

VOLUNTARY TAX REGULARIZATION: A U.S. AND FRENCH COMPARISON

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U.S. AND FRENCH BACKGROUND

The Tax Division is committed to using every tool available in its efforts to identify, investigate, and prosecute [noncompliant U.S. taxpayers who would use secret offshore bank accounts].¹

The above statement, found on the U.S. Department of Justice's website, clearly sets forth the U.S. government's current approach to U.S. tax noncompliance with regard to foreign bank accounts.

In 2000, a State Department report found that \$4.8 trillion are held by U.S. persons in offshore accounts.² In 2008, further investigation showed that the U.S. lost \$100 billion in annual tax revenue as a result of tax abuse using offshore accounts.³ The increase in online communications, global outreach, and sophistication of the taxpayer, made it easier to not only move money around but also to keep it hidden. As a result of these reports, the U.S. Department of Justice launched an offshore program in 2008 that involved investigations of global banks abroad, causing uproar among the international financial industry.

The program launched with the controversial investigation of UBS AG ("UBS"), Switzerland's largest bank, in 2008, and was prompted by the actions of Bradley Birkenfeld, who exposed the schemes the bank had used to lure U.S. taxpayers into avoiding payment of U.S. taxes.⁴ In 2009, the investigation resulted in:

- UBS entering into a deferred prosecution agreement and admitting guilt on charges of conspiring to defraud the U.S. and impeding the I.R.S.;
- UBS terminating its banking relationships with U.S. taxpayers having undeclared accounts;

¹ United States Department of Justice, Offshore Compliance Initiative.
² State of the Offshore Voluntary Disclosure Program: Knowing Your Options and Avoiding Traps. Ivins, Phillips & Barker, November 6, 2014.
³ United States Department of Justice, Offshore Compliance Initiative.
⁴ Kocieniewski, David. "Whistle-Blower Awarded \$104 Million by I.R.S." *New York Times*. September 11, 2012.

- UBS paying \$780 million in fines, penalties, interest, and restitution.

The most significant repercussion was the disintegration of Swiss bank secrecy laws as a result of an agreement negotiated between UBS, the U.S., and the Swiss government. In addition, the adoption of the Foreign Account Tax Compliance Act ("F.A.T.C.A.") in 2010, as part of the Hiring Incentives To Restore Employment Act, requires U.S. taxpayers with non-U.S. accounts to disclose these accounts to the Internal Revenue Service ("I.R.S."). It also requires foreign financial institutions to identify accounts held by U.S. persons and to share this information with the I.R.S.

On the heels of its success with UBS in Switzerland, and as a direct result of F.A.T.C.A., the I.R.S.'s scope now reaches banks and countries worldwide.

In light of these developments, voluntary compliance procedures were established to encourage taxpayers to come into compliance with U.S. laws. A series of voluntary disclosure programs focusing on the disclosure of foreign financial assets and income were offered, starting with the 2009 Offshore Voluntary Disclosure Program. Since then, over 45,000 taxpayers have come forward, voluntarily disclosing their foreign accounts to the I.R.S. and paying delinquent taxes, interests, and penalties to the Treasury. The I.R.S. website states that as of June 2014, \$6.5 billion in tax was collected from more than 45,000 taxpayers.⁵

The 2009 Offshore Voluntary Disclosure Program allowed taxpayers with unreported income related to offshore transactions to voluntarily disclose their information to the I.R.S. A voluntary disclosure did not automatically guarantee immunity from prosecution but did result in prosecution not being recommended. The program ran for a limited period of time and ended in October 2009. Soon after, a new Offshore Voluntary Disclosure Initiative was announced in February 2011 and ran through August of that year.

Because of the strong interest in and overall success of the 2009 and 2011 programs, the I.R.S. began the open-ended O.V.D.P. in January 2012. The biggest differences between this program and its predecessors are that the 2012 program could terminate at any time, the penalties are significantly higher (27.5% through June 2014), and the risk of criminal prosecution is eliminated upon pre-clearance into the program. On June 18 of the current year, the program was further revised to include an offshore penalty that can be as high as 50% of the highest aggregate amount of the offshore assets over the last eight years.⁶ Along with this revised 2012 Offshore Voluntary Disclosure program, the Streamlined Filing Compliance Procedures have been revised and broadened to apply to taxpayers whose U.S. tax noncompliance was non-willful.

France also joined in the effort to combat international tax avoidance. In this spirit, France amended several of its income tax treaties to allow for information exchange procedures for which banking secrecy laws are no longer impediments.

"Over 45,000 taxpayers have come forward, voluntarily disclosing their foreign accounts to the I.R.S."

