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SPECIAL REPORTS

Representing U.S. Taxpayers in List or Declined UBS Voluntary Disclosure Cases

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This article provides practical guidance to legal and tax counsel representing U.S. taxpayers who maintained accounts at UBS AG and who have not been accepted into the Internal Revenue Service's voluntary disclosure program. This article contains four sections. We first review the events leading up to the creation of both the initial February 18, 2009, list of UBS accounts and account holders handed over to the IRS, and the subsequent August 19, 2009, U.S.-UBS settlement agreement list. We then explore the potential civil and criminal tax penalties to which those on either list are exposed. Thereafter, we review the criminal prosecutions and dispositions already finalized as a result of the U.S. government's UBS investigation. Finally, with the context of the three preceding sections, we provide practical guidance for counsel representing list or declined clients.

The February and August Lists

Key Events in 2009

On February 18, 2009, a list of approximately 250 to 300 American client names was handed over under seal to U.S. government authorities (the authors understand the number is close to 285) under section 9 of the deferred prosecution agreement.[1] If one is on the list, the IRS maintains that a voluntary disclosure submitted by such a person will not be timely, as further discussed below.

On February 19, 2009, the day after UBS entered into a deferred prosecution agreement with the United States, the Department of Justice petitioned the U.S.

[1] *United States v. UBS AG*, U.S. District Court for the Southern District of Florida, Case No. 09-60033 (Feb. 18, 2009). Note that on January 8, 2010, the Swiss Federal Administrative Court (SFAC) in Bern ruled in a 60-page opinion that the Swiss Financial Market Supervisory Authority (known as FINMA) exceeded its authority when FINMA directed UBS on February 18, 2009, to deliver the UBS customer account information to the U.S. government. The Swiss court rejected FINMA's argument that this handover was needed to prevent the bank's insolvency and ensure the stability of the Swiss financial system. *See* Bloomberg News, Jan. 8, 2010, ''Swiss Regulator Broke Law on UBS Client Disclosure,'' http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a8H2FM._kjF4. *See also* http://www.justice.gov/opa/pr/2009/February/09-tax-136.html.

District Court to enforce the IRS's John Doe summons against UBS to produce 52,000 names (and records) of U.S. customers of UBS.[2]

On August 19, 2009, the United States, the IRS, and UBS entered into a settlement agreement (the UBS settlement agreement) to resolve the disputed John Doe summons that was served by the IRS on or about July 21, 2008, on UBS and that was the subject of the action before the U.S. District Court for the Southern District of Florida, Miami Division.[3]

Contemporaneous with the signing of the UBS settlement agreement, the United States and Switzerland entered into a separate agreement (the Switzerland-U.S. agreement) in which the two countries agreed on an information exchange mechanism under article 26 of the Switzerland-U.S. income tax treaty (the treaty request).[4] This resulted in the so-called August 19, 2009, ''4,450'' account holders list.

The treaty request included an annex (as further discussed below) that established criteria for granting assistance under the treaty request — that is, articulating the ''secret sauce'' to determine which of the tens of thousands of UBS account holders would be turned over to the United States. However, the annex was not publicly released until November 17, 2009.[5]

To facilitate and support the information exchange mechanism established by the treaty request, UBS agreed to produce account information to the Swiss Federal Tax Administration (SFTA) on a rolling basis according to the timeline explained below, measured from the time UBS received notice from the SFTA that it had received the treaty request from the United States.[6] The authors understand that substantially all of the 4,450 account holders have been issued notices by UBS that their accounts would be turned over to the SFTA in response to the treaty request.[7]

It is interesting to note that the language of the UBS settlement agreement refers to ''10,000 UBS accounts'' and not specifically to 10,000 account holders. Since many American customers of UBS maintained multiple accounts with the bank, the actual number of accountholders could be substantially less than the 10,000 threshold.

UBS Notice to 4,450 Account Holders

UBS agreed to send notices to U.S. persons whose accounts with UBS were subject to the treaty request in order to inform such U.S. persons that they should designate an agent in Switzerland for the receipt of communications concerning the treaty request as soon as the accounts of those U.S. persons are identified by UBS, as further discussed below.

For those accounts described in paragraphs 2.A.b and 2.B.b of the annex to the Switzerland-U.S. agreement, UBS agreed to send notice to account holders beginning on the date when UBS received notice from the SFTA according to a rolling schedule by the terms of which all such account holders should be sent notice within 90 days.

UBS agreed that the notice would advise the U.S. persons that if they choose to appeal any SFTA administrative decision (authorizing the provision of their

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[2] *United States v. UBS AG*, U.S. District Court for the Southern District of Florida, Case No. 09-20423 (Feb. 19, 2009).

[3] *United States of America v. UBS AG*, Case No. 09-20423-CIV-Gold/McAliley (stipulation of dismissal filed). *See also* C. Mollenkamp, L. Saunders and E. Perez, ''UBC to Give 4,450 Names in Settlement,'' *The Wall Street Journal* (Aug. 19, 2009), http://online.wsj.com/article/SB125068571743342973.html.

[4] *See* http://www.justice.gov/opa/documents/us-swiss-agreement.pdf.

[5] *Id. See also* http://www.financialtaskforce.org/2009/11/17/annex-to-the-swiss-us-agreement-in-ubs-case/. The IRS apparently did not want to tip its hand by disclosing the selection criteria (or as we refer to it in this article, the ''secret sauce'') before expiration of the March 23, 2009, IRS limited amnesty voluntary disclosure program on October 15, 2009. In contrast, the authors understand that under Swiss law such a public release was mandatory before a judicial proceeding may be initiated, thereby producing tension between the two legal systems.

[6] The Switzerland-U.S. agreement provides that UBS send notices to holders of 500 such accounts within 15 days of receiving notice from the SFTA, will send notices to holders of 1,000 additional such accounts within 30 days of receiving notice from the SFTA, will send notices to holders of 1,000 additional such accounts within 45 days of receiving notice from the SFTA, and

(Footnote continued in next column.)

will complete notifying all such accounts identified at that time within 90 days of receiving notice from the SFTA (which apparently has been done). As to submitting cases to the SFTA, within 60 days of the treaty request the first 500 cases must be (and apparently were) submitted by UBS to the SFTA. Within 180 days of the treaty request the remaining cases described in paragraphs 2.A.b and 2.B.b of the annex (as discussed below) to the Switzerland-U.S. agreement must be submitted by UBS to the SFTA. Within 270 days of the treaty request all the remaining cases subject to the treaty request must be submitted by UBS to the SFTA. As a practical matter, providing notice via registered mail to about 4,450 account holders is no easy task, and the authors understand that a considerable number of such account holders may have not received notice due to the unavailability of accurate address data. As discussed further in this article, on January 22, 2010, the SFAC ruled that the Swiss government could not legally turn over the name and file data of a U.S. taxpayer who is on the 4,450 list because such taxpayer had not committed actions that constituted ''tax fraud or the like'' under Swiss law. The UBS 4,450 notice letter can be found at http://www.ubs.com/1/ShowMedia/index/crossborder/johndoesettlement?contentId=171065&name=Notification_Letter.pdf.

[7] Within 60 days of the treaty request, the first 500 cases must be (and apparently were) submitted by UBS to the SFTA. Within 180 days of the treaty request, the remaining cases described in paragraphs 2.A.b and 2.B.b of the annex to the Switzerland-U.S. agreement must be submitted by UBS to the SFTA. Within 270 days of the treaty request, all the remaining cases subject to the treaty request must be submitted by UBS to the SFTA.

account information to the IRS) to the Swiss Federal Administrative Court (SFAC), then such U.S. persons would have an obligation under 18 U.S.C. section 3506 to serve an appropriate notice of the appeal on the U.S. Attorney General. As discussed below, this notice has important U.S. legal implications.

