Why Tax Evasion Is A Bad Idea: UBS and Wegelin Bank

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In America, a country that fought a revolution over taxes, tax evasion is a bad idea. U.S. taxpayers with undisclosed offshore accounts with unreported income face "double jeopardy": civil tax fraud (with no statute of limitations) and criminal tax evasion (with a six-year statutes of limitation). Severe financial penalties and jail sentences await those U.S. taxpayers who get caught "cheating on their taxes."

TAX EVASION has never been a good idea. In this article, I'll discuss the Wegelin and UBS Bank cases to make that point.

THE UBS CASE • UBS, Switzerland's largest bank, became "the first crack in the Swiss Banking System" when, on February 18, 2009, they entered into a deferred prosecution agreement with the U.S. Department of Justice ("DOJ"). Under the agreement, UBS agreed to pay a $780 million fine and turn over the names and account information of 285 U.S. account holders who were not reporting their foreign financial accounts, the assets held in these accounts, nor the income from the assets held in these accounts. On February 19, 2009, the DOJ filed a civil suit seeking to force UBS disclosure of up 52,000 accounts held by U.S. taxpayers. On August 19, 2009, UBS

and the DOJ entered into a settlement agreement in which an additional 4,450 accounts of non-compliant U.S. taxpayers were disclosed. A parallel agreement was signed on August 19, 2009 between the U.S. and Swiss government, based on the existing U.S.-Switzerland Double Taxation Treaty, which was approved by the Swiss Parliament on June 17, 2010. On October 22, 2010, the U.S. DOJ agreed to dismiss its criminal prosecution against UBS because UBS complied with its obligations.

In total, UBS paid $780 million in fines, and turned over 4,735 U.S. taxpayers, suspected of tax evasion to the U.S. government. These U.S. taxpayers with Swiss bank accounts at UBS who failed to disclose the accounts, the account assets and the income (from the account assets) violated multiple U.S. tax filing requirements as follows:

- Form 1040 Individual Tax Returns: Annual reporting of world-wide income;
- Report of Foreign Bank and Financial Accounts, ("FBAR") (Form TDF 90-22.1). Annual disclosure of foreign bank and financial accounts in which the U.S. taxpayer has a financial interest in, or signatory authority over any financial accounts in a foreign country, if the total value of such accounts exceeds $10,000 at any time during the calendar year. Signature Authority is defined as the authority (either alone or in tandem with another individual) to control the disposition of assets, funds or money held in a financial institution account, by delivery of written or oral instructions, directly to the financial institution which holds the account. The U.S. taxpayer must file the FBAR, disclose the foreign account on Form 1040/Schedule B (Part III: Foreign Accounts and Trusts) and report all income earned on the foreign account on Form 1040;
- Form 8938: "Specified Foreign Financial Assets" to disclose foreign financial assets in excess of $50,000 (Form 8938 is attached to Form 1040). The filing of Form 8938 (with Form 1040) does not relieve U.S. taxpayers of the requirement to file the FBAR (Form TDF 90-22.1) if the FBAR filing is otherwise due. For those U.S. taxpayers who established UBS accounts, with the assistance of tax advisors, under 18 U.S.C. 371, both the taxpayer and the tax advisors may be held liable for conspiracy to defraud the U.S. A conspiracy to defraud the U.S. for taxes due is known as a Klein Conspiracy. The U.S. government must prove that there was an agreement by 2 or more persons to impede the IRS, and each participant knowingly, willfully and intentionally participated in the conspiracy.

A U.S. taxpayer's failure to report their worldwide income, disclose foreign financial accounts over $10,000, disclose foreign financial assets over $50,000, which appears to be the case for the 4,735 U.S. taxpayers with UBS accounts, subjects these U.S. taxpayers to significant civil and criminal penalties as discussed herein.

Civil And Criminal Penalties

U.S. taxpayers face civil and criminal tax penalties when they:

- Fail to report worldwide income on their tax returns (Form 1040);
- Fail to report foreign financial accounts, in which they have a financial interest or have signatory authority, account value over $10,000 (Form TDF 90-22.1); and/or
- Fail to report foreign financial assets, in which they have an ownership interest, assets over $50,000 (Form 8938).