⁵ "IRS Offshore Voluntary Disclosure Efforts Produce \$6.5 Billion; 45,000 Taxpayers Participate." Internal Revenue Service, June 2014.

⁶ "The 2014 Offshore Voluntary Disclosure Program (OVDP)." Tax Law Offices of David Warren Klasing. 2014.

Following the European trend to fight tax avoidance,⁷ France decided to tighten up its rules⁸ by allowing taxpayers to voluntarily declare assets held abroad in order to benefit from more flexible tax penalties and escape criminal tax avoidance proceedings.

The circular issued by the French Ministry of Economy on June 21, 2013 sets forth the requirements of this new tax regularization procedure.

FRENCH VOLUNTARY COMPLIANCE LANDSCAPE

Framework of the Procedure

The scope and the main principles of this procedure are the following:

- The tax regularization procedure applies to individuals whose tax residence is in France and who hold assets abroad through bank or securities accounts, life insurance contracts, trusts, corporate bodies, or similar arrangements.
- This procedure is only available in the case of a voluntary disclosure made to the French tax authorities ("F.T.A."). Taxpayers who are already under audit or subject to proceedings by tax or judicial authorities in relation to unreported assets held abroad are not eligible to participate.
- In a change from the previous 2009 regularization procedure, under the 2013 procedure a taxpayer can no longer enter the program on an anonymous basis. Taxpayers wishing to come forward must now do so by revealing their identity in the early stages of the process.

Regularization Process

Filing of Amended Tax Returns

Taxpayers who decide to regularize their tax situation must voluntarily file amended tax returns covering all years that are not covered by the statute of limitations and pay all relevant back taxes.



⁷ E.g., the *Directive on Administrative Cooperation in the Field of Taxation*, applicable as of January 1, 2015, provides for information exchange procedures between Member States of the European Union. Also, the announced amendment of the *Taxation of Savings Income Directive*, relating to the automatic reporting by the paying agent of the beneficiaries to their tax authorities, should have an impact on the structuring made available to European clients.

⁸ The law on the fight against tax avoidance and serious economic and financial crime was promulgated on December 6, 2013 and published in the *Official Journal* dated December 7, 2013 (law No. 2013-1117). This law provides for a toughening up of penalties incurred in the case of serious tax fraud organized in particular through accounts held abroad (the fine is raised from to €1 million to €2 million in this case).

"Taxpayers who decide to regularize their tax situation must voluntarily file amended tax returns covering all years that are not covered by the statute of limitations and pay all relevant back taxes."

Considering the extended statute of limitations in the case of noncompliance with reporting requirements related to foreign assets, the following tax returns must be amended, when applicable:

- Income tax returns (including social security contributions) as of 2006;
- Wealth tax returns as of 2007; and
- Inheritance and gift tax returns if the death occurred after January 1, 2007.

Taxpayers must send their request with the amended tax returns to the relevant tax center or to the directorate for the verification of tax situations ("D.N.V.S.F.").⁹ All files will be dealt with by the D.N.V.S.F. in order to guarantee a centralized and uniform approach.

Supporting Documents

In addition to the amended tax returns, the submission must contain the following documents:

- A document detailing the origin/source of the foreign assets held directly or indirectly, with supporting evidence;
- Evidence relating to the value of the foreign assets held, whether directly or indirectly, and to the amount of income derived from these assets over the regularization period;
- A certificate from the foreign financial institution indicating the absence of deposit by the taxpayer or any other evidence to prove that no funds were deposited on the account by the taxpayer, if the assets were received by gift or by inheritance;
- A statement from the individual asserting that his or her file is complete and accurate and covers all the unreported accounts and assets held abroad or for which the taxpayer is the entitled or economic beneficiary;
- A certificate of ownership of the account, if applicable.

Tax Consequences of the Regularization Procedure

All the additional taxes resulting from the regularization will have to be paid. The following penalties must also be paid:

- Late payment interest at a rate of 0.4% per month;
- A willful negligence penalty of 40% or 15% depending on the behavior of the taxpayer (whether or not the taxpayer actively participates in the avoidance of French tax);

⁹ *Direction Nationale des Vérifications de Situations Fiscales.*

"The offshore voluntary disclosure program ('O.V.D.P.') is for taxpayers whose noncompliance was willful."