Withdrawal of John Doe Summons

If UBS satisfied its obligations under the terms of the UBS settlement agreement, the IRS agreed to withdraw, with prejudice, no later than December 31, 2009, the John Doe summons that the IRS served on UBS on July 21, 2008, regarding accounts that are subject to such summons but that are not described in and subject to the treaty request.[8]

For accounts covered by both the John Doe summons and the treaty request, the IRS agreed to withdraw the John Doe summons with prejudice on the earlier of the date on or after January 1, 2010, when the IRS has received, subsequent to February 18, 2009, information concerning 10,000 UBS accounts under the treaty request, whether from the IRS's voluntary disclosure practice, from UBS clients' instructions to have UBS or the SFTA provide their account information to the IRS, or from the deferred prosecution agreement; or no later than 370 days from the date of the UBS settlement agreement, which is August 24, 2010.[9]

The 'Secret Sauce'

As a part of the Switzerland-U.S. agreement, which as noted above was entered into contemporaneously with the UBS settlement agreement, the United States and Switzerland agreed to criteria for granting assistance under the treaty request.

The annex sets forth the criteria (or as we call it, the ''secret sauce'') to determine the pool of UBS account holders to which the request for exchange of information applies, even without specific identification of those persons, and the criteria for determining whether conduct falls within the ''tax fraud or the like'' language of the existing tax treaty.[10]

Applicable Individuals

While under the usual request for exchange of information a clear identification of the person or persons concerned is required, the annex considers this requirement satisfied for two generic groups of individuals because of their specifically described wrongful conduct in maintaining accounts at UBS for which no Form W-9 was filed (whether in their name or in the name of an offshore nonoperating company of which they were the beneficial owner).[11]

'Tax Fraud or the Like' Criteria

According to the annex, for U.S. domiciled taxpayers who held and beneficially owned ''undisclosed (non-W-9) custody accounts'' and ''banking deposit accounts,'' ''tax fraud or the like'' includes when there is a reasonable suspicion that the U.S. domiciled taxpayer engaged in the following:

- Activities presumed to be fraudulent conduct under the protocol to the tax treaty,[12] including activities that led to a concealment of assets and underreporting of income based on a ''scheme of lies'' or submission of incorrect and false documents.[13]

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[8]*See* the UBS settlement agreement at http://www.justice.gov/opa/documents/bank-agreement-consent.pdf.

[9]*Id.*

[10]Under article 26 of the Switzerland-U.S. income tax treaty, the competent authorities of the United States and Switzerland will exchange such information as is necessary for the prevention of tax fraud or the like regarding the taxes that are the subject of the convention. The Switzerland-U.S. income tax treaty is available at *Doc 96-27017* or *96 TNI 194-41*. The Switzerland-U.S. income tax treaty was modified by a new protocol (signed by both countries on September 23, 2009), and, among other provisions, the protocol adopts enhanced exchange of information rules based on the OECD's model income tax treaty (article 26). *See* http://www.ustreas.gov/press/releases/tg297.htm. Under the protocol's revised exchange of information provision, Switzerland may not rely on its bank secrecy rules to reject a qualified

(Footnote continued in next column.)

information request by the U.S. regarding a specified taxpayer; however, ''fishing expeditions'' are prohibited. *See also* http://www.reuters.com/article/idUSTRE58M55S20090923.

[11]Annex 1. The specific groups of individuals are:

(i) U.S. domiciled clients of UBS who directly held and beneficially owned ''undisclosed (non-W-9) custody accounts'' and ''banking deposit accounts'' with a balance in excess of CHF 1 million for which a reasonable suspicion of ''tax fraud or the like'' can be demonstrated. However, U.S. persons with accounts of less than CHF 1 million in assets (except those with below CHF 250,000) will also be included in the group of individuals subject to the request for exchange of information if it is established that there were activities that led to a concealment of assets and underreporting of income based on a ''scheme of lies'' or submission of incorrect and false documents. Annex 2.A.a.

(ii) U.S. persons, wherever domiciled, who beneficially owned ''offshore company accounts'' that were established or maintained during 2001 through 2008 and for which a reasonable suspicion of ''tax fraud or the like'' can be demonstrated. Annex 2.B. However, U.S. beneficial owners of ''offshore company accounts'' below CHF 250,000 will not be included in this group of persons, unless there were acts of ''continued and serious tax offense.'' Annex 2.B.a.

[12]According to the protocol to the tax treaty, fraudulent conduct is assumed in situations when a taxpayer uses, or has the intention to use, a forged or falsified document such as a double set of books, a false invoice, an incorrect balance sheet or profit and loss statement, or a fictitious order or, in general, a false piece of documentary evidence, and in situations when the taxpayer uses, or has the intention to use, a scheme of lies to deceive the tax authority.

[13]Annex 2.A.a.

- A ''scheme of lies'' may exist when the beneficial owners used false documents, used related entities or persons as conduits or nominees to repatriate or otherwise transfer funds in the offshore accounts, or used calling cards to disguise the source of trading.[14]
- Acts of continued and serious tax offense for which the Swiss Confederation may obtain information under its laws and practices. The annex sets forth an interpretation of these acts to include when the U.S. domiciled taxpayer has failed to provide a Form W-9 for a period of at least three years, and when the UBS account generated revenues of more than CHF 100,000 on average per annum for any three-year period.[15]

For ''offshore company accounts,'' ''tax fraud or the like'' includes when there is a reasonable suspicion that the U.S. beneficial owners irrespective of domicile engaged in the following:

- Activities presumed to be fraudulent conduct under the protocol to the tax treaty,[16] and activities that led to a concealment of assets and underreporting of income based on a ''scheme of lies'' or submission of incorrect or false documents.[17] In this instance, a ''scheme of lies'' could include when the bank's records indicate that beneficial owners continued to direct and control the management and disposition of the assets held in the offshore company account or otherwise disregard the formalities or substance of the purported corporate ownership.[18]
- Acts of continued and serious tax offense for which the Swiss Confederation may obtain information under its laws and practices. The annex sets forth an interpretation of these acts to include when the U.S. person failed to prove on notification by the SFTA that the person has met statutory tax reporting requirements, and when the offshore company account has been in existence over at least a three-year period and generated revenues of more than CHF 100,000 on average per annum for any three-year period.[19]

The UBS 4,450 Notice Letter

Paragraph 3 of the UBS settlement agreement stipulates that:

> UBS AG agrees to send notices based on currently available contact information to U.S. persons whose accounts with UBS AG are subject to the Treaty Request informing such U.S. persons that they should promptly designate an agent in Switzerland for the receipt of communications concerning the Treaty Request with respect to their accounts as soon as such accounts are identified by UBS.[20]

UBS was further obligated under the agreement to send notification to the first 500 account holders within 15 days of receiving notice from the SFTA that the treaty request had been received. Thereafter, the letters were to be sent on a rolling basis, with the next 1,000 letters dispatched within 30 days of being notified of the treaty request and the following 1,000 letters within 45 days of such notice. The remaining letters were to be sent within 90 days of receiving notice of the treaty request. Under its obligation under the UBS settlement agreement, UBS sent out the first tranche of notices on or around September 10, 2009.[21]

Because the UBS settlement agreement contemplated the turnover of account information for approximately 4,450 account holders, the account holder notification required by the UBS settlement agreement has been informally referred to as the ''4,450 letter.''

Exhibit B of the UBS settlement agreement provided language to be included in the required letters. This language appeared without material difference in the actual letters sent by UBS to U.S. account holders.[22] While the 4,450 letter is on UBS letterhead, it is reasonable to conclude that much, if not all, of what is contained therein was drafted by U.S. attorneys from the DOJ with input from IRS attorneys.

The 4,450 letter advised U.S. account holders of key points, including that:

- the account falls within the parameters of the treaty request made by the IRS;

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[14]Annex footnote 1.

[15]Annex 2.A.b.

[16]*See supra* note 11.

[17]Annex 2.B.a.

