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Tax Crimes That The Government Relies Upon in offshore bank tax prosecutions

If your name was mentioned in the same sentence as Raoul Weil, Carl Zwerner, or Ty Warner, you can rest assured that you haven't been nominated for an academy award or a Pulitzer Prize. Instead, you'd have joined a group of beleaguered taxpayers who had the misfortune of being among the first "casualties" in the U.S. government's war on offshore tax evasion.

In this blog, I attempt to provide some practical and sound advice to a real world problem facing taxpayers with unreported foreign accounts: "Can I be prosecuted for failing to report my foreign bank account such that there is no other choice but to apply to the Offshore Voluntary Disclosure Program (OVDP)?" This question is so pivotal that it cuts right to the heart of a taxpayer's decision to enter the OVDP.

The government has used one or more of the following tax crimes to prosecute hundreds of offshore bank tax cases. The elements of each can be found in the jury instructions for these crimes:

a. *Willful Failure to File an FBAR (31 USC §§ 5314 and 5322(a) and 31 CFR § 1010.350)*

Willfully failing to file an FBAR is a felony that is subject to criminal penalties under 31 U.S.C. § 5322. This is the most common crime that the government charges in connection with the willful failure to report a foreign bank account. A person convicted of failing to file an FBAR faces a prison term of up to ten years and criminal penalties of up to $ 500,000. In order for the defendant to be found guilty, the government must prove each of the following elements beyond a reasonable doubt:

(1) First, the defendant was a United States person;

(2) Second, the defendant had a financial interest in or signature or other authority over any foreign financial accounts, including bank, securities, or other types of financial accounts, in a foreign county;

(3) Third, the aggregate value of these financial accounts exceeded $ 10,000 *at any time* during the calendar year; and

(4) Fourth, the defendant *willfully* failed to file a Report of Foreign Bank and Financial Accounts ("FBAR").

Those who keep their finger on the pulse of the type of cases that attract the attention of DOJ-Tax know all too well that not every case involving the failure to report an offshore bank account is prosecuted. On the contrary, the Department of Justice (Tax Division) is very selective when it comes to deciding which tax cases are worthy of prosecution. As should come as no surprise, the government prefers to cultivate "winners" and not "losers." Indeed, a conviction helps the DOJ maximize the deterrent effect of the criminal tax enforcement system while an acquittal might suggest that the taxpayer could "get off" if he or she has the money to hire the "right" attorney.

Let's begin with some basics. The Department of Justice tends to prosecute only those cases where the taxpayer's conduct is particularly egregious. Contrary to popular belief, the most important question facing a taxpayer with unreported offshore accounts is not, "How much will my FBAR penalty be if the government discovers my unreported accounts before I voluntarily disclose them?" but instead, "How likely is it that my case will be referred to CI with a recommendation for prosecution?"

This question turns on one word: *willfulness*. This pestilent word is what distinguishes a civil tax matter from a criminal one. The more evidence there is of willfulness, the greater the likelihood is of criminal prosecution. The less evidence there is of willfulness, the lesser the likelihood is of criminal prosecution.

The best way I've seen willfulness explained is through the creative genius of Jack Townsend, author of the wildly popular tax blog, "Federal Tax Crimes." Professor Townsend compares the path between willfulness and non-willfulness to that of a spectrum, with "non-willfulness" lying at one end and "willfulness" lying at the other. To help visualize this, one might think of an electromagnet spectrum,[i] with short-wavelength radiation at one end (i.e., gamma radiation) and long-wavelength radiation at the other. Focusing on the extreme poles, "Not willful" is substituted for the "short-wavelength" pole and "Definite willfulness" is substituted for the "long-wavelength" pole.

The facts of some cases may lean so far in one direction that determining whether the conduct is willful or non-willful will be as easy as finding a free drink in Las Vegas. These are what might be considered "slam dunk" cases for a specific type of disclosure. For example, a taxpayer who falls on the "Definite willfulness" end of the spectrum should not think twice about applying to the Offshore Voluntary Disclosure Program. On the other hand, a taxpayer who falls on the "Not willful" end of the spectrum might have a choice between making a "quiet disclosure" or making a streamlined submission.

