The IRS
Tax Evasion and Money Laundering

Prepared by:

Gary S. Wolfe

THE WOLFE LAW GROUP

LORMAN EDUCATION SERVICES

July 2016

THE WOLFE LAW GROUP

Gary S. Wolfe has over 34 years of experience, specializing in IRS Tax Audits and International Tax Matters including: International Tax Planning/Tax Compliance, and International Asset Protection.

As of July 2016, Gary Wolfe has internationally published 15 books and 28 articles. Gary has received 14 international tax awards from five different Global expert societies in LONDON/UK including being voted one of the 100 leading world's law firms with votes from over 150,000 voters in over 160 countries with the following award: Global 100 (2016) (KMH Media Group) - CA/US International Tax Planning Law Firm of the Year.

For more information please visit our website: gswlaw.com

Gary S. Wolfe, A Professional Law Corporation
6303 Wilshire Blvd., Suite 201
Los Angeles, CA, 90048
Tel: 323-782-9139
Email: gsw@gswlaw.com

The IRS: Tax Evasion and Money Laundering

International tax and estate planning may lead to tax evasion (and additional crimes: money laundering, mail fraud, wire fraud) if the U.S. taxpayer either fails to pay tax due to federal, state or foreign governments. The U.S. taxpayer may be culpable for violation of U.S. wire fraud laws, money laundering laws or mail fraud laws, which may lead to asset forfeiture.

Income tax deficiencies (i.e. failure to pay tax due) which create "tax cheating" proceeds, when used to purchase assets or make investments may subject the taxpayer to separate felonies:

1. Tax Evasion (failure to pay the tax due);

2. Money Laundering -The use of proceeds from a specified unlawful activity, i.e. tax evasion, to purchase or make investments in assets which transmute the original "illegal tax-cheating" proceeds into another asset;

3. Mail Fraud: The use of the postal system to effectuate a scheme to defraud (18 U.S.C. Sec. 1341);

4. Wire Fraud: the use of the telecommunications facilities to effectuate a scheme to defraud (18 U.S.C. Sec. 1341).

MONEY LAUNDERING

Money laundering may be linked to tax evasion. A violation of the money laundering statutes includes a financial transaction involving the proceeds of a specified unlawful activity ("SUA") with the intent to either:

1. Promote that activity;

2. Violate IRC Sec. 7201 (which criminalizes willful attempts to evade tax);

3. Violate IRC Sec. 7206 (which criminalizes false and fraudulent statements made to the IRS).

The tax involved in the transaction (and which is avoided) may be any tax: i.e. income, employment, estate, gift and excise taxes (See: U.S. Dept. of Justice, Criminal Tax Manual, Chapter 25, 25.03(2)(a).

Under the money laundering statutes, the IRS is authorized to assess a penalty in an amount equal to the greater of:

1. The financial proceeds received from the fraudulent activity, or

2. $10,000 (under 18 U.S.C. Sec. 1956(b)), the authority is granted by statute to the U.S. not the IRS, and is enforced either by a civil penalty or a civil lawsuit.

Violations of statutes for:

1. Mail fraud;

2. Wire fraud;

3. Money laundering.

-- are punishable by monetary penalties, civil and criminal forfeiture. (See 18 U.S.C. Sec. 981 (a)(1)(A) which permits property involved in a transaction that violates 18 U.S.C. Sec. 1956, 1957 and 1960 to be civilly forfeited).

Civil forfeiture statutes include:

1. 18 U.S.C. Sec. 1956, which outlaws the knowing and intentional transportation or transfer of monetary funds derived from specified criminal offenses. For Sec. 1956 violations, there must be an element of promotion, concealment or tax evasion;

2. 18 U.S.C. Sec. 1957, which penalizes spending transactions when the funds are contaminated by a criminal enterprise;

3. 18 U.S.C. Sec. 1960, which penalizes the unlicensed money transmitting business.

Under 18 U.S.C. Sec. 981(b)(2), seizures are made by warrant in the same manner as search warrants. Under 18 U.S.C. Sec. 981(b)(1), the burden of proof is by a preponderance of the evidence. The property may be seized under the authority of the Secretary of the Treasury when a tax crime is involved.

Under 18 U.S.C. Sec. 982(a)(1)(A), if the offense charged is a violation of the Money Laundering Control Act, and the underlying specified unlawful activity is mail or wire fraud, courts may order criminal forfeiture of funds involved in the activity on conviction.

