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Menu

- ▶ [About the DBA](#)
- ▶ [Membership](#)
- ▶ [Info](#)
- ▶ [Calendar / CLE](#)
- ▶ [Members Only](#)
- ▶ [Attorney Resources](#)
- ▶ [Public Resources](#)
- ▶ [Judiciary Info](#)
- ▶ [Fee Dispute Rules](#)
- ▶ [Grievance Procedures](#)
- ▶ [Sections](#)

Offshore Activities Draw Scrutiny

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In December 2007, a wealthy property developer in California, Igor Olenicoff, pleaded guilty to filing a false 2002 tax return. Tax lawyers became interested in this case when they learned the government was only seeking probation in a case in which more than \$50 million in taxes, penalties and interest were owed. It was readily apparent that there must be more to the story.

In June 2008, UBS banker Bradley Birkenfeld pled guilty to conspiring with Olenicoff and allegedly turned over 500 additional names of U.S. taxpayers who held secret UBS bank accounts in Switzerland. He also testified that UBS had more than 20,000 such accounts and widely marketed them as tax havens and failed to file proper tax reports which might have alerted the IRS to their existence.

In July, the Justice Department sought and received court permission to issue a John Doe summons to UBS, requesting the account records on any U.S. taxpayer having an account or control of an account at UBS. This summons has the effect of extending both the criminal and civil statutes of limitations on taxpayers having such accounts.

In July, the U.S. Senate Permanent Subcommittee on Investigations held a hearing on Tax Haven Banks and U.S. Tax Compliance. This was the second hearing conducted by the subcommittee into perceived foreign account abuses. The first was in 2006, when it issued a report entitled "Tax Haven Abuses: The Enablers, The Tools and the Secrecy," which concerned the use of offshore trusts to avoid U.S. taxes.

While important, these revelations represent only a small part of the scrutiny by the IRS on offshore tax abuse. The government has brought more than 10 major tax cases involving foreign tax schemes that it views as fraudulent in this year alone.

In 2003, the IRS unveiled a "Voluntary Compliance Initiative." This initiative grew out of another series of John Doe summonses issued to various banks and retail companies seeking information on U.S. residents who held credit, debit or other payment cards issued by foreign banks. The credit card initiative resulted in more than 500 taxpayers coming forward and the collection of taxes in excess of \$150 million.

Given the recently issued John Doe summons involving UBS, U.S. taxpayers are confronted with some hard choices. They could seek to voluntarily disclose their previous non-compliance with reporting requirements relating to foreign bank accounts, and possible unreported income, under the IRS Voluntary Disclosure Policy. But if the IRS already has their names, this policy may not be a viable option.

The Voluntary Disclosure Policy with respect to foreign bank accounts is apparently being handled on an inconsistent basis around the country, and, in some cases, depends on the IRS agent to whom the taxpayer makes the disclosure. It may also depend on which bank holds the account or even, in the case of UBS, which branch holds the account.

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The reporting requirements of the taxpayer begin with the annual tax return that requires disclosure of foreign bank accounts on which the taxpayer is a signatory or that the taxpayer controls. The issue of "control" is factual in nature and is viewed by the IRS in the broadest of terms. The disclosure is accomplished by checking a box on Schedule B of the return.

In addition, the taxpayer is required to file an FBAR (Foreign Bank Account Reports) in June of each year for each foreign account in which the taxpayer has an aggregate value of more than \$10,000 at any time during the tax year. The civil penalties for failing to file an FBAR range from a "warning letter" or a civil penalty not to exceed \$100,000 or the balance in the account. Recently, the IRS has commenced criminal enforcement for violations of this reporting requirement.

Also, Forms 3520 and 3520-A are required of taxpayers who have purchased land in Canada or Mexico through the use of "special land trusts." Filing is required in any year in which the trust is funded or there are disbursements, and Form 3520-A must be filed for any year in which the taxpayer is considered the owner of the trust.

No longer does "offshore" mean "out of sight." The penalties for failure to report and disclose are punitive and may involve criminal sanctions. The IRS has stated that foreign bank accounts and activities of U.S. residents are one of its highest priorities for the next year and taxpayers should be careful.

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