

White Collar Criminal Defense, Regulatory Compliance and Special Investigations Update

08/19/09

IRS Sharpens Tools in Pursuit of Alleged Tax Violations

Two recent court cases - one that received much press and another less-publicized case - both demonstrate the IRS's aggressive stance on investigating alleged tax violations and the degree to which the courts will bless such conduct over the protests of corporate and individual taxpayers.

The much-publicized case is the civil suit brought by the United States Department of Justice against Swiss banking giant UBS AG ("UBS") to force UBS to disclose names of account holders who may have used Swiss UBS accounts to evade the tax laws of the United States. Previously, UBS also had been under criminal investigation by federal prosecutors in a case that was settled in February 2009. While no criminal charges were brought against the bank in that criminal action, in February UBS agreed to pay \$780 million to settle charges that it helped wealthy Americans evade taxes on nearly \$20 billion hidden in offshore accounts. One day later, the Justice Department filed a civil suit seeking to force UBS to disclose 52,000 client names associated with the offshore accounts. Initially, the bank and the Swiss government took hard-line stances against the civil suit. UBS resisted disclosure, arguing that doing so would cause it to violate Swiss banking laws. The Swiss government also said it would block UBS from turning over the names if ordered to do so, while the Justice Department said that it might consider indicting the bank if it refused to do so upon a judge's order. UBS and the Swiss government argued in the tax-evasion case that Swiss bank-privacy law meant the bank couldn't hand over the account identities.

The settlement signals that UBS and the Swiss government appear to have combed through the taxpayer bank files and have identified enough potential fraud to make them willing to hand over information about certain accounts. (Swiss laws don't provide confidentiality if people engage in fraudulent activities.)

Details of the settlement were released on August 19, 2009. The agreement requires the disclosure to the Internal Revenue Service ("IRS") of 4,450 UBS Swiss accounts held by U.S. citizens or residents. The Swiss government will notify the account holders that their names are being released to the IRS but the account holders will have an opportunity to appeal the release of their names. The settlement also provides for a voluntary disclosure program for United States citizens and entities that hold previously undisclosed Swiss bank accounts. Holders of undeclared Swiss accounts with UBS have until September 23, 2009, to participate in the IRS's Voluntary Disclosure Program (the "Program") to disclose their accounts with the possibility of paying reduced tax penalties and clearance from criminal tax prosecution. For more details about

the voluntary disclosure program, our Tax Law Practice Group at Lane Powell has written a companion legal update, "[Agreement Between the United States and Swiss Governments Will Require UBS to Disclose 4,450 Swiss Accounts Held by U.S. Citizens or Residents.](#)" that outlines the procedures and timeframe for participation in the program.

The initiation of the civil and criminal actions and the settlements sought and obtained by the IRS demonstrate that the IRS will not stop at the U.S. border to pursue its investigations; it will aggressively challenge foreign privacy laws that could hinder its investigations.

The second case, while not as well-publicized, also demonstrates the aggressive nature of the IRS. In this case, the IRS won the right to gain access to the internal memoranda of a company later investigated by the IRS. The IRS initiated an investigation to look at certain deductions related to a sale-in, lease-out ("SILO") transaction claimed by conglomerate Textron on its 2001 corporate tax return. The IRS considered the SILO deal to be a potentially illegal tax shelter and sought so-called "tax accrual work papers" prepared or reviewed by Textron's in-house and outside lawyers. These documents analyzed the likelihood that the IRS might challenge this transaction and whether Textron had created adequate reserves to cover any additional tax liability. Textron refused to turn over these documents, citing the work-product privilege. The federal district court judge who heard the case sided with Textron and protected the documents from disclosure to the IRS. The IRS appealed, and a three-judge panel of the First Circuit Court of Appeals upheld the trial judge and sided with Textron. Undeterred, the IRS asked that the case be heard by an en banc panel of the First Circuit. The Court agreed, had new arguments on the case, and, surprisingly, last week, it reversed the prior decisions and ruled that Textron had to turn the papers over to the IRS. The appellate court ruled that the work-product privilege only applies to documents prepared for litigation, and that the documents at issue here are not protected by the work-product privilege because they were not prepared for litigation, but were only prepared for an issue that "might lead to litigation." The court held that "it [is not] enough that the materials were prepared by lawyers or represent legal thinking ... Much corporate material prepared in law offices or reviewed by lawyers falls in that vast category. It is only work done in anticipation of or for trial that is protected."

The ruling is significant for two reasons: One, it again shows the aggressive nature of the IRS, and, two, the ruling should cause in-house counsel and outside tax advisors to give great care as to how they create, characterize, and use work product to keep it within the scope of the work-product privilege.

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