

4-1-1996

International Criminal Tax Cases

Cono R. Namorato

Scott D. Michel

Follow this and additional works at: <https://repository.law.miami.edu/umlr>



Part of the [Taxation-Transnational Commons](#)

Recommended Citation

Cono R. Namorato and Scott D. Michel, *International Criminal Tax Cases*, 50 U. Miami L. Rev. 617 (1996)
Available at: <https://repository.law.miami.edu/umlr/vol50/iss3/10>

This Article is brought to you for free and open access by the Journals at University of Miami School of Law Institutional Repository. It has been accepted for inclusion in University of Miami Law Review by an authorized editor of University of Miami School of Law Institutional Repository. For more information, please contact library@law.miami.edu.

International Criminal Tax Cases

CONO R. NAMORATO AND SCOTT D. MICHEL*

I. CRIMINAL PROSECUTION OF INTERNATIONAL TAX FRAUD	617
A. <i>The Statutory Scheme</i>	618
B. <i>Application in the International Tax Context</i>	621
II. DEFENDING AN INTERNATIONAL CRIMINAL TAX CASE	622
A. <i>Foreign Evidence Issues</i>	623
1. BANK SECRECY	623
2. COMPELLED CONSENTS	624
3. RULES CONCERNING OFFICIAL REQUESTS FOR INFORMATION	625
B. <i>Other Strategic Issues</i>	626
1. CURRENT FILING OBLIGATIONS	626
2. VOLUNTARY DISCLOSURE	628
III. CONCLUSION	630

One consequence of the dramatic growth of international business activity in recent years has been an increase in transnational white collar criminal activity. In addition to prosecuting international narcotics organizations in well-publicized trials, the federal government has increasingly and aggressively begun to detect, investigate, and prosecute cross-border financial criminal activities such as securities, bank, and tax fraud.

International tax crimes range from simple underreporting of income—such as a U.S. taxpayer who diverts taxable receipts offshore or conceals the existence of a foreign investment account from the Internal Revenue Service (IRS) to the more complex tax schemes, such as manipulating Subpart F income¹ or reporting sham international commodity transactions. Investigations of such crimes present interesting and difficult legal and strategic questions.

This Article will describe some of the issues related to international criminal tax fraud. Part I will summarize the relevant criminal statutes and describe their application to cross-border transactions. Part II will review selected strategic and legal topics that arise in defending international tax fraud cases.

I. CRIMINAL PROSECUTION OF INTERNATIONAL TAX FRAUD

The Internal Revenue Service and the Department of Justice annu-

* Mr. Namorato and Mr. Michel are members of the Washington, D.C. law firm of Caplin & Drysdale, Chartered.

1. Subpart F of the Internal Revenue Code governs the treatment of income from controlled foreign corporations. See I.R.C. §§ 951-964 (1994).

ally prosecute approximately two thousand persons for tax fraud and related offenses.² Often, the cases begin as standard civil audits, as when the IRS Examination Division refers to the Criminal Investigation Division a return previously selected for audit. Other criminal cases begin with referrals from the Collection Division or from "information items," such as reports from other federal agencies and public records. These include press reports and required filings, such as Securities Exchange Commission forms and IRS cash transaction reports.³ Additionally, spurned lovers, fired employees, and other disgruntled individuals often tip off the IRS, either out of spite or in hopes of a reward.⁴

A. *The Statutory Scheme*

Most criminal tax cases are prosecuted as violations of the Internal Revenue Code. The primary felony statute, I.R.C. § 7201, allows the IRS to prosecute *anyone* who willfully attempts to evade or defeat an internal revenue tax or payment thereof.⁵ The elements of a section 7201 tax evasion offense are (1) willfulness; (2) the existence of a tax deficiency; and (3) an affirmative act constituting an evasion or attempted evasion of a tax.⁶ In general, tax evasion occurs when an individual willfully acts to defeat the reporting of correct taxable income; payment evasion occurs when a taxpayer, aware of an unpaid tax liability, acts to conceal his ability to discharge that obligation with the specific intent to avoid payment.⁷

The "tax perjury" statute, I.R.C. § 7206(1), makes it a felony for any person to make a false statement on a tax return or other IRS document that declares it is to be filled out under penalties of perjury.⁸ The elements of a section 7206(1) offense are: (1) willfulness; (2) a docu-

2. This article will not focus on narcotics or organized crime in the international tax context. However, when seeking to identify and investigate persons who receive income from illegal activity, the IRS examines their tax affairs to determine if they have violated federal tax laws. Generally, individuals become targets of such investigations if the IRS reasonably believes they are active in organized crime or that they obtain a substantial income from illegal activities such as the sale of narcotics or receipt of wagers. See 6 Administration, I.R.M. (CCH), ¶¶ 9814.1-.2 at 28,629-3.