U.S. Taxpayers include:

- U.S. citizens;

- U.S. "Green Card" holders;
- U.S. resident aliens in the U.S. for 183 days in one year, or 122 days per year over 3 consecutive years.

U.S. taxpayers must file annual U.S. income tax compliance:

- Form 1040: report worldwide income;
- Form TDF 90-22.1 (FBAR) to report foreign financial accounts valued over $10,000;
- Form 8938 to report foreign financial assets with value over $50,000, in which they have an ownership interest.

U.S. taxpayer foreign assets must be reported under the FBAR filing and the FATCA filing for foreign assets over $50,000. These foreign assets must also be reported under Form 1040 Schedule B.

Form 8938 (reporting specified foreign financial assets) must be attached to tax return/Form 1040. Filing Form 8938 does not relieve U.S. income tax residents of obligation to file FBAR (Form TDF 90-22.1) if FBAR filing is otherwise due.

Criminal Penalties

Unreported income, undisclosed foreign financial accounts, and undisclosed foreign financial assets subject U.S. taxpayers to criminal penalties.

Unreported Income

- Internal Revenue Code ("Code") section 7201, Tax Evasion (Willful Evasion of Tax): up to five years in prison; a fine of up to $100,000 (individual), $500,000 (corporation);
- Code section 7212, Obstruction (Impede Tax Collection): up to three years in prison; a fine of up to $5,000;
- 18 U.S.C. §371 Conspiracy to Impede Tax Collection (separate charge of impeding): up to five years in prison;
- Code section 7203, Failure to File Tax return: Up to one year in prison; a fine of up to $25,000 (individual); $100,000 (corporation);
- Code section 7206(1) Filing a false tax return: up to years in prison and a fine of up to $250,000.

FBAR Violation

- 31 U.S.C. §5322(b) and 31 C.F.R. §103.59(c): willful violation up to 10 years in jail and a $500,000 fine.

Foreign Account Tax Compliance Account (FATCA) Form 8938

- Taxpayers who fail to file Form 8938, report an asset, or have an underpayment of tax may be subject to criminal penalties.

Civil Penalties

FBAR (Willful Failure To File)

- Civil penalty is the greater of $100,000 or an annual penalty of 50 percent of the greatest amount in the account. The 50 percent penalty is imposed for each year there is no FBAR filed for the foreign financial account, so if the FBAR is not filed for four years, the penalty is 200 percent of the highest account balance (e.g., if the highest account balance is $1 million, the penalty for four years of non-FBAR filing, is $2 million).

FATCA (Form 8938)

- Taxpayers who fail to file Form 8938, fail to report an asset, or have an underpayment of tax may be subject to civil penalties;
- A 40 percent accuracy-related penalty for underpayment of tax attributable to an undisclosed foreign financial asset understatement; or
- A 75 percent fraud penalty for underpayment of tax due to fraud.

Unreported Income: Civil Tax Fraud

- Code section 6651(f), Fraudulent Failure to File Tax Return: Maximum penalty of 75 percent of the amount of the unpaid tax;
- Code . 6663(a), Fraudulent Tax Return (Unreported Income: maximum penalty of 75 percent of the amount of the unpaid tax;
- Code section 6662(b)(1)-(5): Accuracy-Related Penalty. Penalty of 20 percent of the unpaid tax;
- Code section 6663(c): Spousal Liability. On a joint tax return, both spouses are subject to joint and several liability for the entire tax liability. The civil fraud penalty applies only to the spouse responsible for the tax underpayment attributable to fraud;
- Code section 6651(a)(2): Failure to pay tax shown as due on a tax return penalty of up to a maximum of 25 percent of unpaid tax;
- Code section 6651(a)(3): Unpaid tax not shown as due on a return (i.e., unreported income): penalty of up to a maximum of 25 percent of unpaid tax. Offsetting penalties: Under Code section 6651(c)(1), the amount of the penalty for failure to file is reduced by the amount of the penalty for failure to pay (the amount shown on a return for any month for which both penalties apply). Under Code section 6651(a)(3), there is no offset for the penalty for failure to pay tax not shown as due on a return (i.e., unreported income);
- No credit is allowed against the civil fraud penalty for any criminal fines paid for income tax evasion and conspiracy to defraud the United States.