- A penalty for noncompliance of the reporting obligations regarding the existence of foreign assets. This penalty amounts to:
 - €1,500 per year, per unreported bank account or life insurance policy;
 - €10,000 per year, if the unreported account or the life insurance policy is held in an entity based in a State or territory with which France has not entered into a tax treaty calling for administrative assistance in the fight against fraud and evasion which includes access to banking information (applicable as of the 2008 tax year);
- The penalties of €1,500 or €10,000 per year are increased to 5% of the balance of all the unreported accounts or policies when the aggregate balance of the unreported accounts exceeds €50,000 (applicable as of the 2011 tax year) on December 31 of the relevant year.
- In the case of assets held through an intermediary entity (e.g., trusts, foundations, corporations, etc.) benefiting from a preferential tax regime, the provisions of Article 123bis of the French Tax Code ("F.T.C.") apply.¹⁰

Taking into consideration the voluntary compliance effort of the taxpayer, the F.T.A. may agree to reduce the 40% penalty and the penalty for failure to declare the foreign accounts.¹¹

Moreover, new tax instructions dated December 12, 2013 increased the penalties in the case of noncompliance with reporting obligations relating to trusts. Failure to comply with these reporting obligations is now punishable by the higher of €20,000 or 12.5% of the value of assets put in the trust. In addition, the new law also provides a penalty of 40% applied to taxpayers subject to the wealth tax for the first time. These new provisions of the law are applicable to wealth tax due for the year 2014, but the tax instruction dated December 12, 2013 provides for a possible reduction of these penalties.

U.S. VOLUNTARY OFFSHORE COMPLIANCE

Willfulness, O.V.D.P., and a 27.5% or 50% Offshore Penalty: Protection Against Criminal Prosecution and Closure

The offshore voluntary disclosure program ("O.V.D.P.") is for taxpayers whose noncompliance was willful (*i.e.*, conduct not merely due to negligence,

¹⁰ The application of this Article allows the F.T.A. to tax real or lump sum incomes of these entities on a progressive scale with regard to income tax (under the category of revenue from investment income) and to social security contributions, with an increase of 25% of the amount of incomes.

¹¹ The interest for late payment does not benefit from a reduction because it is not considered to be a penalty. It aims to repair damage suffered by the French State because of noncompliance by taxpayers of their obligations to report and pay tax at maturity.

inadvertence, or mistake; or to conduct that is not merely the result of a good faith misunderstanding of the requirements of the law) and who are not currently under audit. It enables these taxpayers to become compliant and to incur substantially lower penalties than would be applied in an I.R.S. audit. It also generally eliminates the risk of criminal prosecution.

The O.V.D.P. process can be broken down in three steps: Pre-Clearance, Preliminary Acceptance, and Final Submission.

- Pre-clearance involves the submission of a fax to the Criminal Investigation Division of the I.R.S., providing basic identifying information about the taxpayer, the taxpayer's foreign bank accounts, and the way the foreign bank accounts were held. Upon receipt of the submission, the Criminal Investigation Division will either "pre-clear" the taxpayer or advise that he or she is not eligible for participation.
- If the taxpayer is pre-cleared, a Voluntary Disclosure Letter and Attachments must be prepared and submitted. These documents provide more information regarding the foreign, undisclosed assets, including the origin of the funds and the interactions with the foreign financial institutions. One attachment per foreign account must be attached to the Voluntary Disclosure Letter. Once these documents are submitted, the taxpayer waits for the I.R.S. to preliminarily accept the taxpayer into the voluntary disclosure program.
- Upon receipt of the Preliminary Acceptance, the taxpayer prepares the full submission package.
 - This includes copies of originally filed tax returns for the last eight years, copies of originally filed FinCEN Form 114 for the past eight years (if any), amended tax returns for the past eight years, delinquent or amended FinCEN Forms 114 for the past eight years, the payment of the 27.5% or 50% miscellaneous Offshore Penalty and the payment of back-taxes, failure-to-pay, and failure-to-file penalties if applicable, and a 20% accuracy-related penalty. In addition, interest applies to the back-taxes, the failure to file penalties and the 20% accuracy-related penalty.
 - Particular attention must be paid to international reporting forms. These include Form 5471 (*Information Return of U.S. Person with Respect to Certain Foreign Corporations*), Form 8938 (*Statement of Specified Foreign Financial Assets*), Form 8621 (*Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*), Form 8865 (*Return of U.S. Persons With Respect to Certain Foreign Partnerships*), Form 926 (*U.S. Transferor of Property to a Foreign Corporation*), and Form 3520 (*Annual Return to Report Foreign Trusts and Receipt of Certain Foreign Gifts*).
 - In addition, Form 8960 (*Net Investment Income Tax—Individuals, Estates, and Trusts*) is required when the foreign assets generated unreported net investment income for applicable years (2012 and subsequent years in the filing period), and Part III of Schedule B to



Form 1040 (*U.S. Individual Income Tax Return*) relating to the existence of foreign accounts must be submitted in accurate form.