3. Two such IRS forms are Form 4789, filed by financial institutions receiving cash transactions of more than \$10,000, and Form 8300, which all persons in a trade or business must file to report cash transactions in excess of \$10,000, as required by I.R.C. § 6050I (1994).

4. Upon the satisfaction of certain conditions, the IRS may compensate informants. 6 Administration, I.R.M. (CCH), ¶¶ 9371.0-.7 at 28,171-74.

5. I.R.C. § 7201 (1994).

6. *Sansone v. United States*, 380 U.S. 343, 351 (1965). Courts read the third element broadly to include "any conduct, the likely effect of which would be to mislead or to conceal." *Spies v. United States*, 317 U.S. 492, 499 (1943).

7. See, e.g., *United States v. Jannuzzio*, 184 F. Supp. 460, 469 (D. Del. 1960).

8. I.R.C. § 7206(1) (1994).

ment containing a written declaration made under penalties of perjury; (3) making and subscribing the document; and (4) knowledge that the document is false as to a material matter.⁹

Every income tax return acknowledges that it is made under penalties of perjury. To prove making and subscribing, the government need only show that the return was filed.¹⁰ A material matter includes any item necessary for a correct computation of the tax,¹¹ or any item that tends to mislead or impede the ability of the IRS to "police and verify the reporting of" a taxpayer.¹² Unlike under the tax evasion statute, the government can prosecute a taxpayer under the tax perjury statute without having to prove a tax deficiency or an intent to evade.¹³

A third felony tax provision, I.R.C. § 7206(2), inculpatates anyone who aids or assists in the preparation of a false tax return or related document.¹⁴ The elements of a section 7206(2) offense are (1) willfulness; (2) aiding or assisting in, or procuring, counseling, or advising in the preparation or presentation of a return or other document relating to a federal tax matter; and (3) a return or other document that is false or fraudulent as to a material matter.¹⁵ The section applies whether or not the taxpayer has knowledge of, or consents to, the falsity or fraud. The violator need not have signed the return, and the government has no burden to prove a tax deficiency or an intent to evade.¹⁶ Historically, the government has used this section more than any other in prosecuting tax return preparers and tax advisers.

The final common tax code provision used in criminal prosecutions is I.R.C. § 7203.¹⁷ This section contains four separate misdemeanor provisions: (1) willful failure to file a tax return or related document; (2) willful failure to pay a tax required by the Code; (3) willful failure to maintain certain tax records and (4) willful failure to supply information.¹⁸ The most commonly charged misdemeanor under this section is

9. *Id.*

10. *Butzman v. United States*, 205 F.2d 343, 349 (6th Cir.), *cert. denied*, 346 U.S. 828 (1953).

11. *See Siravo v. United States*, 377 F.2d 469, 472 (1st Cir. 1967).

12. *United States v. DiVarco*, 484 F.2d 670, 673 (7th Cir. 1973), *cert. denied*, 415 U.S. 916 (1974) (false representation of income source constitutes a material misrepresentation). The Supreme Court recently decided in a nontax criminal case that the government must prove materiality beyond a reasonable doubt. *United States v. Gaudin*, 115 S. Ct. 2310 (1995). It is likely that this rule will carry over into prosecutions under § 7206(1).

13. *See United States v. Ballard*, 535 F.2d 400 (8th Cir.), *cert. denied*, 429 U.S. 918 (1976).

14. I.R.C. § 7206(2) (1994).

15. *Id.*

16. *See, e.g., United States v. Wolfson*, 573 F.2d 216, 225 (5th Cir. 1978); *United States v. Maius*, 378 F.2d 716, 718 (6th Cir.), *cert. denied*, 389 U.S. 905 (1967).

17. I.R.C. § 7203 (1994).

18. *Id.* The failure to file a Form 8300 (reporting a cash transaction in excess of \$10,000), however, is a felony. *Id.*

failure to file. For that offense, the government must prove that the defendant is a person required by law to file a return for the taxable period, and that he willfully failed to file a return on time.¹⁹

In prosecuting criminal tax fraud, the government also relies on criminal statutes not contained in the Internal Revenue Code. Of these provisions, the most frequently used is section 371 of the federal criminal code.²⁰ This conspiracy statute proscribes an agreement by two or more persons 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."²¹ The elements of a violation under this section are (1) an agreement by two or more persons to commit an offense or to defraud the United States, and (2) an overt act in furtherance of the agreement. The overt act itself need not be illegal.²²

An indictment can charge conspiracy to violate any criminal statute, including title 26 (Internal Revenue Code) offenses. In the tax context, the government can prosecute persons who conspire to defraud the United States by impeding or obstructing the IRS from ascertaining and collecting taxes. This is known as a *Klein* conspiracy.²³ In such cases, the government need not prove a tax deficiency, but it must prove an intent to impede, not merely underreport, taxes.²⁴

Other criminal provisions used in tax cases include 18 U.S.C. § 1001, which proscribes the making of false statements to any federal department or agency,²⁵ and the money laundering statutes, 18 U.S.C. §§ 1956, 1957.²⁶

19. See *United States v. Ostendorff*, 371 F.2d 729, 730 (4th Cir.), *cert. denied*, 386 U.S. 982 (1967); *United States v. McCormick*, 67 F.2d 867, 868 (2d Cir. 1933), *cert. denied*, 291 U.S. 662 (1934).