[18]Annex footnote 2. The list of ways the beneficial owner can disregard the formalities of corporate ownership include making investment decisions contrary to representations made in the account documentation or in tax forms, using calling cards or special mobile phones to disguise the source of trading, using debit or credit cards to repatriate or pay for personal expenses using assets in the offshore company account, conducting wire transfers or payments from the offshore company's account to accounts in the United States or elsewhere that were controlled by the U.S. beneficial owner or related party, using related entities or persons as conduits or nominees to repatriate or otherwise transfer funds, or obtaining ''loans'' to the U.S. beneficial owner or related party directly from, secured by, or paid by assets in the offshore company's accounts.

[19]Annex 2.B.b.

[20]*See supra* note 8.

[21]*Id.* Note that a substantial portion of the 4,450 notices were sent by UBS after expiration of the March 23, 2009, limited amnesty program on October 15, 2009.

[22]*Id.*

- on request of the account holder, an agent will be appointed in Switzerland to receive official correspondence from the SFTA in connection with its decisionmaking process; and
- in the event that account information is determined by the SFTA to be within the scope of the treaty request and thus to be provided to the IRS, the account holder has the right to appeal the decision to the SFAC.

Most important, the letter warns account holders that under 18 U.S.C. section 3506, pleadings filed in connection with the appeal are required to be served also on the U.S. Attorney General, as further discussed below.[23]

Surge in Applicants

As the first wave of the so-called 4,450 letter was received by U.S. account holders in September 2009, tax practitioners experienced a surge of inquiries regarding participation in the IRS voluntary disclosure program, particularly in light of the October 15, 2009, expiration date of the March 23, 2009, limited amnesty program. Account holders who had previously believed that their account profile would not fall within the scope of the treaty request began to come forward after receipt of notice from UBS.

Timeliness

The IRS has stated that the mere receipt of a 4,450 letter by an account holder would not bar as untimely an otherwise eligible voluntary disclosure. Receipt of notice from UBS therefore is not deemed to constitute awareness that the IRS has come into possession of the account holder's information. However, if the SFTA turns over account information to the IRS, then the timeliness condition will be breached.

Regarding timeliness in the context of those U.S. taxpayers who were turned over to the United States by UBS on February 18, 2009, equitable procedures should be adopted by the DOJ and the IRS for this class of taxpayers. Apparently, only a limited number of the 250 to perhaps 285 taxpayers who were turned over on February 18, 2009, were informed of their ''list'' status before the February 18, 2009, handover date to afford them an opportunity to apply for voluntary disclosure on a timely basis. Those remaining taxpayers who were not notified have been denied an equal opportunity to apply for voluntary disclosure on equitable principles.[24]

If the Swiss Federal Tax Administration turns over account information to the IRS, then the timeliness condition will be breached.

It is generally understood that if any one or more of those ''notified'' account holders filed a voluntary disclosure petition before February 18, 2009, then such a filing would have qualified for voluntary disclosure (and thus would not have been subjected to the DOJ criminal justice review process, with a very possible follow-on criminal tax indictment, as further discussed below).

On the other hand, for those of the 250 to 285 taxpayers who were not notified by UBS before February 18, 2009, such taxpayers were deprived of what was otherwise fair notice. In absence of that notice and assuming such taxpayers voluntarily submitted in good faith a voluntary disclosure application *after* February 18, 2009, then they should be equitably treated as qualifying for voluntary disclosure assuming they made such submission before being notified by either UBS or the IRS and the DOJ.

Given that the entire voluntary disclosure program is based on notions of equity and fair play, and in the case of a UBS turnover client who did not receive notice either from UBS or the IRS/DOJ as being on the list before February 18, 2009 (and indeed were never notified of such status), then it seems fair and appropriate for such client to have one shot to file for voluntary disclosure treatment assuming neither the IRS nor the DOJ already contacted or notified such taxpayer.

The applicable IRS guidance discusses the possibility of not meeting the timeliness requirement for an investigation already under way (and presumably no notification to the taxpayer) as a disqualifying event.[25] However, it seems in the context of the unique UBS situation that it is inequitable for the pool of taxpayers

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[23]The letter also contains several other points including:
- the account holder may complete a form letter to UBS consenting to the disclosure of account information to the IRS;
- the account holder may consent to the transmission of account information by the SFTA to the IRS;
- if the account holder has complied with U.S. reporting requirements in connection with the account, he may authorize the SFTA to request evidence of such compliance from the IRS; and
- the account holder may voluntarily disclose the account to the IRS.

[24]The actual number of February 18 list clients who were given notice of such status is not clear, though the authors concluded that this number probably did not exceed about one-third of the approximately 250 to 285 list account holders.

[25]*See* W. Sharp and L. 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*.

who received UBS notice before February 18, 2009, to have the opportunity to file for voluntary disclosure (before that date) yet at the same time to deprive those U.S. taxpayers the opportunity to submit in good faith a voluntary disclosure application after February 18, 2009, but before they were notified by the IRS or the DOJ, assuming such taxpayers had no knowledge of being on the UBS list.

Even if these unique filings are not treated as valid voluntary disclosure submissions, these cases should nonetheless not be processed under the U.S. criminal justice system, but rather by IRS Civil Exam. Given that the Swiss administrative court recently ruled that the February 18, 2009, ''turn over'' was unlawful, such a civil (as opposed to criminal) resolution seems even more appropriate.

Swiss Court Ruling: The Latest Complication

On January 22, 2010, the SFAC issued an opinion in an appeal by a U.S. taxpayer who received the UBS 4,450 notice that the taxpayer's account was to be turned over to the IRS. The court ruled that that the Swiss government was prohibited from turning over the taxpayer's name and UBS file to the United States because the specific facts of the case did not rise to the level of ''tax fraud or the like.'' The essence of the court's rationale was that ''tax fraud or the like'' requires something more than merely not reporting income to the United States. Since this case involved ''nothing more,'' the court determined an absence of ''tax fraud or the like'' and, thus, no basis for allowing the Swiss government to hand over the account information.

As this article goes to press, the impact of this court ruling is under negotiations between the U.S. and Swiss governments. The Swiss government has publicly stated its intention to negotiate and resolve in an amicable manner the effect of this court decision on the UBS settlement agreement. Obviously, the United States is not pleased with this ruling because even though it only applies to the narrow set of facts of this specific appeal, various sources have indicated that it will apply to at least another couple of dozen cases under appeal, and perhaps more.

The practical impact of this court ruling may be limited, however, as the U.S. government announced it has already received 14,700 voluntary disclosure applications under the now-expired limited amnesty program. Moreover, it is unlikely that too many offshore account holders ''did nothing more'' than not report income. A substantial portion of the noncompliant offshore accounts may have involved trusts, foundations, corporations, and other structures, all of which are likely to be viewed as ''something more,'' that is, evidence of ''tax fraud or the like.'' Thus, at this early juncture, the case appears to be the exception, and not the general rule, to the potential successful use of the Swiss appeals process by U.S. account holders seeking to block turnover of their account records. However, from a policy perspective, it certainly represents a setback to the U.S. government's publicly announced program to combat offshore tax haven abuse. How great a setback it is, and for how long, will most certainly be resolved in the diplomatic negotiations presently under way.

Criminal Tax Penalties

Title 26

Tax Evasion — Section 7201

A charge of criminal tax evasion under IRC section 7201 is the principal statutory weapon used by the IRS's Criminal Investigation division and the DOJ Tax Division to prosecute taxpayers attempting to evade payment of U.S. taxes.[26] Section 7201 provides:

> Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 . . . or imprisoned not more than 5 years, or both, together with the costs of prosecution.[27]

Thus, criminal tax evasion requires:

- the existence of a tax deficiency;
- an affirmative act constituting an evasion or an attempted evasion of tax; and
- willfulness.

Each of these three elements is discussed below.