U.S. TAXPAYERS SWISS BANK (WEGELIN)

• On January 4, 2013, Wegelin & Co., Switzerland's oldest bank (est. 1741), which had $25 billion under management, pled guilty in a New York court to helping Americans evade their taxes. Wegelin agreed to fines, restitution, and forfeitures totalling $74 million, as well as ceasing its operation as a bank. In 2012, in a separate civil lawsuit by the U.S., the judge entered a default judgment against the Bank when it failed to appear,, ordering it to forfeit $16.2 million held in the U.S. account.

Wegelin admitted to allowing more than 100 American citizens (who are from UBS) to hide $1.2 billion in undeclared assets from the IRS for almost 10 years. Wegelin became the first foreign bank to plead guilty to tax evasion charges in the U.S.

Previously, UBS agreed to pay a $780 million fine related to tax evasion charges, disclose the details of nearly 5,000 U.S. account holders, but they neither pleaded nor were found guilty. Instead, UBS and U.S. prosecutors had a deferred prosecution agreement, with the fine being paid in exchange for the charges being dropped.

U.S. Attorney Preet Bharara said it was "a watershed moment in our efforts to hold to account both the individuals and the banks — wherever they may be in the world — who are engaging in unlawful conduct that deprives the U.S. Treasury of billions of dollars of tax revenue." He also stated:

"There is no excuse for wealthy Americans flouting their responsibilities as citizens of this great country to pay their taxes, and there is no excuse for foreign financial institutions helping them to do so…. Wegelin became a haven for U.S. taxpayers seeking to circumvent the tax code by hiding their money in secret offshore accounts, and the bank willfully and aggressively jumped in to fill a void that was left when other Swiss banks abandoned the practice due to pressure from U.S. law enforcement. Today's guilty plea is a watershed moment in our efforts to hold to account both the individuals and the banks — wherever they may be in the world — who are engaging in unlawful conduct that deprives the U.S. Treasury of billions of dollars of tax revenue. We will continue our efforts until this practice is eliminated in its entirety."

Otto Bruderer, Managing Partner at Wegelin, admitted that from 2002 to 2010, Wegelin sheltered U.S. clients from tax while aware that its conduct had been "wrong." Mr. Bruderer further admitted that "assisting tax evasion was common practice in Switzerland."

Under the proposed plea agreement, entered by Otto Bruderer on behalf of Wegelin and Co., Wegelin entered a plea to a single count of conspiring to commit tax evasion. The charge stated that Wegelin "willfully and knowingly would and did defraud the U.S.A. and the IRS for the purpose of impeding, impairing, obstructing and defeating the lawful government functions of the IRS."

Sentencing

In *U.S. v. Wegelin & Co., et al.,* U.S. District Court for the Southern District of New York, Case No. 12-CV-00002, on March 4, 2013, U.S. District Judge Jed Rakoff ordered Wegelin to pay $22 million in fines, $20 million in restitution, over $15 million in forfeitures, in addition to over $16 million in previous forfeitures, amounting to a total over $74 million, as well as a period of probation.

Judge Rakoff questioned whether the size of the settlement appropriately reflected the extent of the wrongdoing, saying there was a "funny tension" between the U.S. Department of Justice's decision not to seek the maximum $40 million fine and its assertion Wegelin acted with "extreme willfulness." "Not much pain there, is there?" said Judge Rakoff.