20. 18 U.S.C. § 371 (1994).

21. *Id.*

22. *Yates v. United States*, 354 U.S. 298, 334 (1957), *overruled on other grounds by* *Burks v. United States*, 437 U.S. 1 (1978).

23. See *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957), *cert. denied*, 355 U.S. 924 (1958).

24. *United States v. Tarnopol*, 561 F.2d 466, 474 (3d Cir. 1977).

25. This section prohibits, "in any matter within the jurisdiction of any department or agency of the United States," (1) the knowing and willful falsification, concealment or coverup of a material fact by "any trick, scheme, or device"; (2) the making of false, fictitious or fraudulent statements or representations; and (3) the making or use of any false writing or document knowing that it contains any false, fictitious, or fraudulent statement or entry. 18 U.S.C. § 1001 (1994). The alleged false statements need not have been made under oath or in writing. *United States v. Adler*, 380 F.2d 917, 922 (2d Cir.), *cert. denied*, 389 U.S. 1006 (1967).

26. For a summary of the elements and application of the money laundering statutes in the criminal tax context, see Chapter 11 of IAN M. COMISKY ET AL., 2 TAX FRAUD AND EVASION ¶¶ 11-4 to 11-139 (1994).

B. *Application in the International Tax Context*

The classic international criminal tax fraud case involves an individual or corporate taxpayer who "skims" or diverts receipts, and then deposits (or arranges for the deposit of) these diverted funds into a foreign bank account, usually in a tax haven country with bank secrecy laws. An individual may open such an account in the name of a nominee entity, such as an offshore "shelf" corporation or partnership, or even under an assumed name. At tax time, the offender omits the diverted receipts from his reported income, fails to disclose the existence of the account, and fails to report any interest, dividend, or capital gains earned from the account. He then hopes that the bank secrecy provisions, combined with the concealment of his ownership, will shield information about his conduct from any investigating federal agencies.

The taxpayer in such a case has violated a number of federal statutes. He engaged in tax evasion by omitting taxable income from his return. He also committed tax perjury by reporting a false income figure and by failing to disclose the existence of a foreign bank account over which he has signatory authority.²⁷ The nominee entity probably had independent reporting requirements, that the offender surely ignored. Additionally, any actions undertaken in concert with any other person or entity is likely a *Klein* conspiracy.

International tax crime can be ever more complicated. Two situations that lately have attracted IRS attention involve foreign trusts and Subpart F.²⁸ The IRS has been aggressively prosecuting tax shelters involving foreign trusts. In such cases, U.S. taxpayers establish multiple foreign trusts and use various loan and gift devices to shuttle money through the trusts, with the funds ultimately returning to the taxpayer in purportedly nontaxable transactions.²⁹ The IRS has recommended prosecuting taxpayers who insert a sham third party into an international transaction to make a related party's purchase or sale appear unrelated.

The IRS has also focused on taxpayers who try to evade payment by moving assets beyond the Service's reach through overseas transfers.

27. Form 1040, Schedule B (1995) specifically asks for this information. See *United States v. Franks*, 723 F.2d 1482 (10th Cir. 1983), *cert. denied*, 469 U.S. 817 (1984). Federal law requires any person with signatory authority over a foreign bank account to report such an interest to the IRS, not only on Form 1040, but on the Treasury Department's form to report foreign bank and financial accounts. Treas. Dep't Form 90-22.1; 31 C.F.R. §§ 103.24, .32 (1995). Additionally, the failure to file a required form constitutes a violation of I.R.C. § 7203.

28. See *supra* note 1.

29. See *United States v. Dahlstrom*, 713 F.2d 1423 (9th Cir. 1983), *cert. denied*, 466 U.S. 980 (1984), for a detailed description of the foreign trust concept. In *Dahlstrom*, the court reversed the convictions of promoters of such a scheme, holding that the legality of the foreign trusts was clearly unsettled. *Id.* at 1428.