Since the U.S. tax system operates on an annual accounting basis, the attempt to evade tax for a given tax year is a separate offense from an attempt to evade tax for a different tax year.[28] As a result, separate charges may be brought against a taxpayer for the same violation that occurs in different tax years.

The three principal elements of a section 7201 charge are:

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[26]While we focus on the criminal and civil tax consequences of list cases, other potential non-Title 26 criminal sanctions not covered in this article cannot be ignored. Chief among these concerns is money laundering, under Title 18 U.S.C. sections 1956 and 1957. However, given the fact-specific nature of any money-laundering analysis, and the complexities of defending against such charges, a full explication of the money-laundering issues potentially associated with list cases requires its own article. Suffice it to say for the purposes of this analysis, counsel representing list clients must keep the danger of money laundering and its perilous consequences firmly in mind.

[27]Section 7201. All section references are to the Internal Revenue Code of 1986, as amended.

[28]*United States v. Boulet*, 577 F.2d. 1165, 1167-1168 (5th Cir. 1978).

- *Element No. 1: Existence of a Tax Deficiency*. Tax must be due and owing before a charge under section 7201 may be brought. Courts generally require that the tax due be ''substantial.''[29] Since the term ''substantial'' is subjective, no formula for what constitutes ''substantial'' exists. Consequently, the relevant facts and circumstances in each case will be taken into consideration in making this determination.[30] However, a recent Seventh Circuit case held that ''substantiality'' is not an element of section 7201.[31] The Seventh Circuit held that although many circuits have included substantiality in the elements of section 7201, none of those courts have squarely addressed whether substantiality is an essential element or whether an insubstantial tax deficiency would satisfy section 7201.[32]

- *Element No. 2: Affirmative Act*. Courts have been restrictive in characterizing what acts constitute an attempt to evade taxes. The seminal case on this issue is *Spies v. United States*,[33] in which the Supreme Court addressed whether a taxpayer's failure to file an income tax return was sufficient to constitute an ''attempt'' for purposes of tax evasion. The Court held that mere failure to file a return is insufficient to reach the level of attempt for this purpose, and reasoned that some form of ''willful commission'' in addition to a ''willful omission'' must be present.[34] The court further noted that an ''affirmative willful attempt'' could be inferred from ''any conduct whose likely effect would be to mislead or to conceal.''[35] Such conduct may include keeping a double set of books, making false entries or alterations, false invoices or documents, destroying books or records, and concealing assets or covering up sources of income. The Court has found that filing a false tax return constitutes a sufficient affirmative act to satisfy the requirement under section 7201.[36]

- *Element No. 3: Willfulness*. A finding of criminal tax evasion depends heavily on a concept known as ''willfulness.''[37] The Supreme Court has defined ''willfulness'' as the ''voluntary, intentional violation of a known legal duty.''[38] In proving its case, the government is not required to show that a taxpayer had an evil motive regarding the violation.[39] Rather, it must prove that the law imposed a duty on the taxpayer, that the taxpayer knew of the duty, and that the taxpayer voluntarily and intentionally violated that duty.

Failure to File Return — Section 7203

Criminal ''failure to file'' penalties under section 7203 may apply for the willful failure to file the information required under sections 6038 and 6048 and are therefore in addition to civil penalties assessed under sections 6038 and 6048. According to section 7203, any person required to pay an estimated tax or required to make a return or supply information under section 7203, and who willfully fails to either pay the required tax or make the return or supply information may be fined up to $25,000 or imprisoned up to one year or both.

False Statements — Fraudulent Returns: Section 7206(1)

Under section 7206(1), it is a felony to subscribe a document under penalties of perjury that the person does not believe to be true and correct as to every material matter. The offense occurs if:

- the taxpayer signs a return, statement, or other document under penalties of perjury;
- the return, statement, or other document contained false information regarding a material matter;
- the taxpayer did not believe the material matter was true and correct; and
- the taxpayer acted willfully.

The penalty for violating section 7206(1) is a fine of up to $100,000, imprisonment for not more than three years, or both.

What constitutes a ''material'' matter is an issue of law subject to judicial interpretation.[40] A false statement is material if it ''has a natural tendency to influence, or [is] capable of influencing, the decision of the decisionmaking body to which it was addressed.''[41] A broader test of materiality is whether the item has a natural tendency to influence or is capable of influencing the ability of the IRS to audit or verify the accuracy of the return or a related return.[42]

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[29] *United States v. Anderson*, 319 F.3d 1218, 1219 (10th Cir. 2003), *citing United States v. Mounkes*, 204 F.3d 1024, 1028 (10th Cir. 2000).

[30] *United States v. Nunan*, 236 F.2d. 576, 586 (2d Cir. 1956).

[31] *United States v. Daniels*, 387 F.3d 636 (7th Cir. 2004).

[32] *Id.* at 640.

[33] *Spies v. United States*, 317 U.S. 492 (1943).

[34] *Id.* at 499.

[35] *Id.*

[36] *Sansone v. United States*, 380 U.S. 343, 353 (1965).

[37] Section 7201.

[38] *United States v. Bishop*, 412 U.S. 346 (1973); *United States v. Pomponio*, 429 U.S. 10 (1976).

[39] *Pomponio*, at 12.

[40] *United States v. Taylor*, 574 F.2d. 232, 235 (5th Cir. 1978).

[41] *United States v. Bruno*, 2000 U.S. App. Lexis 29313, *citing Neder v. United States*, 527 U.S. 1, 16 (1999).

[42] *United States v. DiVarcou*, 484 F.2d 670 (7th Cir. 1973).

Fraudulent Returns and Statements — Section 7207

Under section 7207, any person who willfully delivers or discloses to the Treasury secretary any ''list, return, account statement or other document'' that he knows to be false or fraudulent as to any material matter may be fined up to $10,000 or imprisoned up to one year.

Criminal Conspiracy — 18 U.S.C. Section 371

If two or more persons conspire to commit any offense against the United States, or to defraud the United States or any U.S. agency in any manner or for any purpose, and one or more of such persons does any act to effectuate the object of the conspiracy, then each person will be fined $250,000 and/or imprisoned not more than five years.[43]

Note that the conspiracy is a distinct crime from the substantive crime contemplated by the conspiracy; therefore, it is charged as a separate offense.[44]

A *Klein* conspiracy charge (as this charge is commonly labeled) under Title 18 is a conspiracy to frustrate the IRS in ''its lawful information gathering functions.''[45] The government must establish that the members of the conspiracy agreed to interfere with or obstruct one of the government's lawful functions. However, the government does not need to show that the *Klein* conspiracy succeeded or that the government was actually harmed.[46]

The three elements the government must prove to obtain a conviction for conspiracy are:

- an agreement to reach an illegal objective against the United States;
- one or more overt acts in furtherance of the illegal purpose; and
- the intent to commit the substantive offense (that is, to defraud the U.S. government).

Agreement

The essence of a conspiracy is an agreement to commit an unlawful act, but it is not necessary for the government to prove a formal agreement.[47] An understanding among conspirators is sufficient to constitute an agreement.[48] Also, an agreement may be proved through circumstantial evidence or may be inferred from the defendants' actions.[49]

Overt Act

The government must also prove that at least one of the defendants performed an overt act in furtherance of the conspiracy. The overt act does not need to be unlawful, nor does it need to be the substantive offense charged in the indictment.[50] Courts have held that attempting to conceal income constitutes an effort to further the illegal purpose of the parties in satisfaction of the overt act element.[51]

Intent

Finally, the government must prove that the defendant knew of the conspiratorial agreement and voluntarily participated. Acts committed by the defendant that furthered the objectives of the conspiracy are often sufficient to demonstrate that the defendant was a knowing participant.[52]

Reporting Penalties

Legislative Purpose

The Bank Secrecy Act (BSA), officially known as the Currency and Foreign Transaction Reporting Act,[53] is one of the main tools used by the U.S. government in fighting drug trafficking, money laundering, and other serious crimes.[54] The BSA was enacted by Congress to prevent banks from being used as intermediaries in hiding or transferring funds derived from criminal activities.

