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PERSPECTIVE

US gets 'beaned' in offshore tax case

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On July 10, the 7th U.S. Circuit Court of Appeals affirmed the probationary sentence given to billionaire Beanie Babies creator H. Ty Warner for evading $5.6 million in U.S. taxes through the use of undisclosed Swiss bank accounts with balances totaling over $100 million. *United States v. H. Ty Warner*, 14-1330. This high-profile defeat for the government in the largest of the more than 100 offshore tax cases brought to date continues the trend of courts declining to impose prison time on top of the harsh financial penalties that apply in such cases. The decision also emphasizes the continuing value of applying to enter the Internal Revenue Service's ongoing offshore voluntary disclosure program (OVDP), the third version of which started in 2012 and which provides taxpayers with criminal amnesty and reduced penalties if they disclose their unreported foreign accounts before the IRS finds them.

Warner pleaded guilty in 2013 to one count of tax evasion. In his plea agreement, he admitted failing to disclose his accounts at two Swiss banks for over 10 years and failing to pay $5.6 million in taxes on over $24.4 million in interest income during that time. Warner agreed to pay full restitution as well as a civil "FBAR" (Foreign Bank Account Report) penalty of over $53.5 million, representing 50 percent of the maximum balance of over $100 million in his offshore accounts. The U.S. Sentencing Guidelines called for a sentence in the 46- to 57-month range. At the sentencing in January 2014, the government sought an incarceration term "in excess of a year and a day"; the district court rejected that request and imposed a sentence of two years of probation, 500 hours of community service, and a $100,000 fine. The government appealed, arguing that a noncustodial sentence was substantively unreasonable under all the circumstances of the case.

In affirming Warner's sentence, the 7th Circuit emphasized the broad sentencing discretion given to district judges ever since the U.S. Supreme Court rejected mandatory application of the guidelines in *United States v. Booker*, 543 U.S. 220 (2005). The court found that the sentencing judge properly gave weight to Warner's impressive history of charitable works, to his unsuccessful effort to enter the OVDP before learning he was under investigation, and to the massive FBAR penalty that Warner paid before sentencing — the largest such penalty the government has collected to date, and nearly 10 times the size of the tax loss attributable to Warner's conduct. Because the sentencing judge's balancing of the aggravating and mitigating factors was within his discretion, the appellate court gave due deference to the district court's "reasoned and reasonable" probationary sentence and affirmed it.

The result in *Warner* parallels that in the Florida case of Mary Estelle Curran (a case in which these authors served as co-defense counsel). Curran was a 79-year-old widow who pleaded guilty to failing to disclose $43 million in a Swiss UBS account that she had inherited from her late husband. Like Warner, Curran had no criminal history, had an extensive record of philanthropic and charitable work, paid her back taxes of $667,716 and a substantial $21.6 million FBAR penalty (over 30 times greater than the tax loss), and had tried to enter the OVDP but had been rejected because — unbeknownst to her — the government had already secretly obtained her name from UBS mere weeks before she tried to enter the program. At Curran's sentencing in April 2013, the district judge imposed one year of probation and then immediately terminated it, resulting in what the court described as a "five-second" probationary sentence. But the judge went even further, strongly chastising the government for bringing the case, urging Curran to apply for a presidential pardon, and admonishing the government that it would be spiteful if it opposed that application. (The government did not appeal Curran's sentence.)

These cases continue the demonstrable pattern of probationary or substantially below-guidelines sentences imposed in offshore tax evasion cases. As the 7th Circuit noted in *Warner*, roughly half of the defendants convicted since

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H. Ty Warner, the billionaire creator of Beanie Babies, arrives at a federal court in Chicago earlier this year.

2008 (when the Department of Justice began its offshore compliance initiative) have received terms of probation rather than imprisonment. Many judges appear to be sending a message that they view the Sentencing Guidelines ranges for these cases as too high, particularly in light of the often exorbitant FBAR penalties that are imposed — a form of financial punishment and deterrence that does not exist in domestic tax evasion cases, where such pronounced deviations from the guidelines are far less commonplace. The *Warner* court expressly recognized that the FBAR penalty, while technically civil in nature, may be considered in assessing the adequacy of a criminal sentence from the standpoint of both punishment of the defendant and deterrence of others.

As noted above, one factor that appeared to greatly bother the sentencing judges in both of these cases was that the defendants had tried to "come clean" and avail themselves of the OVDP before being contacted by the IRS but were nevertheless prosecuted because they were among the unlucky few whose account information had already been turned over to the IRS by the Swiss banks. The 7th Circuit noted that thousands of tax-evading taxpayers had successfully avoided criminal prosecution entirely by entering the program. Indeed, the IRS boasts that over 45,000 taxpayers to date have entered the OVDP — and not been criminally prosecuted — resulting in the government collecting over $6.5 billion in taxes, penalties and interest. The court recognized both the seeming randomness of this eligibility determination and the attendant financial consequence (a 50 percent FBAR penalty rather than the 20 percent penalty under the OVDP, a difference in Warner's case of over $32 million) in finding that Warner's failed good-faith attempt to enter the OVDP was a mitigating factor supporting probation.

Together, these cases offer valuable insights for future offshore tax cases. First, these cases, along with the track record in other offshore tax prosecutions since 2008, show that courts are willing to sentence these tax offenders to probation or significantly below-guidelines sentences where defendants plead guilty, pay significant FBAR penalties, have no criminal histories, and are charitably active or otherwise contributing members of the community. Second, entering or attempting to enter the OVDP has strong positive benefits, either providing taxpayers with full criminal amnesty or offering a powerful argument for a probationary sentence. Third, where the government overreaches to pile incarceration on top of a felony conviction and a draconian FBAR penalty, courts will often step in to reject the government's unreasonable position. Lastly, in the post-Booker tax sentencing world, defense attorneys need to provide the court with a robust record of all of the defendant's good acts and character to counterbalance the government's standard argument that general deterrence in tax cases always requires incarceration.

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