



The Tax Lawyer

Six Questions About Secret Foreign Bank Accounts

Robert W. Wood, 08.02.10, 1:00 PM ET

I recently listed 10 things you should know about [foreign bank accounts](#). Calls and e-mails in response to that column suggest that still undisclosed foreign bank accounts are bothering many people. As tax practitioners continue to ruminate on these subjects, here are some questions taxpayers with these accounts are asking.

1. Should You Wait and See?

Whether (and how) to come forward is the most pressing question in many foreign bank account disclosure situations. It may be tempting to think you are better off waiting to see if you are caught. Surely, you might reason, some kind of deal would be available at that time? Unfortunately, this is quite dangerous.

Indeed, although it is understandable that many taxpayers would rather stick their heads in the sand, don't do it. There are risks in stepping forward and saying that you failed to report overseas income and failed to report a foreign account. Although the risk of criminal prosecution in such a disclosure is pretty remote, the risk of significant financial penalties is certainly present.

As I have previously described, the Internal Revenue Service allows taxpayers to fess up to their offshore transgressions through voluntary disclosure. In 2009 the IRS offered a special voluntary disclosure program regarding unreported offshore accounts that guaranteed a fixed penalty structure. However, that program ended in October 2009. Currently taxpayers can still make a voluntary disclosure to the IRS regarding the existence of their undisclosed foreign activity. The penalties that may attach are unclear, but such a voluntary disclosure may mitigate taxpayers' criminal liability.

Fans of *Law and Order* will recognize that it seems risky to make any kind of disclosure that seems self-incriminating without a definite deal on the table. True. Yet the risks on the opposite side of the equation (i.e., doing nothing) are vastly greater.

2. Should You Attempt A "Pre-Clearance"?

An additional idea some tax lawyers favor is known as "preclearance." Essentially, this involves the tax lawyer going to the IRS Criminal Investigation Division on behalf of a specific client and disclosing the bare minimum about that client. The disclosure might include the name and Social Security number of the client. The idea of a preclearance is to ask the IRS to check its databases (and the taxpayer's file) to determine whether any event has already occurred that would render the taxpayer ineligible for a voluntary disclosure.

Such as? Maybe the taxpayer is already under criminal investigation.

Maybe the IRS has already received the individual's name from UBS or another foreign bank enmeshed in disclosure problems. In such cases, the taxpayer would generally not get the benefits of voluntary disclosure, since the key to voluntary disclosure is that you come forward before the IRS starts investigating you.

In all likelihood, however, the preclearance inquiry would result in the IRS saying they have no facts or data suggesting this particular taxpayer cannot make a voluntary disclosure. Think of it as sticking your toe in the water. If the temperature of the water seems OK, the tax lawyer proceeds to make the full disclosure of the facts and the figures to the IRS. Conversely, if the temperature is not to your liking, meaning the IRS says, "It's too late for this person," you can start circling your wagons and prepare your defense. Either way, you've acquired some valuable intelligence.

3. Who Should Complete Tax Forms and FBARs?

Provided you elect to make a voluntary disclosure, another question is just how involved you want to be in preparing the necessary documentation for the IRS. For example, let's say you inherited a Swiss account from your European grandmother when she died three years ago. You failed to check the box on Schedule B of your Form 1040 reporting that you had a foreign bank account containing more than \$10,000. You also failed to report the interest on the account annually, and you failed to file an FBAR.

This may be very simple to fix. If you do your own tax returns, there's no reason you can't prepare the amended returns and delinquent FBARs yourself. You still should have a tax lawyer handle the IRS communications, but you can prepare the documents if you like. First, you would need the bank records showing how much (if any) income you earned on the account. Most foreign bank account statements are not as easy to understand as American ones. On the other hand, you may have experienced a loss.

4. Should You Hire An Accountant?

If you want to engage an accountant, you generally should not hire the accountant yourself. Have your tax lawyer do it. All voluntary disclosures to the Criminal Investigation Division of the IRS should be done through an attorney. You don't have attorney-client privilege with an accountant. You do with your lawyer.

Your lawyer will hire the accountant. Most tax lawyers are happy to hire whichever accountant you want. It can even be the accountant you have used in the past. This is admittedly artificial, but the case law indicates that this imports attorney-client privilege to the accountant communications as well.

5. Should You Send In Penalty Money?

No. If you amend your tax returns and file delinquent FBAR forms explaining that you didn't know about FBAR filing requirements (a common excuse), wait to see if the IRS adds penalties. Don't penalize yourself, or put differently, don't "self-assess" penalties. Rest assured that if the IRS thinks you should be penalized, it will send you penalty notices.

You'll have a separate opportunity to discuss penalties with the IRS even if you've made a voluntary disclosure. In other words, your tax lawyer can present the case that you had "reasonable cause" for failing to file FBARs. Of course, what you hope will happen is that the IRS will simply accept your forms and any additional tax money and choose not to attach penalties.

6. Where Did That Offshore Money Come From?

Finally, as you consider how serious your tax and disclosure problems may be, consider the source of your foreign monies. Did the original deposits represent income that has already been taxed in the U.S., or money that should have been taxed in the U.S. and wasn't? Not all foreign account problems are the same. Where did the money in the foreign account come from? Money that is inherited is not income. Only the earnings on that income (interest or dividends) would be taxable. Of course, it is not clear what standard the IRS will use to judge people who failed to come forward during the special disclosure period that ended in October 2009. However, if you have sympathetic facts like an inherited account, chances are the IRS may be more lenient.

Conversely, what if you own a U.S. trade or business and you diverted money to your Swiss bank account, perhaps deducting it on your corporate tax return as consulting fees? Here, your problem is a serious one. The fact that it occurred with respect to a foreign bank account is only part of the problem, but certainly not all of it. At a minimum, you need some thoughtful professional tax advice about what to do. In such fact patterns, it is often not merely your personal income tax return that needs to be addressed, but the tax returns for the business too.

*Robert W. Wood is a tax lawyer with a [nationwide practice](#). The author of more than 30 books, including *Taxation of Damage Awards & Settlement Payments (4th Ed. 2009, taxinstitute.com)*, he can be reached at wood@woodporter.com.*