Obligations to Report

Under the BSA, whenever a U.S. taxpayer has a financial interest in or a signature or other authority over a foreign bank or financial account that meets applicable thresholds, specific disclosure obligations arise. A U.S. person who opens a financial account in a foreign country either directly or indirectly through an offshore corporation, trust, or other entity has an obligation to report the interest in that foreign bank account by filing Form TD F 90-22.1, Report of Foreign

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[43] 18 U.S.C. section 371; 18 U.S.C. section 3571(b)(3).

[44] *Pinkerton v. United States*, 328 U.S. 640, 643-44 (1946) (holding ''conspiracy is a partnership in crime'' distinct from the substantive offense).

[45] *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957).

[46] *United States v. Rosengarten*, 857 F.2d 76, 79 (2d Cir. 1988) (stating that conspiracy need not be successful to be criminal).

[47] *Iannelli v. United States*, 420 U.S. 770, 777 (1975).

[48] *United States v. Acosta*, 17 F.3d 538, 544 (2d Cir. 1994).

[49] *Glasser v. United States*, 315 U.S. 60, 80 (1942) (stating that common purpose and plan may be inferred from ''development

(Footnote continued in next column.)

and collocation of circumstances'') (quoting *United States v. Manton*, 107 F.2d 834, 839 (2d Cir. 1938)).

[50] *Yates v. United States*, 354 U.S. 298, 334 (1957) (''It is not necessary that an overt act be the substantive crime charged in the indictment as the object of the conspiracy''); *United States v. Montour*, 944 F.2d 1019, 1026 (2d Cir. 1991) (''An overt act need not be inherently criminal to support a conspiracy conviction'').

[51] *United States v. Vogt*, 910 F.2d 1184 (4th Cir. 1990) (finding abundant evidence of overt acts by defendant specifically designed to conceal his source of unreported income).

[52] *United States v. Gonzales*, 121 F.3d 928, 935 (5th Cir. 1997) (''The essential elements of a conspiracy may be established by circumstantial evidence'').

[53] Titles I and II of P.L. 91-508, as amended, codified at 12 U.S.C. 1829b, 12 U.S.C. sections 1951-1959, and 31 U.S.C. sections 5311-5330.

[54] *Bank Secrecy Act/Anti-Money Laundering, Comptroller's Handbook*, U.S. Department of Treasury (Sept. 2000).

Bank and Financial Accounts (FBAR). The legal precedent focuses on the beneficial owner of the account assuming some conditions are met.

Foreign Financial Accounts

Form 1040, Schedule B. Part III of Schedule B of Form 1040 contains a question regarding foreign financial accounts, which reads:

> At any time during [the tax year], did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See instructions on back for exceptions and filing requirements for Form TD F 90-22.1.

Civil Penalties. The civil nonwillful penalty for failing to report the existence of an account by filing Form TD F 90-22.1 is up to $10,000.[55] However, the $10,000 penalty will not be imposed if the violation is due to reasonable cause, so long as the amount of the transaction or the balance in the account at the time of the transaction was properly reported.[56]

A *Klein* conspiracy charge is a conspiracy to frustrate the IRS in 'its lawful information gathering functions.'

Also, if a willful violation is found, the $10,000 penalty will be increased to the greater of $100,000 or 50 percent of the account balance.[57] There is no reasonable cause exception for a willful violation.

The IRS may assess this civil penalty at any time before the end of the six-year period beginning on the date of the transaction for which the penalty is assessed.[58] The penalty described above may be asserted for each foreign account and for each year, cumulatively.

Criminal Penalties. The criminal penalty for willfully violating the FBAR reporting requirement is a fine of not more than $250,000, or imprisonment for not more than five years, or both.[59] FBAR prosecutions are brought under Title 31 U.S.C. sections 5314, 5322(a), and 31 C.F.R. section 103.24.

The penalty may increase to a fine of not more than $500,000, or imprisonment for not more than 10 years, or both, if the violation occurs while violating another law of the United States or as part of any illegal activity involving more than $100,000 in a 12-month period.[60]

The criminal statute of limitations for violating this reporting requirement is found in 18 U.S.C. section 3282, which is the catchall statute of limitations provision for violations of U.S. law. Section 3282 provides that:

> except as otherwise expressly provided by law, no person shall be prosecuted, tried, or punished for any offense, not capital, unless the indictment is found or the information is instituted within five years next after such offense shall have been committed.

TD F 90.22-1 and the Willfulness Standard

Both the civil willful and criminal violation penalties require that a violation be ''willful.'' The question thus arises as to what constitutes willfulness on the part of the taxpayer. The Court of Appeals for the Sixth Circuit addressed this issue in *United States v. Sturman*.[61] In that case, the taxpayer was convicted of violating the reporting requirements because he failed to maintain records and file Form TD F 90-22.1. The taxpayer argued that the government did not prove that he was aware of his obligation to file. The court stated that statutory willfulness means a ''voluntary, intentional violation of a known legal duty'' and that willfulness may be inferred from conduct meant to conceal or mislead sources of income or other financial information.[62]

Recent cases have followed the same logic of *Sturman*. More particularly, in *United States v. Tarwater*,[63] the court stated that willful conduct could be inferred through taxpayer conduct, such as handling one's affairs to avoid a record, as well as any other steps that

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[55]31 U.S.C. section 5321(a)(5)(B)(i).

[56]31 U.S.C. section 5321(a)(5)(B)(ii).

[57]31 U.S.C. section 5321(a)(5)(C),(D). This enhanced penalty is applicable to the FBAR violations that occur on or after October 22, 2004, and subsequent tax years. Before the amendment by the American Jobs Creation Act of 2004 (P.L. 108-357, section 821(a), 118 Stat. 1586 (2004)), the penalty was the greater of $25,000 or the maximum account balance during the tax year but not exceeding $100,000, for each unreported account. For an in-depth discussion of the FBAR penalty and its questionable legal support, *see* S. Toscher and B. Lubin, ''When Penalties Are Excessive — The Excessive Fines Clause as a Limitation on the Imposition of the Willful FBAR Penalty,'' *J. Tax Prac. & Proc.*, Dec. 2009-Jan. 2010.

[58]31 U.S.C. section 5321(b).

[59]31 U.S.C. section 5322(a).

[60]31 U.S.C. section 5322(b).

[61]951 F.2d 1466 (6th Cir. 1991).

[62]*Id.* at 1476 (*citing Spies v. United States*, 317 U.S. 492 (1943)).

[63]308 F.3d 494, 506 (6th Cir. 2002).

might mislead or conceal assets. The court pointed out that the taxpayer violated section 7206(1) by concealing information without which the taxpayer could not reasonably believe that his tax return was complete and true.[64] The court determined that such concealment could be taken as an illustration of willful evasion.

Statute of Limitations

Overview

The statute of limitations for criminal tax prosecutions is generally limited to three years following the date on which the offense is committed.[65]

However, a six-year statute of limitations applies to many criminal tax prosecutions, including those involving criminal fraud (whether by conspiracy or not), criminal tax evasion, willful failure to pay tax or file a return, making false statements under penalties of perjury, filing fraudulent tax returns, or engaging in a conspiracy to evade tax.[66]

Anderson Doctrine

In an important development, the Tenth Circuit Court of Appeals held that the normal six-year statute of limitations for potential criminal violations does not expire in cases when the taxpayer engages in ''continuing acts.''[67]

For instance, if a taxpayer fraudulently conceals income that the taxpayer earned from an undisclosed foreign financial account and this concealment continues in subsequent years, then for each year in which this concealment activity occurs, a new six-year statute of limitations arises.