U.S. taxpayers who use Swiss Bank accounts to hide unreported U.S. income and annual earnings from those accounts face a myriad of civil and criminal tax penalties. The spotlight may now shine on these U.S. taxpayers who committed tax evasion because 13 other Swiss Banks are under IRS investigation, including:

- Credit Suisse, with over 1 trillion dollars in total assets, another trillion dollars in clients' money;
- HSBC Holdings, P.C., who paid a $1.5 billion fine for laundering drug money (and other offenses);
- Basler Kantonalbank;
- Julius Baer;
- Nine other local, central Swiss banks.

Wegelin ceased to function as a Swiss Bank in 2011, selling off its core Swiss and other non-U.S. businesses in January 2011, to protect non-U.S. clients from the fallout of the legal battle. The sale left Wegelin responsible only for its American clients. In February 2012, Wegelin, as an institution, was indicted by U.S. authorities and later declared a fugitive from justice when the Bank's executives failed to appear in a U.S. court (the three Wegelin bankers, Michael Berlinka, Urs Frei and Roger Keller, are still fugitives). Wegelin had previously vowed to fight the charges, claiming that because it only had branches in Switzerland, it was bound only by its home country's banking laws, not by U.S. law. The Bank's guilty plea ensured their demise. Wegelin told U.S. taxpayers that their undeclared accounts would not be disclosed to the U.S. authorities because the bank had a long tradition of secrecy and unlike UBS, had no offices outside of Switzerland and was less vulnerable to U.S. law enforcement.

To further the goals of the conspiracy from 2002-2011, Wegelin took steps including:

- Opening and servicing undeclared accounts for U.S. taxpayer-clients in the names of sham corporations and foundations formed under the laws of Liechtenstein, Panama, and Hong Kong (and other jurisdictions) to conceal clients' identities from the IRS;
- Wegelin and Company accepted documents falsely declaring that the sham entities were the beneficial owners of certain accounts, when in fact the accounts were beneficially owned by U.S. taxpayers;
- U.S. taxpayers maintained Wegelin accounts (undeclared), using code names and numbers to

minimize references to the actual names of the U.S. taxpayers on Swiss Bank documents;
- Wegelin Bank ensured that account statements and other mail were not mailed to U.S. clients in the U.S.; they were instead sent to U.S. taxpayer clients' personal email accounts, to reduce risk of detection by law enforcement;
- Wegelin issued checks drawn on, and executing wire transfers to, its U.S. correspondent bank accounts for the benefit of U.S. taxpayers with undeclared accounts at Wegelin (and at least two other Swiss banks);
- Wegelin separated the transfers into batches of checks or multiple wire transfers in amounts that were less than $10,000 to reduce the risk that the IRS would detect the undeclared accounts;
- Wegelin used its correspondent bank accounts at UBS to help U.S. taxpayers with undeclared accounts repatriate money that they had hidden in Wegelin;
- U.S. taxpayers asked Wegelin to issue and send their checks drawn on Wegelin's correspondent bank accounts, and that represented funds held in their bank accounts at Wegelin;
- Wegelin permitted at least two other Swiss banks to issue checks drawn on its correspondent bank account for the benefit of U.S. taxpayers holding undeclared accounts at these other banks.

The sheer volume of transfers in Wegelin's correspondent bank accounts served to conceal the repatriation of money from U.S. taxpayers' undisclosed accounts at Wegelin and other banks.

On January 3, 2013, Otto Bruderer admitted:

"From about 2002-2012, Wegelin agreed with certain U.S. taxpayers to evade the U.S. tax obligations of these U.S. taxpayer clients who filed false tax returns with the IRS." "In furtherance of its agreement to assist U.S. taxpayers to commit tax evasion in the U.S., Wegelin, among other things, opened and maintained accounts at Wegelin in Switzerland for U.S. taxpayers who did not complete Form W-9 tax disclosure forms to report their income to the IRS."

Bruderer admitted that Wegelin and Company knew the U.S. taxpayers were creating non-W-9 accounts at Wegelin and Company in order to evade their U.S. tax obligations in violation of U.S. law. he stated that "Wegelin intentionally opened and maintained non W-9 accounts for U.S. taxpayers" with the knowledge that, by doing so, Wegelin and Company was assisting these taxpayers in violating their legal duties and that "Wegelin was aware that this conduct was wrong."