The U.S. Dept. of Justice Tax Division policy requires U.S. attorneys to obtain Tax Division approval before bringing any and all criminal charges against a taxpayer involving a violation of the Internal Revenue Code. Absent specific approval, additional criminal charges for wire fraud, mail fraud and money laundering would not normally be included (U.S. Dept. of Justice Criminal Tax Manual, Chapter 25, 25.01). If the additional criminal charges are approved, the taxpayer risks having the trust assets seized or forfeited.

Regarding asset seizure, the U.S. government may seize assets pursuant to a violation of the money laundering laws. In addition, the IRS has authority for seizure and forfeiture under Title 26. Under IRC Sec. 7321, any property that is subject to forfeiture under any provision of Title 26 may be seized by the IRS.

IRC Sec. 7301 allows for the IRS to seize property that was removed in fraud of the Internal Revenue laws. IRC Sec. 7302 allows the IRS to seize property that was used in violation of the Internal Revenue laws.

In the case of transfer of funds to an offshore trust, it can trigger a violation of U.S. money laundering laws and lead to asset forfeiture. For example, tax counsel may recommend a tax planning strategy, and provide instructions by telephone, email or U.S. mail, which include client’s transfer of funds pursuant to tax counsel’s instructions. These combined actions may trigger a violation of U.S. money laundering laws and lead to asset forfeiture.

TAX COUNSEL, TAX EVASION (and Money Laundering) OFFSHORE TRUSTS

A U.S. taxpayer's failure to comply with U.S. tax law may implicate tax counsel in tax evasion. The IRS or the U.S. Dept. of Justice may allege that tax counsel aided and abetted the client in evading U.S. tax, if tax counsel:

1. Aided and assisted the U.S. taxpayer in the submission of materially false information to the IRS; IRC Sec. 7206(2), or

2. Assisted the client in removing or concealing assets with intent to defraud— (IRC Sec. 7206(4)).

For a U.S. taxpayer's transfer of assets to an offshore trust, despite receiving U.S. tax counsel's tax compliance recommendations, the U.S. taxpayer fails to comply with U.S. tax law, and tax counsel fails to ensure ongoing tax compliance, tax counsel may be implicated in money laundering.

If the U.S. taxpayer's tax noncompliance includes: tax evasion and transfer of the "tax evasion proceeds" to the offshore trust by wire transfer or U.S. mail, the transfer of funds may be classified by the IRS/U.S. Dept. of Justice as wire fraud or mail fraud, both of which are "specified unlawful activities" under the Money Laundering Control Act (18 U.S.C. Sec. 1956 and 1957), the U.S. taxpayer and their tax counsel may be criminally prosecuted for violation of the money laundering statutes.

Specified Unlawful Activities ("SUA") are listed in 18 U.S.C. Sec. 1956(c)(7). SUAs are the predicate offenses for money laundering and come in three categories:

1. State crimes;

2. Federal crimes; and

3. Foreign crimes.

If the U.S. client transfers funds to an offshore trust under a tax counsel's tax-planning strategy and the U.S. tax client is not in compliance with U.S. tax laws (despite tax counsel's recommendations) then tax counsel may be exposed to IRS penalties:

1. IRC Sec. 6694: imposes civil penalties on tax preparers;

2. IRC Sec. 7212: imposes criminal penalties for interfering with the administration of the Internal Revenue laws.

In addition, tax counsel may receive attention from the IRS/Treasury Dept. from the Office of Professional Responsibility in connection with Circular 230, which sets forth the rules to practice before the U.S. Treasury Dept. and is governed by regulations that appear in Title 31, Part 10 of the Code of Federal Regulations, which contains rules governing the tax professionals who represent taxpayers before the IRS, including attorneys, CPAs and enrolled agents.

A U.S. taxpayer risks having their trust assets seized or forfeited if the additional charges are approved; i.e. tax evasion/money laundering. Tax counsel may also be subject to asset seizures if their fees received come from illegal sources.

In Greenstein (superseding Indictment No. CR 08-0296 RSM, Western District of Washington at Seattle, United States Attorney's Office, Western District of Washington, News Release 6/9/09): the U.S. government sought criminal forfeiture in a tax shelter scheme by adding charges of wire fraud, mail fraud and conspiracy to launder monetary instruments. The Greenstein case also involved additional offenses such as ill-gotten professional fees not disclosed to investor clients.