Recent Prosecutions

UBS and Associated Advisers

UBS

UBS was charged by information with conspiracy to defraud the United States and entered into a deferred prosecution agreement on February 18, 2009, the same day the information was unsealed.[68] The DOJ, with support from the IRS, used information gathered in the UBS investigation to bring several follow-on indictments. The following is a summary of the ex-UBS bankers and independent service providers who have been individually charged for their roles in promoting tax evasion schemes to U.S. taxpayers who maintained accounts with UBS.

Bradley Birkenfeld

On April 10, 2008, Birkenfeld (a dual U.S.-Swiss citizen) was indicted by a grand jury on a single count of conspiracy to defraud the United States in violation of 18 U.S.C. 371 for his role in assisting California billionaire Igor Olenicoff to commit acts of tax evasion.[69] Two months later, on June 19, 2008, Birkenfeld pleaded guilty as charged and was sentenced on August 21, 2009, to 40 months in federal prison.[70] This sentence exceeded the recommendation of prosecutors by 10 months and was imposed despite the substantial assistance rendered by Birkenfeld in connection with the government's ongoing investigation into the cross-border business of UBS.

On the date of Birkenfeld's sentencing, DOJ Senior Trial Lawyer Kevin Downing requested that Birkenfeld not be required to report to prison for an additional 90 days. It was anticipated that Birkenfeld would continue to provide assistance in the meantime, and Downing indicated to the court that the government may request a sentence reduction before the postponed turn-in date.[71]

Also, Birkenfeld is claiming a reward under the Internal Revenue Code whistle-blower statute[72] that establishes a mandatory reward for informants when their information leads to the collection of taxes, penalties, and interest when the amount in dispute is in excess of $2 million.[73] Whistle-blowers may be entitled to an award between 15 and 30 percent with no maximum award amount.[74] The IRS Whistle-Blower Office said they received 1,246 claims for 2008 that met the criteria under section 7623(b).[75]

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[64] *Id.* at 506.

[65] Section 6531.

[66] Section 6531(1)-(8).

[67] *United States v. Anderson*, 319 F.3d 1218 (10th Cir. 2003); *see also United States v. Thomas*, 2007 U.S. Dist. LEXIS 84464 (W.D. La. Nov. 14, 2007).

[68] *See* http://www.justice.gov/opa/pr/2009/February/09-tax-136.html.

[69] *See* http://www.justice.gov/tax/usaopress/2008/txdv08_080513-02.pdf.

[70] Erik Larson and Carlyn Kolker, ''UBS Tax Fraud Case Whistleblower Gets 40-Month Prison Sentence,'' Bloomberg, Aug. 21, 2009, *available at* http://www.bloomberg.com/apps/news?pid=20601127&sid=aqRUmD2LzH.E. *See also* http://www.justice.gov/usao/fls/PressReleases/080619-01.html.

[71] *Id*. *See also* CBS, ''60 Minutes,'' Jan. 3, 2009, ''Banking: A Crack in the Swiss Vault,'' *available at* http://www.cbsnews.com/stories/2009/12/30/60minutes/main6038169.shtml. It appears that Birkenfeld's efforts to obtain a reduced sentence failed (at least for the time being), given that he reported to the Schuylkill Federal Correctional Institution in Minersville, Pennsylvania, on Jan. 8, 2010.

[72] Section 7623(b).

[73] *Id.*

[74] *Id.*

[75] David D. Stewart, ''Attorney Sees UBS Reward Claim as Test of Whistle-Blower Policy,'' *Tax Notes Int'l*, Dec. 14, 2009, p. 862, *Doc 2009-26660*, or *2009 WTD 232-2*.

Mario Staggl

Staggl is a Liechtenstein national and resident who was indicted as a codefendant with Birkenfeld for conspiracy to defraud the United States. Staggl worked as an asset manager with New Haven Trust Company Ltd. and is accused of assisting Birkenfeld in facilitating tax evasion on the part of a U.S. citizen and UBS customer, Igor Olenicoff.[76] Staggl has failed to turn himself in and was declared a fugitive by the court on May 21, 2008.[77]

Raoul Weil

In an indictment that was unsealed on November 12, 2008, this former chair of Global Wealth Management at UBS was charged with one count of conspiracy to defraud the U.S. government.[78] Weil has failed to turn himself in on the charge and was declared a fugitive by the court on January 13, 2009 (Weil is neither a U.S. citizen nor resident).[79] Birkenfeld allegedly is credited with providing information leading to the indictment of Weil, although given the unlikelihood that Weil will ever face extradition in his home country of Switzerland, he may never stand trial.[80]

Hansreudi Schumacher

Schumacher (a Swiss national and resident with no U.S. status) was indicted on August 20, 2009, for conspiracy to defraud the United States. A previous UBS banker, he subsequently was an executive manager at Neue Zürcher Bank in Zurich at the time of his indictment. Together with codefendant Matthias Rickenbach, Schumacher is accused of promoting sham offshore entities as a means for U.S. taxpayers to conceal their ownership of assets held in Swiss accounts.[81]

Matthias Rickenbach

Rickenbach (a Swiss national and resident with no U.S. status) was indicted on August 20, 2009, as a co-defendant with Hansreudi Schumacher for conspiracy to defraud the United States.[82]

U.S. Taxpayers Who Were UBS Customers

Igor Olenicoff

Olenicoff was charged by information with filing a false income tax return in violation of section 7206(1) and pleaded guilty on December 12, 2007. His case involved approximately $200 million in assets held offshore through UBS. As part of the plea agreement Olenicoff paid $52,018,460 in back taxes, civil penalties, and interest for the previous six years. Primarily due to his cooperation with the U.S. government (including providing information regarding Birkenfeld),[83] Olenicoff was sentenced on April 14, 2008, to two years probation, a criminal fine of $3,500, and 120 hours of community service.[84]

Steven Michael Rubinstein

In a criminal complaint dated April 1, 2009, Rubinstein was charged with filing a false tax return in connection with the concealment of approximately $6 million in a UBS account that he held through a nominee British Virgin Islands corporation. Rubenstein pleaded guilty on June 25, 2009, and was sentenced on October 29, 2009, to three years probation, including one year of house arrest (despite the government's request for a one-year prison term). The court also imposed a criminal fine of $40,000.[85]

Robert Moran

Moran was charged by information on April 14, 2008, with filing a false income tax return and pleaded guilty on the same date. Moran had maintained more than $3 million in an undisclosed UBS account that was held through a Panamanian entity. On November 6, 2009, Moran was sentenced to two months in prison, having previously paid the $1.9 million in back taxes, civil penalties, and interest.[86]

Jeffrey Chernick

Chernick was charged by information with filing a false tax return on July 14, 2009, and pleaded guilty on July 28, 2009.[87] Chernick was accused of holding approximately $8 million in undisclosed accounts with UBS and other Swiss banks. The accounts were controlled through Hong Kong entities. Having paid back taxes and a $4.5 million penalty as well as providing

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[76] *See* http://www.justice.gov/usao/fls/PressReleases/080619-01.html.

[77] Minute Order, *U.S. v. Mario Staggl*, Case No. 08-60099-CR-Zloch (S.D.Fla. May 21, 2008).

[78] *See* http:www.usdoj.gov/opa/pr/2008/November/08-tax-1001.html

[79] Larson and Kolker, *supra* note 70.

[80] *See United States v. Raoul Weil*, SD Fl. No. 08-60322, DE 7, Order Transferring to Fugitive Status as to Raoul Weil; *see also* ''Ex-UBS Executive Raoul Weil Declared a Fugitive by U.S. Judge,'' Bloomberg News, Jan. 14, 2009, *available at* http://www.bloomberg.com/apps/news?pid=20601087&sid=aSEvhPR7Ok6A&refer=home. Another key U.S. government informant who apparently provided assistance is Martin Liechti, who was detained in Miami on April 21, 2009, but was released after providing cooperation. Haig Simonian, ''Top UBS banker held in U.S. tax probe,'' *Financial Times*, May 7, 2008.