In a typical case, a taxpayer, perhaps facing a large tax bill as a result of an ongoing civil examination, attempts to transfer assets out of the country to evade IRS administrative collection methods. In such a case, the IRS recommends prosecution under section 7201's evasion-of-payment prong.³⁰

Finally, because the IRS has increased its focus on criminally prosecuting those involved in sophisticated tax schemes, tax advisers are more vulnerable as potential targets of investigations. In many such prosecutions, a lawyer or accountant rendered advice during the underlying transactions. In fact, individuals who engage in criminal activities commonly employ tax practitioners to devise means to conceal their unlawful income; when the schemes are uncovered in an investigation, they blame the practitioner for the alleged tax fraud. From the government's point of view, prosecuting practitioners has more of a deterrent effect than other types of tax prosecutions. Thus, IRS investigators will scrutinize the practitioner's role in any transaction under investigation, and will recommend criminal prosecution if they believe a professional has violated the law.³¹

II. DEFENDING AN INTERNATIONAL CRIMINAL TAX CASE

The U.S. government has many ways of gathering information on international criminal offenses including tax fraud. Much of this is done through the use of tax treaties and mutual legal assistance agreements.³² In seeking evidence located abroad, the IRS, with the assistance of the Department of Justice and the Department of State, may petition a U.S. court to issue letters rogatory to a foreign court.³³ The Internal Revenue Code authorizes the issuance of an administrative summons to investigate any tax offense,³⁴ and contains special provisions concerning the acquisition of certain types of foreign documentation.³⁵ In addition, any U.S. court can issue a grand jury subpoena for testimony or documents,

30. See, e.g., *United States v. Voorhies*, 658 F.2d 710, 713 (9th Cir. 1981); *United States v. Townsell*, 367 F.2d 815, 816 (7th Cir. 1966).

31. See, e.g., *United States v. Bryan*, 896 F.2d 68 (5th Cir.), *cert. denied*, 498 U.S. 824, and 498 U.S. 847 (1990).

32. The United States has entered into tax treaties and mutual information exchange agreements with many foreign countries. The Internal Revenue Manual instructs special agents of the IRS Criminal Investigation Division to look to these international agreements when conducting criminal tax investigations. I Audit, I.R.M. (CCH), ¶ 4233-45 at 7283-39.

33. See 28 U.S.C. § 1781 (1994).

34. I.R.C. § 7602 (1994).

35. See, e.g., I.R.C. § 6038A (1994) (setting forth recordkeeping and reporting requirements and summons procedures for certain foreign-owned corporations); I.R.C. § 982 (1994) (prohibiting a taxpayer from admitting in a civil tax case any "foreign-based documentation" when the taxpayer has refused, without reasonable cause, to comply with a "formal document request").

and may even compel the appearance of a U.S. national or resident who is located abroad.³⁶ These investigative procedures present potential complications and conflicts to the practitioner who represents a person or entity in an international criminal tax case.

A. Foreign Evidence Issues

1. BANK SECRECY

Americans who cheat on their taxes frequently park their unreported income in offshore bank accounts, maintained in tax haven countries with bank secrecy. These countries include Switzerland, the Cayman Islands, the Jersey Islands, and the Bahamas. In recent years, the United States has successfully obtained international agreements that allow investigators to penetrate haven bank secrecy in limited situations.³⁷ Despite such agreements, the IRS runs into roadblocks, and often cannot obtain the taxpayer's foreign bank records.

Two issues frequently surface concerning the government's ability to serve and enforce a summons or grand jury subpoena on a foreign bank. First, can the government properly serve the institution? In general, where a foreign business engages in commerce in the United States, a court will find *in personam* jurisdiction,³⁸ particularly where there are allegations of illegal conduct.³⁹ If a foreign bank has a branch in the United States, this requirement is easily met.⁴⁰

Second, will a bank's compliance with the summons or subpoena violate foreign law, such as where the haven's laws provide for bank secrecy?⁴¹ Foreign institutions often contend that they might be prosecuted by their own government if they comply with U.S. process and

36. 28 U.S.C. § 1783 (1994); FED. R. CRIM. P. 17.

37. See, e.g., Treaty Concerning the Cayman Islands and Mutual Legal Assistance In Criminal Matters, July 3, 1986, 26 I.L.M. 536 (1987) (providing for legal assistance in certain types of non-tax cases, such as narcotics investigations).

38. See *Asahi Metal Indus. Co. v. Superior Court*, 480 U.S. 102 (1987); *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980); *United States v. Toyota Motor Corp.*, 569 F. Supp. 1158 (C.D. Cal. 1983); *United States v. Toyota Motor Corp.*, 561 F. Supp. 354 (C.D. Cal. 1983).

39. See *Marc Rich & Co. v. United States*, 707 F.2d 663, 667-68 (2d Cir.), cert. denied, 463 U.S. 1215 (1983).

40. See, e.g., *In re Grand Jury* 81-2, 550 F. Supp. 24, 27 (W.D. Mich. 1982).

41. A taxpayer may not invoke foreign nondisclosure laws in refusing to comply with a formal IRS document request. I.R.C. § 982(b)(2) (1994). However, the penalty for refusing to comply with such a request is merely a prohibition from using the foreign records in a *civil* proceeding. I.R.C. § 982(a). A taxpayer who fears a criminal investigation upon disclosure of the records may well refuse to comply with a formal document request because he is more concerned about criminal than civil ramifications.