Once the I.R.S. has concluded an examination of the final submission, a Form 906 (*Closing Agreement on Final Determination Covering Specific Matters*) is signed by the taxpayer and the I.R.S. and the matter is put to rest. This procedure thus gives finality to the taxpayer.

"Filing under the Streamlined Filing Compliance Procedures has a shorter look-back period than the O.V.D.P."

Non-willfulness, Streamlined Procedures, and a 0%-5% Offshore Penalty: No Protection against Criminal Prosecution and No Immediate Closure¹²

When the taxpayer's noncompliance was non-willful, and income generated from the foreign financial accounts was previously unreported, the Streamlined Filing Compliance Procedures may be applicable. Announced on June 18, 2014, this program is available to U.S. taxpayers residing within or outside the U.S. In contrast to the O.V.D.P., entering into the Streamlined Procedure does not eliminate the risk of criminal prosecution. Once a submission is made under the Streamlined Compliance Procedure, the O.V.D.P. cannot be entered anymore and vice-versa.

Filing under the Streamlined Filing Compliance Procedures has a shorter look-back period than the O.V.D.P. For income tax purposes, the look-back period is three years and for F.B.A.R. purposes, the look-back period is six years. In addition, a non-willful certification must be submitted by the taxpayer. In this certification, the taxpayer must certify, under penalties of perjury, that the past noncompliance was not willful. The rules vary slightly depending on whether the taxpayer is considered a U.S. resident.

- For taxpayers not spending more than 35 days in the U.S. in any of the most recent three years for which the due dates (including extensions) have passed, no offshore miscellaneous penalty is imposed on the highest aggregate value of the foreign assets over the past six years.
- If the 35-day threshold of U.S. presence is exceeded, the taxpayer can come into compliance under the Domestic Streamlined Procedures, as long as tax returns were actually filed for the most recent three years for which the due dates (including extensions) have passed. In this scenario, an offshore penalty of 5% of the highest aggregate balance of the taxpayer's foreign financial assets must also be paid at the time of the submission.
- In either scenario, once the final submission is made, the taxpayer must wait for the statute of limitations to run out to be certain that penalties will not be imposed.

This program is much less burdensome than the O.V.D.P., but facts supporting non-willful behavior must be carefully analyzed because the O.V.D.P. and the

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"The 2014 IRS Offshore Voluntary Disclosure Program and New Streamlined Filing Procedures," Duane Morris. June 23, 2014.

Streamlined Filing Compliance Procedures are mutually exclusive and a false certification of non-willfulness is itself a felony.

Non-Willfulness, Proper Past Income Reporting, Delinquent Submission Procedures and Potentially no Penalties

For taxpayers whose failure to file F.B.A.R.'s or international information returns was non-willful, delinquent submission procedures are available under certain circumstances. These procedures do not provide any protection against criminal prosecution. In addition, the I.R.S. may subject these filings to a full audit.

- Taxpayers whose failure to file F.B.A.R.'s was non-willful and who reported the income from the non-disclosed foreign accounts on their U.S. tax returns can file delinquent F.B.A.R.'s and provide a reason for late filing, provided they are not under civil or criminal investigation by the I.R.S., have not already been contacted by the I.R.S. regarding delinquent F.B.A.R.'s, or have no other noncompliance issue that is currently being addressed through either the Streamlined Procedure or the O.V.D.P.
- Taxpayers whose failure to file international information returns was non-willful, can file delinquent international information returns along with a reasonable cause statement, provided that they are not under civil or criminal investigation by the I.R.S., have not already been contacted by the I.R.S. regarding delinquent international information returns, or have no other international information return noncompliance that is currently being addressed through either the Streamlined Procedure or the O.V.D.P.

COMPARATIVE TABLE

	FRANCE	U.S.
<i>Number of Official Offshore Compliance Programs</i>	1	2 – O.V.D.P. and Streamlined Filing Procedures
<i>Number of Steps Prior to Final Submission Package</i>	1	3 for O.V.D.P.; 1 for Streamlined
<i>Disclosure of Taxpayer's Identity</i>	On the first step	As of first step for O.V.D.P.; At time of submission for Streamlined
<i>Guidance</i>	Yes – "Circulaire Cazeneuve"	On the I.R.S. webpage
<i>Possibility for Taxpayers to Negotiate with I.R.S./ French Tax Authorities</i>	No	No – Rules set on I.R.S. website and Frequently Asked Questions for O.V.D.P. and Streamlined
<i>Back Taxes, Penalties, and Interest</i>	Yes	Yes
<i>Penalties on Highest Foreign Accounts</i>	Yes	Yes
<i>Criminal Charges</i>	No	Generally not under O.V.D.P. and no reason under Streamlined if Streamlined requirements met