Excerpt from eBook

Offshore Tax Evasion: The IRS and Swiss Banks

International Tax Evasion: Tax Evasion & Money Laundering

International Tax Evasion: Offshore Accounts

International Tax Evasion: Civil/Criminal Penalties

International Tax Evasion: Willfulness Defense

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Chapter 11 - International Tax Evasion: Tax Evasion & Money Laundering

"Money Laundering" is the disguise of the nature or the origin of funds. The predicate offenses (known as Specified Unlawful Activities; i.e. "SUA"), under the Money Laundering Control Act (18 U.S.C. Sec. 1956 and 1957) include: state tax evasion, federal tax evasion and foreign tax evasion.

A U.S. Taxpayer (or Foreign Taxpayer) may be held liable for Tax Evasion if: - They willfully fail to pay a tax due. - They willfully fail to file a tax return due. - They willfully file a false or fraudulent tax return.

U.S. Taxpayers (and tax advisors) implicated in U.S. tax evasion face separate felonies for tax evasion and money laundering. Foreign Taxpayers, who commit Foreign Tax Evasion, may implicate U.S. tax advisors in money laundering felonies, for the foreign client transfer of funds, which involve the U.S. tax advisors.

For both U.S. and Foreign Taxpayers, undisclosed foreign accounts, may be the depository accounts used to commit tax evasion, including:

Taxpayer failure to pay tax, file tax returns, or file false (fraudulent) tax returns for the original funds (which are the source of the proceeds used to fund the foreign accounts). Taxpayer failure to pay tax, file tax returns, or file false (fraudulent) tax returns for the earnings, on the assets held in the undisclosed foreign accounts

Depending upon the counsel's role in taxpayer's non-compliance, counsel may be held liable for aiding and abetting the client in tax evasion. Counsel may be held liable for:

- Aiding and assisting in the submission of materially false information to the IRS (IRC Sec. 7206(2).

- Assisting the client in removing or concealing assets with intent to defraud (IRC Sec. 7206(4).

Under *Pasquantino*, 96 AFTR 2d 2005-5392 (2005), the U.S. Supreme Court held that a foreign government has a valuable property right in collecting taxes (in this case Canadian excise taxes), and that right may be enforced in a U.S. court of law. Counsel who advise on international tax issues could be viewed as interfering with a foreign government's right to collect taxes. In this case, taxpayer used interstate wiring to execute a scheme to "defraud a foreign sovereign of tax revenue" (both wire fraud and tax evasion, two separate predicate offenses for foreign money laundering).

Under *Pasquantino*, international tax evasion is deemed a "Specified Unlawful Activity," which is a predicate offense for money laundering.

"Klein Conspiracy Prosecution"

Under 18 U.S.C. Sec. 371 it is a crime for two or more persons to conspire to commit an offense against the U.S. Under Klein an agreement by two or more persons to impede the IRS with each participant knowingly, willfully and intentionally participating in the conspiracy.

International Estate Plan

Tax counsels who advise a client on an international estate plan, may subject themselves to liability. Once the estate plan is in place, a client's subsequent actions may lead to U.S. or foreign tax evasion; e.g., violation of U.S. money laundering, wire fraud or mail fraud laws.

If a Tax Attorney forms entities (e.g. Trust, Limited Liability Company, Corporation) sends instructions to a client via telephone, email, U.S. Mail, and a client transfers funds pursuant to counsel's instructions, it may lead to tax evasion, a predicate offense (an "SUA"), which can trigger a violation of U.S. money laundering laws.

After the entities are formed, and despite receiving tax compliance guidance from counsel, the client fails to comply with the tax law, and counsel fails to ensure ongoing full tax compliance, the client may be held liable for both tax evasion and money laundering. If so, tax counsel may be subject to civil and criminal penalties: - IRC Sec. 6694: civil penalties imposed on tax preparers. - IRC Sec. 7212 (criminal penalties imposed for interfering with the administration of the internal revenue law).

U.S. Financial Reports

U.S. financial institutions file Currency Transaction Reports (CTR) and Suspicious Activity Report (SAR) with the Detroit Computing Center (uploaded at the IRS Currency Banking and Retrieval System database at the IRS/DCC).

The combined CTR/SAR currency transaction reports provide a paper trail (i.e. a "road map") for the IRS Criminal Investigation Division ("CID") investigation of "financial crimes" (i.e. tax evasion and money laundering).

A Currency Transaction Report (CTR) is filed by financial institutions that engage in a currency transaction in excess of $10,000.