For U.S. taxpayers, although under the Fifth Amendment they cannot be forced to incriminate themselves, the courts have held that offshore banking records fall within the required records exception. The Ninth Circuit in *In re: Grand Jury Investigation M.H.*, 648 F.3d 1067 (9th Cir. 2011), *cert. denied,* 133 S.Ct. 26 (2012) compelled an offshore account holder to produce account data even if it was self-incriminating.

Jeffrey Neiman, a former U.S. federal prosecutor, stated: "It is unclear whether the bank was required to turn over American clients who held secret Swiss bank accounts. What is clear is that the Justice Department is aggressively pursuing foreign banks who have helped Americans commit overseas tax evasion."

James Mastracchio, of Baker Hostetler's National Tax Controversy Practice stated:

"This is an unprecedented plea by a foreign institution subjecting itself to U.S. jurisdiction ... as the global banking community becomes FATCA controversy compliant — particularly for those foreign institutions operating in countries with intergovernmental agreements — transparency and the sharing of information will continue with the

U.S. and by agreement and in practice, such that FFI will be under greater pressure to make unprecedented agreements to follow U.S. law and regulations. This plea does provide an example of what might become the normal relations between the U.S. and FATCA-compliant jurisdictions."

Tax Evasion, Conspiracy, And Money Laundering

U.S. taxpayers who hide money in Swiss bank accounts, and their tax advisors who assist them, may be held liable for tax evasion, conspiracy, and money laundering.

In the *Wegelin* case, for the first time a Swiss Bank has pled guilty to a felony; i.e., conspiracy to commit tax evasion. Wegelin facilitated tax fraud by accepting deposits from U.S. taxpayers who did not pay income tax on the earnings (i.e., interest) from the bank accounts. The U.S. taxpayers relied on "Swiss Banking Secrecy" (i.e., the U.S. taxpayers did not disclose their Swiss income or the assets in the accounts, which earned the income), specifically, that Wegelin would not disclose either the assets in the accounts or the income from the accounts.

As Wegelin director Otto Bruderer stirringly admitted, Swiss banking practices "profit" by committing tax fraud. Swiss Banks entice foreign (i.e. U.S. and other) investors to establish Swiss Bank accounts, which accounts are maintained secretly listing "nominee owners" (i.e., corporations, trusts, limited liability corporations and third-party individuals). The income from the Swiss Bank accounts is unreported and the banks do not disclose the actual account owner's country of tax residence, rendering them not subject to tax reporting or payment of tax in their country.

In the U.S., under the "Klein Conspiracy," doctrine, if two or more parties intentionally impede the IRS from collection of tax, they are liable for conspiracy to commit tax fraud, which is a felony (with a five-year prison sentence). The object of the conspiracy, the unlawful activity (tax evasion) is a predicate offense for a second felony, money laundering (i.e. a specified unlawful activity).

By Wegelin director Otto Bruderer admitting that Swiss Banks intentionally commit tax evasion, by shielding client accounts from reporting taxable income, his admission is evidence of willfulness (i.e., the U.S. taxpayer "intentionally" committed tax fraud) which makes the U.S. taxpayer and the bank criminally liable for tax evasion, conspiracy, and money laundering, tax crimes which are subject to severe civil and criminal penalties.

IRS Summons

On January 29, 2013, Judge Pauley directed the IRS to issue a summons requiring the Swiss Bank, UBS, to produce information about U.S. taxpayers who were trying to evade U.S. income taxes by holding accounts at other Swiss banks that did business with UBS.

Judge Pauley entered an order on January 28, 2013 authorizing the IRS to require UBS to produce records on U.S. taxpayers with accounts at Swiss Bank Wegelin and other Swiss banks that used Wegelin's U.S. correspondent account at UBS.

Judge Pauley's order would enable U.S. authorities to determine the identity of U.S. taxpayers who hold or held interests in financial accounts at Wegelin and other Swiss financials that used Wegelin's UBS account.