U.S. courts take this position seriously.⁴² In resolving these conflicts, courts have performed a "balancing of interests" as suggested by the *Restatement (Second) of Foreign Relations Law of the United States*.⁴³ Not surprisingly, many courts will order the enforcement of U.S. subpoenas after completing this balancing test.⁴⁴

2. COMPELLED CONSENTS

Presumably because it is unseemly and disruptive of international relations to compel banks to violate the criminal laws of other countries, the U.S. government does not routinely try to persuade U.S. courts to direct entities to violate the laws of other jurisdictions. In addition to its efforts to improve access to foreign records through international agreements, the government has attempted, with some success, to obtain foreign bank records through U.S. court orders compelling investigation targets to execute "consents." This "consent" directs the foreign bank to produce records of the U.S. taxpayer's accounts.

In *Doe v. United States*,⁴⁵ the U.S. Supreme Court held that requiring the target of a grand jury investigation to execute a directive consenting to the disclosure of his foreign bank records did not violate the

42. See, e.g., *Societe Internationale pour Participations Industrielles et Commerciales, S.A. v. Rogers*, 357 U.S. 197, 211 (1958).

43. RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1962). Section 40 requires a court to weigh factors such as the "vital national interests" of the two countries, "the extent and the nature of the hardship that inconsistent enforcement actions would impose," and "the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by the state." *Id.* Section 40 has been revised for § 403 of the RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES (1986). However, the balancing test contemplated by the revision is in substance similar to that set out in § 40. Cf. *Reinsurance Co. of Am. v. Administratia Asigurarilor de Stat* [Administration of State Insurance], 902 F.2d 1275, 1281-82 (7th Cir. 1990) (comparing modified balancing test under related § 442 of the Third Restatement with that in § 40).

44. In *In re Grand Jury Proceedings* (United States v. Bank of Nova Scotia), 691 F.2d 1384, (11th Cir. 1982), *cert. denied*, 462 U.S. 1119 (1983), the Eleventh Circuit affirmed a district court order holding a Canadian bank in contempt for refusing to produce records maintained in the bank's Bahamas branch office, after a grand jury had served a subpoena on its Miami-based agent. The Eleventh Circuit affirmed the order even though the bank's production would have violated the criminal laws of the Cayman Islands. *Id.* at 1390-92. The Eleventh Circuit later affirmed a district court order that held the same bank in civil contempt and levied a \$1,825,000 fine. *In re Grand Jury Proceedings* (United States v. Bank of Nova Scotia), 740 F.2d 817, 832-33 (11th Cir. 1984), *cert. denied*, 469 U.S. 1106 (1985); see also *United States v. Vetco Inc.*, 644 F.2d 1324 (9th Cir.) (upholding enforcement of a summons seeking production of records located in Switzerland), *modified on other grounds*, 691 F.2d 1281, *cert. denied*, 454 U.S. 1098 (1981); *Garpeg, Ltd. v. United States*, 588 F. Supp. 1237 (S.D.N.Y. 1984) (upholding enforcement of a summons seeking production of records located in Hong Kong). But see *United States v. First Nat'l Bank*, 699 F.2d 341, 342 (7th Cir. 1983) (denying enforcement of a summons seeking production of records located in Greece).

45. 487 U.S. 201 (1988).

target's Fifth Amendment privilege against self-incrimination.⁴⁶ The Court ruled that the consent directive was not a compelled "communication" because it did not convey facts or testimony from the target's mind.⁴⁷ Under *Doe*, the IRS could attempt to circumvent a foreign bank's secrecy rules by serving a summons on a U.S. branch of a foreign bank and another summons on a taxpayer, seeking his execution of a compelled consent directive. Some foreign courts have held, however, that such compelled consents are invalid.⁴⁸

3. RULES CONCERNING OFFICIAL REQUESTS FOR INFORMATION

In 1984, as part of the Comprehensive Crime Control Act, Congress adopted a series of provisions relating to U.S. requests for information from foreign governments. One provision requires that any U.S. "national or resident" who files a pleading or related document in a foreign jurisdiction in opposition to a U.S. "official request" for information, must serve that document on the appropriate attorney for the United States.⁴⁹ Accordingly, defense counsel cannot oppose a letter rogatory, treaty request, or related investigative procedure in a foreign country without notifying the U.S. government.

Another provision permits a district court to suspend the statute of limitations for any offense under investigation by a grand jury when the government makes an official request for information from a foreign country.⁵⁰ If the government can prove that a request was made and that the evidence is or was in a foreign country, the court can suspend the running of the statute of limitations for up to three years.⁵¹

A third provision authorizes a U.S. court to admit, as a "record of regularly conducted activity," foreign records.⁵² Under this provision, a foreign bank official can certify that the document satisfies the requisite elements of the business records exception to the Hearsay Rule under the Federal Rules of Evidence.⁵³ The court may admit such evidence

46. "[N]or shall [any person] be compelled in any criminal case to be a witness against himself" U.S. CONST. amend. V.