In Daugerdas (Indictment No. 51 09 Cr. 581, So. Dist. N.Y., U.S. Attorney, So. Dist. of N.Y., Press Release 6/9/09) the U.S. government used a civil forfeiture in a tax shelter and Klein conspiracy prosecution under 18 U.S.C. 371.

In U.S. v. Velez, Kuehne and Ochoa, D.C. Docket No. 05-20770-CR-MGC (CA-11, 10/26/09), while the U.S. government lost, it still may prosecute counsel who received fees from a client if the funds being used to pay the fee come from illegal sources.

Tax counsel may be implicated in a “Klein conspiracy” (18 U.S.C. 371 is the general conspiracy statute). It makes it a crime for two or more persons to conspire to commit an offense against the U.S. by violating a specific statute or statutes, as well as two or more persons to agree to defraud the U.S.

A Klein conspiracy is a prosecution where the government must prove that there was agreement by two or more persons to impede the IRS and each person knowingly, willfully and intentionally participated in the conspiracy. Additionally, there is no attorney-client privilege for the crimes.

U.S. MONEY LAUNDERING LAW AND FOREIGN TAX EVASION

In the Pasquantino case, (96 AFTR 2d 2005-5392 (2005), the U.S. Supreme Court determined that a foreign government has a valuable property right in collecting taxes and that right may be enforced in a U.S. court of law.

Under the CRS Report for Congress, Money Laundering: An abridged overview of 18 U.S.C. Sec.1956 and Related Federal Criminal Law, Charles Doyle, Senior Specialist, American Law Division (7/18/08), specified unlawful activities (“SUAs”) which are predicate offenses for money laundering offenses, include: state crimes, foreign crimes and federal crimes (SUAs are listed in 18 U.S.C. Sec. 1956(c)(7).

As stated in the U.S. Dept. of Justice Criminal Tax Manual, Chapter 25, 25.03(2)(a), tax evasion as a predicate offense for money laundering is a financial transaction involving the proceeds of specified unlawful activity with the intent either to promote that activity or to violate IRC Sec. 7201 (willful attempt to evade tax, IRC Sec. 7206), (false and fraudulent statements made to the IRS) with the tax involved in the transaction being any type of tax including but not limited to: income tax, employment tax, estate tax, gift tax and excise tax.

In Pasquantino, the defendants evaded Canadian excise taxes in a liquor smuggling scheme. The U.S. government prosecuted the taxpayers under a wire fraud statute, based on communications made within the U.S. In addition, it appears the defendants committed tax evasion in Canada, which under the cited authority (CRS Report for Congress, money laundering, the U.S. Dept. of Justice Criminal Tax Manual) would be predicate offenses (i.e. SUAs) for money laundering.

In the U.S. "wire fraud" is governed under 18 U.S.C. Sec. 1343 which provides: "whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both. If the violation affects a financial institution, such person shall be fined not more than $1M or imprisoned not more than 30 years, or both."

The wire fraud statute (18 U.S.C. 1343) forbids schemes to obtain "money or property" by fraud. If no property or money is involved, the statute does not reach the conduct in question.

The defendants in Pasquantino objected to being tried under the wire fraud statute on the grounds that uncollected Canadian taxes were not "property" for purposes of the wire fraud statute. The court disagreed, concluding that because the defendants would have paid taxes had they disclosed the liquor to border officials, their failure to pay taxes inflicted economic injury on Canada "no less than had they embezzled funds from the Canadian treasury".

In concluding that Canada had a property right in its attempt to collect tax, it states: "Petitioners used interstate wires to execute a scheme to defraud a foreign sovereign of tax revenue. Their offense was complete the moment they executed the scheme inside the United States; "the wire fraud statute punishes the scheme, not its success". (United States v. Pierce, 224 F.3d 158, 166 (CA-2, 2000); (internal quotation marks and brackets omitted). See Durland, 161 U.S. at 313 ("the significant fact is the intent and purpose"). This domestic element (i.e. the wire fraud in the U.S.) is what the government is punishing in this prosecution, no less than when it prosecutes a scheme to defraud a foreign individual or corporation, or a foreign government acting as a market participant."

