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I. Introduction

A US person is taxable in the United States (“US”) on all income from whatever source or jurisdiction the income is derived. The term “US person” includes the following individuals:

1. A US citizen;
2. A lawful permanent resident of the US;
3. An alien who has been in the US for 30 days in the current year and a total of 183 days in the three most recent years (prior years are subject to a multiplier).

On occasion, a US person intentionally or inadvertently fails to disclose to the Internal Revenue Service (“IRS”) income from certain sources (i.e. foreign bank and security accounts). In an effort to assist taxpayers to comply with the US federal tax laws with regards to past noncompliance, the IRS has instituted the voluntary disclosure practice. The IRS voluntary disclosure practice is set forth in the Internal Revenue Manual. Generally, a voluntary disclosure is the process whereby a taxpayer voluntarily reports previously undisclosed income through an amended return (“informal approach”) or by direct contact with the IRS Criminal Investigation Division (“CID”) (“formal approach”). The IRS CID considers a taxpayer’s timely voluntary disclosure as an important factor in determining whether the matter should be referred to the US Department of Justice for criminal prosecution. It is important to note that a timely voluntary disclosure will not guarantee immunity from criminal prosecution; however, the IRS will normally not recommend criminal prosecution to the Department of Justice if a taxpayer makes a truthful, timely and complete voluntary disclosure.

II. Truthful, Timely and Complete

A voluntary disclosure must be truthful, timely and complete. The taxpayer also must show a willingness to cooperate with the IRS in determining the correct tax liability and must make good faith arrangements with the IRS to pay in full, the tax, interest and any penalties determined by the IRS to be applicable.

To be timely, a voluntary disclosure must be received before:

1. The IRS has initiated a civil examination or criminal investigation of the taxpayer, or has notified the taxpayer that it intends to commence such a examination or investigation.
2. The IRS has received information from a third party (e.g. informant, other governmental agency, or the media) alerting the IRS to the specific taxpayer’s noncompliance.
3. The IRS has initiated a civil examination or criminal

investigation which is directly related to the specific liability of the taxpayer.

4. The IRS has acquired information directly related to the specific liability of the taxpayer from a criminal enforcement action (e.g., search warrant, grand jury subpoena).

Specific examples of valid voluntary disclosures include the following:

1. A letter from an attorney, certified public accountant or enrolled agent which encloses amended returns from a client which are complete and accurate (reporting legal source income omitted from the original returns), which offers to pay the tax, interest and any penalties determined by the IRS to be applicable in full and which meets the timeliness standard set forth above.
2. A disclosure made by a taxpayer of omitted income facilitated through a barter exchange after the IRS has announced that it has begun a civil compliance project targeting barter exchanges but before it has commenced an examination or investigation of the taxpayer or notified the taxpayer of its intention to do so. In addition, the taxpayer files complete and accurate amended returns and makes arrangements with the IRS to pay in full, the tax, interest and any penalties determined by the IRS to be applicable. This is a voluntary disclosure because the civil compliance project involving barter exchanges does not yet directly relate to the specific liability of the taxpayer.
3. A disclosure made by a taxpayer of omitted income facilitated through a widely promoted scheme that is the subject of an IRS civil compliance project. Although the IRS already obtained information which might lead to an examination of the taxpayer, it not yet commenced any such examination or investigation or notified the taxpayer of its intent to do so. In addition, the taxpayer files complete and accurate returns and makes arrangements with the IRS to pay in full, the tax, interest and any penalties determined by the IRS to be applicable. This is a voluntary disclosure because the civil compliance project involving the scheme does not yet directly relate to the specific liability of the taxpayer.
4. A disclosure made by an individual who has not filed tax returns after the individual has received a notice stating that the IRS has no record of receiving a return for a particular year and inquiring into whether the taxpayer filed a return for that year. The individual files complete and accurate returns and makes arrangements with the IRS to pay, in full, the tax, interest, and any penalties determined by the IRS to be applicable. This is a voluntary disclosure because the IRS has not yet commenced an examination or investigation of the taxpayer or notified the taxpayer of its intent to do so.

A taxpayer may be disqualified from making a voluntary disclosure if any of the following factors exist:

1. The taxpayer is the subject of a criminal investigation or civil investigation.
2. The IRS has notified the taxpayer that it intends to commence an examination or investigation.
3. The taxpayer is under investigation by a law enforcement agency.
4. The source of the undeclared funds is from illegal activity.
5. The taxpayer has reason to believe that the IRS has obtained information concerning his tax liability.

If any of these factors are present, then the facts and circumstances must be clarified with the CID agent to determine if it is a disqualifying factor.