A Suspicious Activity Report (SAR) is filed on transactions involving at least $5,000 that the financial institution knows, suspects, or has reason to suspect the money was derived from illegal activities. The SAR is also filed when transactions are part of a plan to violate federal laws and financial reporting requirements.

IRS Audits

Under a civil tax audit, the IRS may obtain evidence that may be illegal under criminal proceedings (e.g., Fifth Amendment defenses, objections to "tainted evidence"). With tax evidence obtained from the civil tax audit, the IRS (with the U.S. Attorney) may initiate criminal proceedings.

U.S. Taxpayers with unreported foreign bank accounts (and income) are subject to IRS civil tax audits with civil penalties (monetary penalty, only) and criminal tax prosecution (monetary penalty and jail).

The IRS, under a civil tax audit:

May summon evidence, which support culpability for a crime (e.g., tax evasion) and civil penalties (e.g., 75% fraud penalty).

May trigger investigation into money laundering (i.e., when U.S. Taxpayers attempt to repatriate funds from undisclosed foreign bank accounts, they may be liable for money laundering).

Use evidence obtained under a civil tax audit to support a subsequent criminal prosecution (including culpability for 3rd party co-conspirators for obstructing tax collection and conspiracy).

Tax Conspiracy

18 U.S.C.A. §371 is the Federal Statute for conspiracy which provides that: "If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $ 10,000 or imprisoned not more than five years, or both."

Tax Conspiracy offenses include: willfully aiding or assisting in, or procuring, counseling, or advising, the preparation or presentation under, or in connection with any matter arising under, the Internal Revenue laws, of a false or fraudulent return, affidavit, claim or document (whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim or document).

Tax Conspiracy offenses include: willfully failing to pay any tax or make any return (other than a return required under authority of Part III of Subchapter A of Chapter 61) at the time or times required by law or regulations; for offenses described in Sections 7206(1) and 7207 relating to false statements and fraudulent documents.

Offenses for tax conspiracy arise under Section 371 of Title 18 of the United States Code (Conspiracy), where the object of the conspiracy is to attempt in any manner to evade or defeat any tax or the payment thereof.

If an individual or individuals charged with committing any of the offenses articulated above, are outside the United States or are fugitives from justice, within the meaning of Section 3290 of Title 18 of the United States Code, the Statute of Limitations is tolled.

Money Laundering

When individuals attempt to repatriate into the United States, the funds contained in the undisclosed foreign bank accounts, they may be liable for money laundering. Individuals who maintain foreign bank accounts where disclosure of said bank accounts is not revealed pursuant to law, and who would be culpable under the various offenses recited above, may be liable for money laundering (specifically 18 U.S.C. 1956 and 1957, which is part of the Money Laundering Control Act of 1986).

18 U.S.C 1956 penalizes individuals who knowingly and intentionally transport or transfer monetary proceeds from specified unlawful activities. While the funds reposing in the foreign bank accounts may have been derived from lawful activities conducted within or without the United States by American citizens, the various violations of the Internal Revenue Code and the conspiracy statute, could well subject individuals to charges of money laundering.

If in fact the unreported bank accounts contained funds derived from unlawful activities, it may subject individuals to not only violations of Federal statutes but California statutes as well (e.g., California Penal Code §§ 182 and 186.10, which deal with conspiracy and money laundering).

Undisclosed Offshore Accounts: Records Subpoenas

At the California Tax Bar November 2012 Conference, San Diego speaker Kevin M. Downing (Miller Chevalier, Washington, D.C.) former lead U.S. Attorney prosecuting UBS, advised of new subpoena rules for Foreign Accounts which are undisclosed by U.S. taxpayers.

Once a records subpoena is served, there is no 5th Amendment right not to produce records, no production immunity.

If U.S. taxpayer does not have records, they must get records from the Foreign Financial Institution (i.e., undisclosed offshore account).

A refusal to comply with the records subpoena can result in the U.S. taxpayer being put in jail, with the account subject to an annual 50% penalty (of the highest account balance) under the "FBAR" rules. The U.S. government will not tolerate U.S. taxpayer's "stonewalling" (the incarceration and penalty have been affirmed by the 5th Circuit, the 7th Circuit and the 9th Circuit Court of Appeals).

Civil and Criminal Tax Fraud: Burden of Proof (Evidentiary Standards)

The U.S. taxpayer's exposure to civil penalty/criminal prosecution for unreported income and undisclosed foreign financial accounts is a "double-edged" sword with dual civil/criminal:

- Evidentiary Standards of Proof; - Statute of Limitations; - Collateral Estoppel Issues

If the IRS first institutes a civil tax audit, they may summons evidence, which may support both a civil penalty (e.g. fraud) and criminal culpability (e.g. tax evasion). The evidence from the civil tax audit may then be used for a subsequent criminal prosecution of the same U.S. taxpayer.