47. *Id.* at 214-17. In a footnote, however, the Court recognized that to the extent that another jurisdiction has deemed a "compelled consent" invalid, sensitive international comity considerations may arise in compelling a bank to violate that country's law. *Id.* at 218 n.16; see also *In re Grand Jury Proceedings (Marsoner v. United States)*, 40 F.3d 959, 965 (9th Cir. 1994) (upholding a district court's requirement that defendant sign a consent allowing the government to obtain material from Austrian banks, even though Austria had an interest in protecting the defendant's rights), *cert. denied*, 115 S. Ct. 2558 (1995).

48. See *In re ABC Ltd.*, 1984 C.I.L.R. 130 (Cayman Islands Grand Ct.).

49. 18 U.S.C. § 3506 (1994).

50. 18 U.S.C. § 3292 (1994).

51. *Id.*

52. 18 U.S.C. § 3505 (1994).

53. FED. R. EVID. 803(6).

unless "the source of information or the method or circumstances of preparation indicate lack of trustworthiness."⁵⁴

B. *Other Strategic Issues*

1. CURRENT FILING OBLIGATIONS

Because of the cumbersome and time-consuming nature of gathering and reviewing reams of financial information, large-scale criminal tax investigations can take years to complete. A target of such an investigation is legally obligated to continue filing annual income tax returns. When the time comes for the target to file a current tax return, difficult issues arise for both the taxpayer and the practitioner.

Particularly problematic are cases where U.S. taxpayers engage in criminal transactions involving foreign countries. The taxpayer with an undisclosed bank account will likely find himself faced with the decision of how to report earnings in that account and how to answer the foreign bank account question on a current return. Some of the most sensitive issues that a tax practitioner may face concern the reporting of transactions on a client's current return during a pending criminal investigation.

The pendency of a criminal investigation is not a basis for failing to file a return.⁵⁵ Each year's return must be timely, complete, and accurate. If it contains false statements or omissions, the taxpayer has committed further tax crimes. Nevertheless, an accurate current return can incriminate the client.

The current return may report income from a source or in an amount that confirms a Special Agent's suspicions that the taxpayer has omitted income in prior years. For example, a complete and accurate income tax return can present a serious risk of exposure for a taxpayer who "skims" receipts and deposits funds in an undisclosed foreign bank account. The return could expose his prior skimming, and may identify the previously unreported bank account by indicating the taxpayer's signatory authority over the account. The return could also report interest and dividend income earned on the account. Not only are such items damaging admissions in and of themselves, they can also provide important leads to an investigating agent.

There is no question that a current return can be used as an admission against a taxpayer.⁵⁶ Tax returns are often important in cases where the government relies on an indirect method of proof to establish the

54. 18 U.S.C. § 3505 (1994).

55. *United States v. Sullivan*, 274 U.S. 259, 263 (1927).

56. *United States v. Dinnell*, 428 F. Supp. 205, 208 (D. Az. 1977), *aff'd without op.*, 568 F.2d 779 (9th Cir. 1978); *United States v. Hornstein*, 176 F.2d 217, 220 (7th Cir. 1949).

taxpayer's net worth,⁵⁷ and may also be used in non-tax criminal investigations.⁵⁸

To avoid these consequences, a taxpayer under criminal investigation has the option of filing a current return that invokes the Fifth Amendment privilege against self-incrimination. The privilege, however, has limits. The Fifth Amendment cannot be invoked to justify failure to file a return, failure to provide required information on a return, or making false, incomplete or misleading statements on a return.⁵⁹ A blanket or arbitrary invocation of the Fifth Amendment may result in the IRS's refusal to recognize the return as valid for purposes of starting the statute of limitations.⁶⁰ A "Fifth Amendment return" may also subject the taxpayer to frivolous-return penalties under section 6702,⁶¹ or even criminal prosecution under section 7203 for willful failure to file.⁶²

The privilege must be affirmatively asserted with respect to specific entries or information that might tend to incriminate the taxpayer.⁶³ When a taxpayer is faced with the Hobson's choice of (a) alerting the IRS to his prior fraud by filing accurate returns or (b) compounding his criminal exposure by failing to file or filing falsely, he may be well-advised to invoke the Fifth Amendment. The taxpayer can validly assert the privilege whenever there is a bona fide reason why an accurate response to a specific item might subject the taxpayer to criminal prosecution.⁶⁴

The circuit courts vary in their treatment of the Fifth Amendment privilege on tax returns. The Ninth Circuit has suggested that the taxpayer cannot invoke the privilege on a tax return in order to avoid incrimination for violations of tax laws.⁶⁵ The taxpayer is entitled to "only those [claims of privilege] justified by a fear of self-incrimination

57. See, e.g., *United States v. Mackey*, 345 F.2d 499, 504 (7th Cir.), *cert. denied*, 382 U.S. 824 (1965).

58. I.R.C. § 6103(i) (1994).

59. See, e.g., *United States v. Sullivan*, 274 U.S. 259, 263 (1927); *United States v. Milder*, 459 F.2d 801, 803 (8th Cir.), *cert. denied*, 409 U.S. 851 (1972).