III. Informal Voluntary Disclosure

An informal voluntary disclosure is generally not encouraged in most circumstances. However, if the taxpayer's total tax liability remains unchanged after the undisclosed funds are included, then an informal voluntary disclosure may be appropriate. To correct the past tax noncompliance under an informal voluntary disclosure, the taxpayer must submit amended returns (typically for a period of 3 to 6 years) with any tax payments due, including interest. The IRS will likely issue penalties (e.g. failure-to-file or accuracy). However, the taxpayer will not receive a formal letter stating that he has complied. A significant drawback to informal voluntary disclosure is that the taxpayer will not receive any assurances that he will not be criminally prosecuted in future years.

IV. Formal Voluntary Disclosure

The formal voluntary disclosure procedure involves contacting the IRS CID directly. Generally, the IRS CID agent will either request a face-to-face meeting with the taxpayer or a conference call to discuss the issues and facts involved. Following this discussion, the IRS CID agent will inform the taxpayer if his voluntary disclosure is accepted by the IRS. If the agent confirms that the taxpayer has made a valid voluntary disclosure, then the taxpayer will be required to prepare and file amended or delinquent tax returns and pay any appropriate taxes and interest.

V. Potential Penalties

Aside from potential criminal prosecution, the civil penalties associated with noncompliance can be severe. Below is a list of the civil penalties that may be imposed on US persons for noncompliance.

- **Failure to File** – The Internal Revenue Code imposes a “failure to file” penalty if a required tax return is not filed on or before its due date, unless such failure is due to reasonable cause. The penalty is generally equal to 5% of the net tax amount required to be shown on the tax return for each month (or fraction of a month) that the return is late, up to a maximum of 25% of the net tax amount.
- **Accuracy** – The accuracy-related penalty for underpayments is imposed at the rate of 20% on the portion of any underpayment of tax required to be shown on a return that is attributable to negligence.
- **TD. F. 990-22.1 Report of Foreign Bank and Financial Accounts** – A US person is required to file a Report of Foreign Bank and Financial Accounts to report any financial interest or signature authority that the US person has in a foreign financial account with an aggregate amount exceeding \$10,000 during the year. The penalty for a *willful* failure to file this form is \$100,000 or 50% of the total balance of the foreign account. The penalty for a *non-willful* failure to file is \$10,000.
- **Form 3520 Annual Return to Report Transactions with Foreign Trusts** – Among other things, this form is used to report distributions the US person received from a foreign trust. The penalty for failing to file this form is 35% of the gross value of the distribution from the foreign trust.
- **Form 3520-A Annual Information Return of Foreign Trust with a US Owner** – A US person who is treated as the owner of a foreign trust must ensure that the foreign trust files this form annually. The penalty for failure to file is 5% of the gross value of the foreign trust's assets treated as owned by the US person.
- **Form 5471 Information Return of US Person with Respect to Certain Foreign Corporations** – Certain US persons who are direct, indirect or constructive owners of a

foreign corporation may be required to file this form. The penalty for failing to file this form is \$10,000 which may increase to \$60,000 once the IRS has mailed notice of the failure.

VI. Reduced Penalties Through October 15, 2009

On March 23, 2009 the IRS issued a temporary penalty guidance for taxpayers who come forward before October 15, 2009. To be considered for this reduced penalty structure the taxpayer's advisor must provide the IRS with the following information before October 15:

- Taxpayer's name
- Taxpayer's address
- Taxpayer's social security number
- Taxpayer's passport number
- Taxpayer's date of birth

Under the temporary penalty guidance, a taxpayer who comes forward before October 15 will be subject to the following reduced penalties:

1. First, all applicable taxes and interest will be imposed during the six-year period (2003-2008) and the taxpayer must file all required amended income tax returns, information returns and Forms TD F 90-22.1.
2. Second, either an accuracy or delinquency penalty of 20% of the amount of tax underpaid will be assessed for all years during the six-year period.
3. Third, in lieu of all other penalties that may otherwise be assessed, including the TD F 90-22.1 penalty, a penalty equal to 20% of the amount in the offshore account will be imposed for the year with the highest aggregate account value during the six-year period.

An important exception to the general rule may apply. A taxpayer may receive a reduced penalty of 5% of the highest value in the account if the taxpayer did not open the account, there have been no deposits or withdrawals from the account and there is no bottom line change to the taxpayer's US income tax liability once the income is disclosed.

* * *

A taxpayer should seek competent tax advice to understand the applicability of this information to his specific situation.

Under applicable US Treasury regulations (Circular 230), we are required to inform you that, unless we specifically state otherwise, any tax advice in this communication and in any attachments were not intended or written to be used, and cannot be used, for the purpose of: (i) avoiding tax related penalties; or (ii) promoting, marketing or recommending to another party any matter(s) addressed herein.

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