Civil and criminal tax deficiencies may differ-

Criminal violations are charged only against the tax deficiency that results from fraud.

Civil tax deficiency includes all tax due on the tax returns (i.e. "evaded income and deductions adjustments).

Under a civil tax audit, the IRS may obtain evidence that may be illegal under criminal proceedings (e.g. Fifth Amendment defenses objecting to "tainted evidence") tax evidence obtained from the civil tax audit may enable the IRS (i.e. the U.S. Attorneys to initiate criminal proceedings against the taxpayer).

Criminal tax fraud requires a higher standard of proof than civil tax fraud. The government must prove "beyond a reasonable doubt" that the defendant is guilty of criminal tax fraud.

In civil tax fraud, the burden of proof required is a preponderance of the evidence (also termed "by clear and convincing evidence") which is a lower evidentiary standard).

A criminal tax decision of a court or jury will bind a civil tax decision, but a civil tax decision does not bind a criminal tax decision.

Collateral Estoppel

When criminal tax proceedings are followed by civil tax proceedings, the legal doctrine of collateral estoppel may apply. This doctrine provides that an issue necessarily decided in a previous proceeding (the first proceeding) will determine the issue in a subsequent proceeding (the second proceeding) but only as to matters in the second proceeding that were actually presented and determined in the first proceeding.

A conviction for criminal tax evasion collaterally estops the taxpayer from contesting the existence of tax fraud for purposes of the civil tax fraud penalty (i.e. 75% of the unpaid tax) because a finding of criminal tax fraud (beyond a reasonable doubt) establishes proof of civil tax fraud (by clear and convincing evidence).

Acquittal of criminal tax evasion does not collaterally estop the government from proving civil tax fraud (by clear and convincing evidence). The criminal acquittal may establish that proof of fraud did not exist beyond a reasonable doubt, but that does not mean that proof of fraud by clear and convincing evidence does not exist.

Unreported Income (Undisclosed Foreign Bank Accounts)

U.S. taxpayers with unreported income and disclosed foreign financial accounts are subject to

IRS civil tax audits with civil tax penalties (monetary penalty only) and criminal tax prosecution (monetary penalty and jail).

The U.S. taxpayer's tax records may include evidence, which supports culpability for a crime (e.g. tax evasion) and civil tax penalties (e.g. 75% fraud penalty).

Statutes of Limitation

Civil and criminal tax proceedings have different statutes of limitation.

Civil Tax Fraud - For civil tax fraud (i.e. unreported income/undisclosed foreign bank accounts), there is no statute of limitations. The tax can be assessed at any time.

Criminal Tax Evasion - For criminal tax evasion (i.e. unreported income) the criminal statute of limitations is only on the prosecution of the crime of tax evasion, (not the assessment of the tax owed).

Offenses arising under the Internal Revenue laws generally have a 3-year period of limitation for prosecution (IRC Sec. 6531).

When the prosecution is for the offense of willfully attempting in any manner to evade or defeat any tax, the statute of limitations is 6-years (i.e. unreported Income).

IRC Sec. 6531(1): for offenses involving the defrauding or attempting to defraud the United States (whether by conspiracy or not, and in any manner);

IRC Sec. 6531(2): for the offense of willfully attempting in any manner to evade or defeat any tax;

IRC Sec. 6531(3): for the offense of willfully aiding or assisting in the preparation of a false or fraudulent tax return.

IRC Sec. 6531(4): for the offense of willfully failing to pay any tax or make any tax return.

IRC Sec. 6531(5): for offenses relating to false statements and fraudulent documents under IRC Sec. 7206(1) and Sec. 7207.

IRC Sec. 6531(8): for offenses arising under 18 U.S.C. 371, where the object of the conspiracy is to attempt in any manner to evade or defeat any tax.

Under IRC Sec. 6531, the 6-year statute of limitations shall be tolled, while the U.S. taxpayer who committed the offenses is outside the United States.

Form 8938

Under Form 8938 (Statement of Specified Foreign Financial Assets):

A 3-year statute of limitations for failure to report a specified foreign financial asset or failure to file Form 8938;

A 6-year statute of limitations for U.S. taxpayer’s failure to include in gross income an amount relating to specified foreign financial assets and the amount omitted is more than $5,000.