60. See *National Contracting Co. v. Commissioner*, 37 B.T.A. 689, 695-96 (1938), *aff'd*, 105 F.2d 488 (8th Cir. 1939).

61. *Boday v. United States*, 759 F.2d 1472, 1475 (9th Cir. 1985); *Baskin v. United States*, 738 F.2d 975 (8th Cir. 1984).

62. See *United States v. Daly*, 481 F.2d 28 (8th Cir.), *cert. denied*, 414 U.S. 1064 (1973).

63. See *Garner v. United States*, 424 U.S. 648 (1976); *United States v. Jordan*, 508 F.2d 750 (7th Cir.), *cert. denied*, 423 U.S. 842 (1975). Accordingly, resort to the Fifth Amendment is of little use to a taxpayer who is not under criminal investigation and whose goal is to avoid IRS inquiry into a sensitive issue.

64. *United States v. Verkuilen*, 690 F.2d 648, 654 (7th Cir. 1982); *United States v. Neff*, 615 F.2d 1235, 1239 (9th Cir.), *cert. denied*, 447 U.S. 925 (1980).

65. See *United States v. Carlson*, 617 F.2d 518 (9th Cir.), *cert. denied*, 449 U.S. 1010 (1980).

other than under the tax laws.”⁶⁶ In contrast, the Second Circuit has suggested that under appropriate circumstances a taxpayer can assert the privilege with respect to the amount of income reportable on his return.⁶⁷ However, that case addressed the issue in the context of a motion to exclude the defendant’s tax return in a nontax prosecution. Other Courts of Appeal have held that the taxpayer cannot assert the Fifth Amendment on a return to avoid disclosing the amount of his income.⁶⁸

Tax advisers have limited options to offer taxpayer’s on how to file a complete and accurate return without incriminating themselves. One approach is to advise the taxpayer to i) report all income generated from his business, ii) report all interest and dividend income generated by the account, but invoke the Fifth Amendment privilege as to the source of this income, and iii) assert the privilege as a basis for failing to answer the question on the 1040, Schedule B, of whether the taxpayer has signatory authority over a foreign bank account.⁶⁹ But each case is different, and even experienced practitioners differ on how to file returns in this context.

The act of filing a return for a taxpayer under criminal investigation is fraught with peril. The practitioner must advise the taxpayer to comply with current filing requirements, even if the taxpayer believes that doing so is not in his or her interest. A practitioner can advise the taxpayer to use the Fifth Amendment privilege where appropriate, but should not—indeed may not—counsel the client not to file, or to file on inaccurate or incomplete return.

2. VOLUNTARY DISCLOSURE

A client who has committed tax fraud can avoid criminal liability by filing amended or delinquent returns before the IRS or any other government agency begins an inquiry that might lead to discovery of the fraud. Because such a “voluntary disclosure” can backfire and lead to

66. *Id.* at 520 (quoting *Garner v. United States*, 424 U.S. 648, 662 (1976) (emphasis added)).

67. *United States v. Barnes*, 604 F.2d 121, 148 (2d Cir. 1979), *cert. denied*, 446 U.S. 907 (1980).

68. *See United States v. Goetz*, 746 F.2d 705, 710 (11th Cir. 1984); *United States v. Brown*, 600 F.2d 248, 252 (10th Cir.), *cert. denied*, 444 U.S. 917 (1979); *United States v. Johnson*, 577 F.2d 1304, 1311 (5th Cir. 1978).

69. Ownership over the foreign bank account triggers a separate reporting requirement—the filing of Treasury Department Form 90-22.1. *See supra* note 27. No court has specifically addressed whether the taxpayer can simply decline to file Form 90-22.1 on the basis of the Fifth Amendment privilege. However, based on the decisions involving other tax forms it would appear that the privilege is not a defense for simply failing to file. Rather, the taxpayer can file the form in such a way that it cannot be used against him, such as by claiming that the Fifth Amendment shields him from having to file the form.

criminal prosecution, it should be approached with caution, particularly in complicated cases such as those involving international tax issues. The final decision concerning whether and how to make a voluntary disclosure, should always be based on a careful analysis of all relevant facts.

Voluntary disclosures of international criminal tax fraud are not uncommon. Taxpayers with undisclosed foreign bank accounts often resolve to clean up their affairs so as not to burden their family when they die. International businesses may deposit a portion of a U.S. employee's compensation into secret foreign accounts. In those situations, both the employee and the employer risk serious criminal sanctions in the event of detection. In these circumstances, taxpayers may want to take advantage of the IRS method for treating voluntary disclosures.

