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Voluntary Compliance Program

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You may be aware that UBS and other foreign banks are being reported in the press related to Americans with Swiss accounts that fail to report income, or make the necessary disclosures in their tax returns, or fail to file a foreign bank account form TDF 90.22-1. We've been assisting several clients in this area, and wanted to alert you to IRS procedures for resolving this problem in a favorable manner.

As part of the effort to get people "back in the system", the IRS provides a voluntary compliance program that permits taxpayers who have unreported or underreported income in the past to come forth with amended returns to report the proper amount of income with only moderate consequences. The voluntary compliance program can be used in such cases as the UBS matter to alleviate client concerns of criminal penalties and excess civil penalties. While voluntary compliance is not a new procedure, due to the scope and number of US Citizens caught up in the UBS matter, the IRS is looking at ways to make the process as taxpayer friendly as possible to maximize the opportunity to get people back to being tax compliant.

The procedures currently in place:

1. The taxpayer's representative is able to confirm with the IRS whether the taxpayer is currently under investigation or audit, and whether a person's name has been provided by the Swiss authorities to the IRS.
2. Informal confirmation on a no-name basis can be made with a criminal investigation agent that particular facts will not result in a criminal prosecution. For example, merely holding funds in a foreign account and failing to report the income will generally not be considered criminal. However, actively diverting income to a foreign account to avoid it being reported or detected will most likely be considered criminal.
3. Assuming the taxpayer wishes to proceed, a letter of intent with specific facts (full disclosure is required at this time) along with amended returns for either three or six years depending on the circumstances, are forwarded to the IRS for review.
4. Upon receipt of this information, the IRS will review the facts and the returns, either locally or in Philadelphia, and will confirm the final amount due. Typically, tax, interest from the original due date of the return, and a twenty percent penalty for underpayment will be assessed. The penalty can be waived by the IRS if it can be shown that the underpayment is due to reasonable cause as defined in the statute.

With respect to the UBS matter, the Swiss authorities are providing the names of US persons that have accounts in Switzerland. While a US person's name may have already been submitted to the IRS by the Swiss authorities, merely being on such a list does not constitute being under an audit or investigation, so a taxpayer can still proceed with the voluntary compliance procedures to mitigate costs prior to receiving an audit notice from the Service.

Our recent discussions with IRS tax counsel for Northern California have been very encouraging regarding the UBS problem in particular. Notices as a result of the information provided by the Swiss authorities may not be issued for several months. The IRS will confirm over the phone whether an individual's name is on the list. The call will not trigger any action

whether or not the person is on any such list. If the taxpayer (or his or her counsel) submits a letter of intent with amended returns to the IRS, the particular facts will be reviewed and the returns will be given to the civil division of the Service for review and confirmation of the taxes due, along with penalties and interest.

The goal of the voluntary compliance program is to get taxpayers reporting again. Undue punishment would be counter productive to that end. Consequently, the IRS looks mostly to impose the civil penalties and civil statute of limitations in reviewing returns unless there is clear evidence of criminal intent. While the criminal statute of limitations is six years, the IRS indicated that it might be satisfied with three years returns for many of the UBS types of cases where there is no active concealment of income and the unreported income is passive in nature such as interest on deposits.

The situations we often see involve a variety of offshore structures including foreign corporations and foreign trusts. In many of these cases the taxpayer is receiving advice from professionals and while the structures often don't work for a variety of reasons, the Service will usually view such cases as not being criminal since the taxpayer is following the advise of outside counsel compared to merely forming a maze of foreign subsidiaries to obscure the facts and avoid reporting.

Terminating offshore structures can add some complexity to the tax analysis and settlement process because the liquidation or termination of a foreign corporation or trust can result in higher taxes in the US, along with corresponding interest and penalties if not handled properly. For example, if a foreign company with positive earnings and profits is liquidated, the accumulated income or appreciation that has built up on investments held by the foreign entity can result in ordinary income tax compared to the normal capital gains rates for liquidating a US corporation. Consequently, the process often involves tax planning at the front end to minimize the costs.

Ultimately, the voluntary compliance process can provide a client with peace of mind since looming unresolved tax reporting issues can be put to rest. The voluntary compliance program can allow one to settle their taxes without the fear of an impending audit that might involve six years of returns, significantly higher taxes and penalties, and potential criminal issues that can otherwise be negotiated away. For example, the non-filing of the annual Treasury form TDF 90.22-1, itself, can potentially result in a penalty of up to 50% of the account balance. In some cases the cost to get legal representation down the road can far exceed the delinquent taxes. Voluntary compliance in this light might even be dubbed a capital preservation plan.

Please call or email Peter Trieu or Brian Rowbotham if you have any questions.

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