The U.S. "Fraud Enforcement and Recovery Act" (S. 386), 94 DTR G-3, codified the definition of the term "proceeds" in the money laundering statute to make clear that the proceeds of specified unlawful activity includes the gross receipts of the illegal activity, not just the profits of the activity. The "Fraud Enforcement and Recovery Act" overruled the U.S. Supreme Court ruling in the Santos case (128 S.Ct. 2020 (2008)), defining proceeds as "net proceeds" (not gross proceeds, which Supreme Court decision limited the reach of money laundering statutes to "profitable crimes"), which was also held by the 11th Circuit in Khahani, 502 F.3d 1281, 1296-97 (CA-11, 2007) which stated: "proceeds does not contemplate profits or revenue indirectly derived from labor or from the failure to remit taxes".

The 3rd Circuit in Yusuf (536 F.3d 178 (CA-3, 2008) held that the government could use the mail fraud statute in support of an international money laundering charge. The Yusuf case dealt with a scheme to defraud the U.S. Virgin Islands out of a gross receipts tax. The tax at issue in this case was not an income tax, but a tax on a straight percentage of sales. In addition to holding that the retained taxes were the proceeds of mail fraud, the 3rd Circuit further held that the retained taxes amounted to profits.

The IRS and the U.S. Dept. of Justice have significant legal authority to treat international tax evasion as a predicate offense to money laundering. On 10/29/04, the Dept. of Justice Tax Division amended Tax Division Directive 128 so that domestic tax offenses may be charged as mail or wire fraud (emphasis added). Tax offenses are predicate offenses for a money laundering violation include: state, federal or foreign taxes. These tax evasion offenses may arise as an adjunct to an international estate plan because of the attendant income and transfer taxes that may be due incident to the implementation or ongoing maintenance of an estate plan.

For example, a taxpayer who mails a false state income tax return may be a subject to both mail fraud (and tax evasion). See: Helmsley, 941 F.2d 71, 68 AFTR 2d 91-5272 (CA-2, 1991), cert. den. 502 U.S. 1091 (1992).

Tax Division Directive No. 128 permits the Dept. of Justice to bring mail fraud or wire fraud charges in tax-related schemes if:

1. There is a large loss related to fraud;

2. There is a significant benefit to bringing such charges.

Tax Division Directive No. 128 does not apply in routine tax prosecutions but does apply to fraud charges. If there is “significant benefit”, fraud charges will be considered:

1. At the charging order stage to ensure that there is support for forfeiture of the proceeds of a scheme to defraud;

2. At trial, all relevant evidence will be admitted;

3. At sentencing, to ensure full restitution, promoters of tax schemes are particularly targeted [See USAM G-4.210].

The U.S. Dept. of Justice, Tax Division policy will not authorize prosecution for money laundering “where the effect would merely be to convert routine tax prosecutions into money laundering prosecutions, as the statute was not intended to provide a substitute for traditional Title 18 and Title 26 charges related to tax evasion, filing of false returns or tax fraud conspiracy” (U.S. Dept. of Justice Criminal Tax Manual, Ch. 25, 25.01). The U.S. government may seize taxpayer assets under either tax evasion or money laundering charges.

In Ianniello, 98 TC 165 (1992) taxpayers were convicted of mail fraud and tax evasion for $666,667 in restaurant profits that had been illegally skimmed. The IRS assessed a fraud penalty for failure to include skimmed profits in taxable income.

The taxpayers’ defense was that the skimmed receipts were not income because they were forfeited to the government. The court held that the receipts were income: “A taxpayer obtains possession, custody and control of proceeds he acquires unlawfully, despite a statutory forfeiture provision that tests legal title to the proceeds in the United States, on the date he acquires such proceeds (See: Wood, 863 F.2d 417), 63 AFTR 2d 89-709 (CA-5, 1985); Gambino, 91 TC 826 (1988); Holt 69 TC 75 (1977); Bailey, TCM 1989-674, aff’d 929 F.2d 700 (CA-6, 1991).

The U.S. Supreme Court held: (“IRC Sec. 61 provides that gross income means all income from whatever source derived”). “Gross income includes all accessions to wealth, clearly realized and over which the taxpayers have complete dominion (James v. U.S. 213, 7 AFTR 2d 1361 (1961), quoting Glenshaw Glass Co., 348 U.S. 426, 47 AFTR 162 (1955).)

Tax evasion may expose U.S. taxpayers to additional crimes: money laundering, mail fraud and wire fraud, which can expose the taxpayer to violations of U.S. criminal law, forfeiture of assets, and exposure of counsel to violations of U.S./state criminal laws, IRS Circular 230 and claims for malpractice, when a client's assets are seized or forfeited.