[81] *See* http://www.justice.gov/usao/fls/PressReleases/090820-02.html.

[82] *Id*.

[83] *See* http://www.justice.gov/usao/fls/PressReleases/080619-01.html.

[84] John Gittelsohn, ''No prison time for billionaire in tax case,'' *The Orange County Register*, Apr. 14, 2008.

[85] *See* http://www.justice.gov/tax/txdv09626.htm.

[86] *See* http://www.justice.gov/tax/txdv09344.htm.

[87] *See* http://www.justice.gov/tax/txdv09729.htm.

assistance to the government, Chernick was sentenced to three months in prison followed by six months house arrest.[88]

John McCarthy

On August 14, 2009, McCarthy was charged with willfully failing to file an FBAR in connection with approximately $1 million that he transferred to an account with UBS in Switzerland.[89] McCarthy entered into a plea agreement filed on August 14, 2009, and his sentencing is pending.[90]

Juergen Homann

Homann was charged with willfully failing to file an FBAR and pleaded guilty on September 25, 2009.[91] Homann is accused of concealing approximately $5 million in an account with UBS whose ownership was structured through a Hong Kong corporation. On January 6, 2010, Homann was sentenced to five years probation, fined $60,000, and ordered to perform 300 hours of community service.[92]

Roberto Cittadini

Cittadini was charged by information on October 2, 2009, with filing a false income tax return and pleaded guilty on October 5, 2009.[93] Cittadini was accused of holding almost $2 million in undisclosed Swiss accounts. On January 8, 2010, Cittadini was sentenced to six months of home detention, 200 hours of community service, a $10,000 criminal fine, and one year of supervised release.[94]

Counseling Those Not in the Program

SFAC Appellate Process

Introduction

As noted above, the 4,450 letter puts U.S. account holders on notice of 18 U.S.C. section 3506, an otherwise obscure provision of federal criminal law. It reads in relevant part:

> Any national or resident of the U.S. who submits, or causes to be submitted, a pleading or other document to a court or other authority in a foreign country in opposition to an official request for evidence of an offense shall serve such pleading or other document on the Attorney General at the time such pleading or other document is submitted.[95]

Thus, an appeal to the SFAC of a decision by the SFTA to provide account information to the IRS triggers an obligation to serve any pleadings made in connection with such appeal on the U.S. Attorney General. This requirement effectively eliminates any advantage that otherwise might be gained through the Swiss appeals process.

The relevant legislative history indicates that Congress enacted this provision to assist the U.S. government in obtaining documents, information, and other data in tax favored or tax haven countries.[96] The legislative history also discusses the notification provision in the context of ''certain steps taken in another country to oppose an official request made by the United States for evidence located in that country.''[97] A full discussion of the scope of this section 3506(a) notification provision is beyond the scope of this article.[98] However, it is fair to say in general that the U.S. government will likely interpret section 3506(a) to apply to all objections to foreign treaty requests in all contexts, whether the subject matter pertains to a civil or a criminal proceeding.

In reviewing the limited case law adjudicated under section 3506(a), one may hold that section 3506(a) should not be invoked unless the specific treaty request and objection related thereto relates to a criminal, and not a civil proceeding. Given the broad language of section 3506(a) this position has several weaknesses.[99] Further, at such an early stage of a treaty request and an objection related thereto, it is not clear whether the matter would be treated as a civil or criminal proceeding. Therefore, to posit that section 3506(a) is not applicable on the basis of the absence of a criminal proceeding seems to beg the question of whether such criminal or for that matter civil proceeding is applicable.

This unique provision of U.S. law places the applicable U.S. taxpayer in a Catch-22 in which he is disadvantaged regardless of which option is selected. If, on

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[88] *See* http://www.justice.gov/opa/pr/2009/July/09-tax-729.html.

[89] *See* http://www.justice.gov/usao/cac/pressroom/pr2009/101.html.

[90] *See United States v. John McCarthy*, CD Cal. No. 09-00784, DE 29, Notice of Reassignment of Case.

[91] *See* http://www.justice.gov/tax/txdv091027.htm.

[92] *See* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aU0HWNzA3F7A; *see also* http://www.irs.gov/newsroom/article/0,,id=110092,00.html.

[93] *Id.*

[94] *See* http://www.justice.gov/usao/waw/press/2010/jan/cittadini.html. On February 4, 2010, the DOJ announced the plea agreement with Jack Barouh of Golden Beach, Florida, also stemming from noncompliance UBS activities.

[95] 18 U.S.C. section 3506(a).

[96] H.R. Rep. No. 907, 98th Cong., 2nd Sess. (July 25, 1984).

[97] *Id.*

[98] Also beyond the scope of this article are the potential, but very real, Fifth Amendment implications of a law that requires one holding an offshore account to notify federal law enforcement that he is potentially violating the law, and thus, compels one to become a witness against oneself.

[99] *See* discussion in the relevant legislative history, *supra* note 96.

the one hand, the U.S. taxpayer chooses to seek whatever secrecy protection the Swiss appellate procedure may offer, he is forced to reveal the same secrets directly to the U.S. Attorney General, thus rendering the Swiss appellate process moot. If, however, the U.S. taxpayer elects to file an appeal under Swiss law while ignoring the dictates of U.S. law, he faces potential additional criminal sanctions should the Swiss appeals process prove unavailing and a U.S. prosecution ensues. These additional penalties are explained below.

Contempt of Court

Enacted as part of the Comprehensive Crime Control Act of 1984, section 3506 does not contain its own sanction for noncompliance. Instead, failure to follow its dictates subjects a violator to criminal contempt.[100] Such criminal contempt is punishable by up to six months imprisonment and/or a $1,000 fine under 18 U.S.C. section 402.

Federal Sentencing Guidelines

Of even greater concern is the potential impact that failure to comply with section 3506 could have on a U.S. taxpayer facing prosecution for a noncompliant offshore account. Since 1987 sentences in federal courts have been dictated by the federal sentencing guidelines (the guidelines). Although in 2005 the U.S. Supreme Court[101] ruled that the guidelines are ''advisory,'' and thus sentences calculated under the guidelines are no longer absolutely binding on a district court judge, the guidelines nonetheless still have a substantial impact on sentencing.

One of the many factors considered by the guidelines is ''relevant conduct'' under sections 1B1.3(a) and 3C1.1. In essence, these sections allow the sentencing judge to consider conduct not an element of the offense of conviction (for example, tax evasion), but conduct that is otherwise relevant, such as attempts to avoid detection, or to impede the administrative or judicial process investigating the evasion.[102] When relevant conduct is included in the sentencing calculation, the defendant faces an increase in his ''total offense level'' and, thus, a longer prison term.

Advice of Swiss Counsel

As some of the initial recipients of the UBS 4,450 letter reportedly discussed their options with Swiss legal counsel, it appears that despite the cautionary language of the UBS 4,450 notice letter, the importance and applicability of 18 U.S.C. section 3506 may have been minimized. Indeed, some account holders apparently have been advised by some Swiss advisers to pursue an SFAC appeal while disregarding the requirements of section 3506. Given the potential consequences of failure to comply as set forth above, anyone counseling recipients of a 4,450 letter to ignore the mandate of section 3506 does so at great risk to client and to self.

Analysis

The authors believe most U.S. taxpayers with noncompliant UBS accounts who received a UBS 4,450 letter will not be able to successfully invoke the SFAC appellate review process (in a U.S.-compliant manner) to prevent ultimate disclosure of UBS account information to U.S. authorities.[103] Especially in light of the section 3506 Catch-22 described above, the best practice, absent unusual circumstances, would be to bypass the Swiss appeals process and instead pursue an IRS voluntary disclosure.