A voluntary disclosure raises no legal impediment to prosecution for tax fraud or failure to file.⁷⁰ The felonies of tax evasion and filing false returns are considered completed crimes at the time the taxpayer willfully files the false return. Subsequent correction of the error by an amended return will not expunge or mitigate the fraud. Similarly, the misdemeanor of failure to file is committed on the due date of the return. Filing a delinquent return will not undo the crime, nor will it affect the criminal statute of limitations for the underlying return.⁷¹

The legal effect of an amended or delinquent return is an admission of all but one of the elements necessary for a conviction. A taxpayer who files an amended return admits that the original return was materially false and that additional tax was due. A taxpayer who files a delinquent return admits that he was required to file and did not. In either case, the government need only prove willfulness to make out a *prima facie* criminal case.⁷²

Because the IRS has limited investigative resources and cannot hope to detect more than a small percentage of nonfilers or tax evaders, it is obviously in the government's interest to encourage taxpayers who owe additional tax to file amended and delinquent returns. Thus, the government has had a long-standing "non-policy" that a voluntary disclosure is a relevant factor in deciding whether to initiate a criminal

70. *United States v. Hebel*, 668 F.2d 995 (8th Cir.), *cert. denied*, 456 U.S. 946 (1982).

71. The statute of limitations for tax crimes runs for six years after the filing of a fraudulent return, and for six years after the due date of an unfiled return. I.R.C. § 6531 (1994).

72. Although an amended or delinquent return will not preclude criminal prosecution, it may have an impact on the likelihood of a conviction. Experience shows that a jury is less likely to find that a taxpayer acted willfully when it learns that he voluntarily admitted and corrected his error prior to any contact or inquiry by the IRS.

investigation or recommend prosecution.⁷³ As a practical matter, the government generally will not prosecute a taxpayer who, prior to IRS detection, files a delinquent return or corrects inaccuracies—even significant ones—on prior tax returns.

To be effective, a voluntary disclosure must be timely and unprompted. A timely voluntary disclosure is one that occurs prior to an IRS contact or an event known to the taxpayer and likely to cause an inquiry into the taxpayer's liabilities.⁷⁴ A prompting event might be, for example, a divorce, a business dispute, or the taxpayer's filing for bankruptcy.

An acceptable voluntary disclosure must also be complete. A taxpayer cannot claim to have made a voluntary disclosure if, for example, he discloses some but not all of his previously unreported income. Indeed, the filing of such a return would constitute a separate and independent crime.⁷⁵ In order to take advantage of the voluntary disclosure non-policy, the taxpayer must make a full disclosure and cooperate with the IRS in the determination and payment of his tax liability. No consideration will be given to a partial voluntary disclosure that is followed by a Fifth Amendment claim, a refusal to cooperate in an audit, or a refusal to provide relevant financial information.⁷⁶

In many cases, making a voluntary disclosure entails nothing more than preparing delinquent or amended returns and filing the returns with the IRS, accompanied by a check for the tax and interest. In situations where the facts are complicated, however, counsel may decide to approach the IRS about the matter. Examples include cases where foreign corporations pay employees in the United States "off book" compensation, or where an individual has significant assets in previously undisclosed foreign bank accounts. In such cases, counsel might meet with appropriate IRS personnel, deliver a hypothetical set of facts, and identify the taxpayer only when assured that the matter will be treated as a voluntary disclosure.

III. CONCLUSION

In the past ten years, the U.S. government has plainly increased its interest in international criminal tax fraud. With other law enforcement agencies, the IRS has strengthened its powers to reach overseas evi-

73. See *Hebel*, 668 F.2d at 999; see also GLENN L. ARCHER, JR. ET AL., U.S. DEP'T OF JUSTICE, CRIMINAL TAX MANUAL 4.01[1] (1985) (providing that "the Treasury Department and the Department of Justice give consideration to a 'voluntary disclosure' on a case-by-case basis in determining whether to prosecute but it is not conclusive of the issue").

74. 6 Administration, I.R.M. (CCH), ¶ 9781, M.S. 342.142, at 28,681-2.

75. I.R.C. §§ 7206, 7207 (1994).

76. See ARCHER ET AL., *supra* note 73, at 4.01[3].

dence. The courts have become less sympathetic to pleas that disclosing foreign evidence will violate foreign secrecy laws. Tax offenders who use foreign bank accounts now face enhanced sentences under the federal sentencing guidelines.⁷⁷ A tax practitioner, in the course of vigorously representing a client, must use all lawful means available to frustrate the government in obtaining enough evidence to indict and convict. The IRS, however, will continue to use the criminal function to detect and punish American taxpayers who cheat on their taxes by engaging in overseas activity in an effort to foster voluntary compliance among the taxpaying public.

77. See, e.g., 18 U.S.C. § 2T1.1(b)(2), and commentary n.4 (1994).