Determining willfulness is not an exact science. Instead, it can be as mind-numbing as solving a quadratic equation. According to Professor Townsend, this occurs when the facts of a particular case lie at points *other* than at the extreme poles of the spectrum, such as when they lie in

the middle. When the pendulum vacillates in the middle, questions abound. For example, how close must the facts be to one end before one can confidently make a decision?

In cases as challenging as these, assessing willfulness, not to mention the corresponding risk of prosecution, becomes exceedingly difficult, requiring a careful balancing of the facts both for and against it. Needless to say, it should be left to the professionals.

In dealing with these gray areas, one should never forget that there will always be risk – it is inherent in any activity that lacks certainty, whether it be an investment risk involving stock or a valuation risk that estimates the value of a barrel of crude oil a year into the future. Indeed, "a taxpayer *not* at material risk for prosecution is not the same as a taxpayer at 'no risk' of prosecution."[ii] This implies that a person must be willing to assume at least *some* risk. At the risk of sounding abrasive, those who are risk-averse should seek shelter in the OVDP bunker rather than subjecting themselves to any unnecessary anxiety.

b. Filing a False Tax Return (IRC § 7206(1))

The tax charge most commonly used by the government to prosecute offshore bank tax cases is Filing a False Tax Return. And for good reason. Filing a False Tax Return requires nothing more than proof of a false item on the return and proof that the false item was material. Stated simply, the jury must decide whether the item was false and, if so, whether it was material.

Proving materiality is not as difficult as one might expect. Under the law, a statement on a tax return is deemed *material* if at least one of the following conditions exists: (1) it is necessary to correctly calculate the tax due or (2) it has a direct impact on the IRS's ability to verify the tax declared or to audit the taxpayer's returns.

In order for the defendant to be found guilty, the government must prove each of the following elements beyond a reasonable doubt:

(1) First, the defendant made and signed a tax return for the year [ ] that he knew contained false information as a to a material matter;

(2) Second, the return contained a written declaration that it was being signed subject to the penalties of perjury; and

(3) Third, in filing the false tax return, the defendant acted *willfully*.

c. Failure to File a Tax Return

Failure to file a tax return is a misdemeanor that carries a maximum sentence of one year in prison for each tax year.

As far as information reporting crimes go, the government's burden to prove failure to file a return is ever so light. The government must prove the minimal amount of income required to invoke the duty to file. However, it need not wreak havoc on the taxpayer by unleashing the "face that launched a thousand ships" or by dispatching Special Agents to all four corners of the world in order to build an "air tight" case.

The government must prove three essential elements beyond a reasonable doubt:

1. Defendant was a person required to file a return;

2. Defendant failed to file at the time required by law; and,

3. The failure to file was willful.

There is no requirement that a tax be due. In theory, the failure to file timely would be satisfied by any delinquency – even one day. However, the government will not prosecute for a minor delay.

d. Klein Conspiracy (18 USC § 371)

The defendant is charged in the indictment with conspiracy to defraud the IRS. In order for the defendant to be found guilty, the government must prove each of the following elements beyond a reasonable doubt:

(1) First, there was an agreement between two or more persons to defraud the United States by impeding, impairing, obstructing, and defeating the lawful government functions of the IRS of the Treasury Department, by deceit, craft, trickery, or means that are dishonest, in the ascertainment, computation, assessment, and collection of the revenue: to wit, income taxes;

(2) Second, the defendant became a member of the conspiracy knowing of at least one of its objects and intending to help accomplish it; and

(3) Third, one of the members of the conspiracy performed at least one overt act for the purpose of carrying out the conspiracy, with all of the members agreeing on a particular overt act that was, in fact, committed.

[i] This metaphor comes from the creative genius of Professor Jack Townsend, author of the wildly popular blog, Federal Tax Crimes, available at http://federaltaxcrimes.blogspot.com.
[ii] Id.