Chapter 12 - International Tax Evasion: Offshore Accounts

Under Treasury Department Circular #230 (Rev. 8/11), Title 31 Code of Federal Regulations, Subject A, Part 10 (published June 3, 2011), Section 1021 requires a tax practitioner who knows that the client has not complied with U.S. revenue laws, or made an error or omission in a tax return, to promptly advise the client of the fact of such non- compliance, error or omission and the consequences under the Internal Revenue Code and Treasury Regulations.

Under Circular #230, Section 1022, a practitioner must exercise due diligence in preparing and filing tax returns.

For U.S. taxpayer offshore accounts, in order to ensure U.S. taxpayer IRS compliance, the tax practitioner should confirm the following, prior to filing a client's tax returns:

Offshore Accounts: Tax Compliance Issues

1. Original source of proceeds?

2. How was the money earned?

3. Were the proceeds reported for tax purposes? If so, what tax year?

4. Was the fund transfer of the original proceeds from the U.S. sent directly to the offshore account?

5. Were there any intermediary transfers to third party banks or accounts? (If so, dates, accounts).

6. Total amount in each account (highest balance/each tax year).

7. Regarding the offshore account, did you file FBARs? Yes/No:
a. Every year?
b. Accounts over $10,000?
c. Did you own the account?
d. What was the name on the account?
e. Did you have signatory authority over the account?

8. Regarding offshore accounts, did you disclose the account on Form 1040/Schedule B, Part III, No. 7?

9. For foreign financial assets over $50,000, did you file Form 8938 for each tax year?

10. For financial assets over $50,000, did you purchase these assets with funds from the offshore account? If not, what was the source of funds for these purchases?

Chapter 13 - International Tax Evasion: Civil/Criminal Penalties

Civil Penalty Issues

1. Civil Tax Fraud (75% of tax due) (no statute of limitations).

2. Underpayment of Tax (25% of tax due).

3. For voluntary disclosures, under the IRS Offshore Voluntary Disclosure Program (2012), the values of foreign accounts and other foreign assets are aggregated for each year and the penalty is calculated during the period covered by the voluntary disclosure. Under the 2012/IRS Voluntary Disclosure, total penalties of up to 85% of unpaid tax, and 27.5% of highest balance total foreign bank accounts/foreign assets as follows:
a. Failure to File a Tax Return (IRC Sec. 6651(a)(1), up to 25% tax due.
b. Failure to Pay Tax (IRC Sec. 6651(a)(2), up to 25% tax due.
c. Accuracy Related Penalty (IRC Sec. 6662), a 40% penalty for tax underpayment attributable to undisclosed foreign financial asset understatement.
d. Title 26 Penalty – 27.5% highest aggregate balance of foreign bank accounts, entities and assets.

IRS/Criminal Penalty Issues

U.S. taxpayers with undisclosed offshore bank accounts and unreported income face criminal charges for:

1. Tax Evasion (IRC 7201), five years in jail, $25,000 fine;

2. Filing False Tax Return (IRC Sec. 7206(1)), three years in jail, $250,000 fine;

3. Failure to File Tax Return (IRC Sec. 7203), one year in jail, $100,000 fine;

4. Willful failure to file FBAR or Filing False FBAR (31 USC Sec. 5322), ten years in jail, fines up to $500,000 with related civil penalty the greater of $100,000 or 50% of the total balance of the foreign account per violation (IRC Sec. 5321(a)(5).

Chapter 14 - International Tax Evasion: Willfulness Defense

U.S. taxpayers, who fail to file tax returns or pay taxes due, face a felony for willful evasion of tax (IRC Sec. 7201). U.S. taxpayers, particularly international investors who are classified as U.S. taxpayers, under either the "Substantial Presence Test" or "Green Card Test", often defend their tax non-compliance by stating that they were "unaware of the law".

Under U.S. tax law, "ignorance of the law is no excuse" (in Latin: ignorantia juris non excusat). The legal principal is that a person who is unaware of a law may not escape liability for violating that law because they were unaware of its content.

U.S. Model Penal Code Section 2.02(9) states that knowledge that an activity is unlawful is not an element of an offense unless the statute creating the offense specifically makes it one.

For federal tax evasion, willfulness is required. This legal position was enshrined in Cheek v. U.S., (1991) 498 U.S. 192, which stated that in a federal criminal tax case, a taxpayer's "good faith" belief that he was not required to file tax returns would negate the 'intent element' of the crime of tax evasion (however, the defendant Cheek was held to not have a "good faith belief" and was convicted by the jury; i.e., the final arbiter of the evidence) and served a year and a day in jail.

On the issue of intent, the jury may consider "willful blindness"; i.e. the defendant willfully, knowingly and intentionally concealed the truth from himself, so that the defendant "intentionally" committed a tax crime.