntary Disclosure," *Tax Notes Int'l*, Sept. 22, 2008, p. 1043, *Doc 2008-19459*, or *2008 WTD 186-12*.

²A termination of the account with a transfer of the account proceeds to another foreign financial account before a U.S. taxpayer becomes compliant could give rise to additional violations of U.S. law upon movement of the account funds.

basis with the IRS through legal counsel to virtually eliminate the risk of criminal tax exposure and also to resolve all civil tax issues, including tax deficiencies and penalties. Although the voluntary disclosure program is not an amnesty program, and does not in and of itself create any substantive legal rights, the non-compliant U.S. taxpayer may effectively bring closure to all civil and criminal tax exposure for all open non-compliant years by entering into a binding and final closing agreement with the IRS.

The voluntary disclosure program requires the U.S. taxpayer's disclosure to be truthful, accurate, and complete, along with a taxpayer commitment to cooperate with the IRS in determining the correct tax liabilities for the years at issue, as well as making good-faith arrangements to pay the full amount of tax, interest, and agreed-on penalties. The U.S. taxpayer must demonstrate that the income-producing and related activities, including source of funds and use of funds, are associated with legal activities, as opposed to illegal activities or conduct. Of key importance in the context of the UBS summons case, the disclosure must be timely, meaning that the disclosure must be received before the IRS has initiated an inquiry that is likely to lead to the identification of the U.S. taxpayer.

Based on our experience, voluntary disclosures made by U.S. taxpayers affected by the UBS summons should be able to satisfy the "timeliness" requirement. However, the IRS apparently has a list of identified UBS clients whom the IRS Criminal Investigation Division (CI) is either investigating or will likely investigate soon, and thus those appearing on this list will not as a threshold matter qualify for voluntary disclosure treatment (although CI representatives have informally advised us that, depending on the facts and circumstances, even a U.S. taxpayer who is on the list may not necessarily be subject to criminal prosecution and thus voluntary disclosure might be a viable alternative).

Considerations for UBS Cases

Assuming the IRS does not release a national settlement initiative (discussed below), the most prudent voluntary disclosure approach may be the "negotiated walk-through" (aka the noisy route) because of the certainty and binding nature of that method, as opposed to a "Service Center" filing (aka the quiet route).³ However, only after the "legal audit" (noted

³Both voluntary disclosure alternatives are discussed in more detail in the September 22 *Tax Notes International* article referenced in note 1 above.

below) is completed can a decision be made on which voluntary disclosure approach to pursue.

The negotiated walk-through process involves completing all case due diligence (in effect a legal audit), followed by a presentation on a no-name basis to IRS senior representatives, which usually includes a territory manager, IRS legal counsel, an IRS technical or international specialist and, most importantly, a representative from CI (usually the special agent in charge).

In contrast to other typical voluntary disclosure cases, for UBS-affected cases CI will not issue a "clearance" letter until the name and identifying details of the U.S. taxpayers at issue are first given to CI. After the CI clearance letter is issued, legal counsel for the U.S. taxpayer negotiates the final terms and conditions with the IRS Civil Examination Division, including the amount of all taxes and penalties. The terms and conditions are documented in a final and binding closing agreement entered into between the U.S. taxpayer and the IRS.

We understand that the IRS has drafted a national settlement initiative for undeclared UBS account cases. However, we further understand that this initiative is being heavily debated internally within the IRS because officials in the IRS National Office have yet to agree on the appropriate penalty treatment for UBS cases. Although a national settlement initiative has not yet been finalized, we believe that in most cases noncompliant UBS U.S. accountholders would be in a better position if they consider initiating the voluntary process now, rather than waiting for a national settlement initiative to be released (particularly given the time pressure associated with the UBS account termination letters and given that U.S. accountholders who indirectly hold UBS accounts through a Liechtenstein structure may be subject to a U.S. tax information exchange agreement that is in the process of being finalized).

Summary

In view of the UBS policy to "suspend" the completion of account closure under the impending termination letters, affected U.S. taxpayers clearly have a window of opportunity to use the IRS voluntary disclosure process to minimize if not contractually eliminate the criminal tax liability exposure and commensurately to reduce overall penalty exposure, as well as resolve all open prior tax years. ◆