Account Records Not Yet in DOJ's Possession

If, as the authors believe, most 4,450 letter recipients cannot prevent disclosure via the SFAC appellate process and at the same time comply with U.S. law, what avenues remain available? For appropriate clients we have adopted a proactive, two-pronged approach.[104] First, despite the expiration on October 15, 2009, of

[100] *See, e.g.*, *Fraser v. United States*, 834 F.2d 911, 914 (11th Cir. 1987). The language of the court in *Fraser* arguably supports the position that section 3506 may be invoked only if associated with the criminal as opposed to a civil proceeding. Although various restrictive arguments may be made regarding the scope of section 3506 as noted in the language of the court, it appears that the primary purpose of the court's discussion was to make it clear that section 3506 could be applicable in the context of a factual situation in which an indictment has yet been issued and the case could actually go either in that direction or possibly revert to a civil proceeding. It is somewhat of a legal stretch to maintain that section 3506 is not a concern on the basis that the proceeding will only evolve into a civil tax proceeding as opposed to a criminal case, particularly given the broad language of section 3506(a) and the legislative intent as noted in this article. It is also plausible that the U.S. government most certainly will argue that section 3506 will apply to these cases, although it is fair to say that the UBS notice letter uses the word ''may'' when determining whether the section 3506 notification obligation may be applicable.

[101] *United States v. Booker*, 543 U.S. 220 (2005).

[102] There is also a possible exposure to one of the many obstruction of justice violations set forth in Title 18, U.S.C. section 1501 et seq. However, since none of these substantive violations fits neatly into the section 3506 fact pattern, and enhancements under the guidelines require a lower evidentiary standard of proof than for establishing substantive crimes, prosecutors are likely to choose the easier (and far more appropriate) way to punish violators offered by a sentencing guidelines obstruction enhancement.

[103] Despite the recent success of the U.S. taxpayer challenging disclosure of his account, we believe this case represents the exception and not the general rule.

[104] We use the term ''appropriate client'' as shorthand to describe a client we believe can withstand the rigors of IRS/CID scrutiny (and avoid an IRS criminal referral to DOJ) via the voluntary disclosure process. Key to determining whether a particular client is appropriate for this approach is a thorough analysis of the underlying facts and circumstances relating to the noncompliant account(s) in question from a criminal law perspective,

(Footnote continued on next page.)

the IRS March 23, 2009, limited amnesty voluntary disclosure program, appropriate taxpayers who receive the UBS 4,450 letter should engage legal counsel in order to apply for voluntary disclosure, supplying the same information in substantially the same manner as under the expired program. This is more than justified because the now-expired limited amnesty voluntary disclosure program was based on long-standing IRS voluntary disclosure policies that did not evaporate on October 15, 2009.

This unique provision of U.S. law places the applicable U.S. taxpayer in a Catch-22.

Surely post-October 15, 2009, voluntary disclosure submissions can anticipate a more punitive schedule of penalties than were offered in the now-expired limited amnesty program. However, if the case otherwise meets the conditions for a qualifying voluntary disclosure, an IRS referral for criminal prosecution should be avoided — a significant benefit. If satisfied that a particular 4,450 letter recipient is ''appropriate,'' in addition to applying for voluntary disclosure, in some cases the practitioner should notify DOJ Tax Division attorneys in writing that:

- counsel represents the particular client, providing full client identification information;
- counsel has applied for voluntary disclosure on behalf of that client, and will cooperate with the IRS as required; and
- request notification on the DOJ's receipt of the client's offshore account records.

This notification letter is an attempt to afford the time to permit IRS review of counsel's voluntary disclosure position particularly if for whatever reason the offshore account records were handed over to the DOJ, and, assuming the voluntary disclosure is declined, offers a chance to be heard in Washington before prosecutorial decisions are set in stone. Again, key to this process is counsel's threshold judgment in evaluating the client and all underlying facts to determine how they will play with both the IRS and DOJ.

Offshore Files in the Hands of the DOJ

Presumption of Indictment

For those list clients whose underlying offshore account records are already in the possession of the DOJ, an indictment will presumably follow. By this stage of the process it is too late to pursue a voluntary disclosure, and thus the matter ordinarily would be referred for indictment to the U.S. Attorney for the judicial district in which the taxpayer files. This does not mean, however, that there is no role for constructive lawyering.

In appropriate circumstances, counsel should be able to convince the DOJ not to pursue an indictment despite this presumption. Based on the reasoning explained below, there are necessarily exceptional cases among the almost 5,000 account holders whose UBS account records have been, or are in the process of being, provided to the U.S. government through the treaty process described above. These exceptions generally fall into the following categories.

First are cases involving the types of human and practical issues that white-collar criminal defense lawyers know quite well. Age, infirmity, difficult or unusual family issues, and de minimus benefit to the prospective defendant are just a few of the kinds of exceptional personal circumstances that can exist. In this regard, counsel can expect to be challenged by DOJ regarding any assertions made, and will in all cases be required to provide supporting and substantiating documentation and information, including an interview of the taxpayer.

Another category consists of technical impediments to tax prosecutions that seasoned tax practitioners can use to build a case that very little if any tax is due and owing. For example, if the offshore structure qualifies for U.S. tax income deferral treatment, and very little (if any) tax is owed, then we may be talking about

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including the client's personal and business history; a determination of how credible a witness he will be if an IRS CID interview is required; the source of income; if offshore structures were used, and if so, the nature of such; the identity of any U.S., Swiss, or other foreign advisers involved; the ability to reconstruct all relevant account information; the method in which deposits were made; how long the account has been in existence; the degree to which the account was accessed; and the relative value of the undeclared account(s) as compared with reported assets. It is only after these and other questions are asked, and the answers filtered through the criminal law prism and accounting for the IRS/DOJ specialized approach to the UBS matter, that such a judgment can safely be made.

Of special concern is the danger that the client may have other potential criminal issues beyond undeclared offshore accounts. For example, an account may have been created by the principal of a business using undeclared money from that business to fund the account. If no other legal violations exist, proactively pursuing a voluntary disclosure is the preferred option. However, that same business may also be involved in making illegal payments to obtain contracts, or employing illegal aliens, or be involved in a host of other illegal activities having very little relevance to the noncompliant offshore activities. Since applying for voluntary disclosure means being scrutinized by an IRS CID agent and promising to cooperate fully with the IRS, the potential exposure of all of these problems looms large. As always, good legal advice is premised on experience and sound judgment. The analysis of how (or even whether) to proceed in light of other, seemingly unrelated criminal law issues is crucial.

avoiding the criminal justice system, despite information reporting noncompliance, for example, failure to properly file the TD F 90-22.1, Form 5471, or Forms 3520/3520-A.

Finally, albeit infrequently, if the subject noncompliant activities were implemented under the taxpayer's reasonable reliance on the advice of legal counsel or a qualified tax return practitioner, and the taxpayer fully complied with such advice, grounds may exist to rebut the presumption of indictment.[105]

There are two keys to potential success in accomplishing the exceptional result of overcoming the presumption of indictment. First, counsel should begin dealing with the DOJ as soon as possible, hopefully before the case has been referred to the appropriate U.S. Attorney's office for indictment. As previously noted, the further the criminal justice process has progressed, the less impact counsel is likely to have. Second, whether the issues counsel stresses are practical or technical, knowing the case thoroughly, accurately assessing your client's ability to be an effective witness on his own behalf, being able to prepare your client to testify before DOJ attorneys, and providing meaningful supporting documentation for your position are all mandatory. If either counsel or his presentation lacks credibility, the client has no chance of avoiding prosecution. ◆

[105]However, this is an inherently dangerous approach, as the advice of counsel defense necessarily involves a waiver of the attorney-client privilege previously enjoyed between the taxpayer and the lawyer whose advice is at issue. The potential pitfalls involved should be obvious. While, as with any defense, an interview of the taxpayer is almost always involved, with advice of counsel, an interview of all attorneys involved in the claimed advice, along with any opinion letters or documents related thereto, are also necessarily in play. For these, and a host of other reasons, the advice of counsel defense is, to say the least, problematic.