The Panama Papers and Lessons Learned from Years of Offshore Leaks

By Charles P. Rettig

Chuck Rettig discusses the international tax avoidance schemes exposed by the Panama Papers.

The Panama Papers

A massive law firm data breach of otherwise secretive financial information identifying numerous high-ranking government and public officials around the world was recently disclosed online by the International Consortium of Investigative Journalists (ICIJ).[1] Almost 40 years of confidential information from 1977 to December 2015 was somehow obtained by an anonymous source from the internal database of Panama-based law firm Mossack Fonseca & Co.[2] and apparently includes approximately 11.46 million files comprising approximately 2.6 terabytes (the equivalent of approximately 600 DVDs) of otherwise confidential financial data.

In what ICIJ claims to be the largest media collaboration ever undertaken, more than 370 journalists working in more than 25 languages and over 76 countries combed through the purloined data and traced the transactions involving the law firm's clients around the world. They shared information and hunted down leads generated by the leaked files using corporate filings, property records, financial disclosures, court documents and interviews with money laundering experts and law-enforcement officials.

The Panama Papers link up direct and indirect offshore holdings of some 140 current and former world leaders, politicians, public officials and others, disclosing a day-to-day, decade-by-decade look at how funds flowed through the global financial system. The searchable list[3] of individuals includes billionaires from throughout the world, current and former leaders of countries around the world, former spy chiefs and relatives of various politicians and public officials.

The data were initially obtained by the German newspaper Suddeutsche Zeitung and include emails, financial spreadsheets, passports and corporate records

CHARLES P. RETTIG is a Principal with Hochman, Salkin, Rettig, Toscher & Perez, P.C. in Beverly Hills, California. Mr. Rettig is Past-Chair of the IRS Advisory Council, a member of the Advisory Board for the California Franchise Tax Board, a past-member of the Advisory Council for the California State Board of Equalization and a Regent and Elected Fellow of the American College of Tax Counsel.

Wolters Kluwer CCH

© 2016 C.P. RETTIG

revealing the secret owners of financial accounts and companies in 21 jurisdictions ranging from Singapore to the British Virgin Islands to Nevada. The ICIJ is a collective of 190 investigative journalists spanning more than 65 countries who collaborate on in-depth investigations involving cross-border crime, corruption and the accountability of power.

Lessons Learned: Professional Advisors

An offshore company can be a logical, legitimate decision for various international business transactions. Mossack Fonseca & Co.,[4] a leading international company with a presence in over 40 countries and with close to 40 years of history in the legal industry, is well recognized in international business transactions.

Anyone, located anywhere, who is potentially impacted by the public release of the Panama Papers should consider immediately contacting competent, experienced counsel.

Mossack Fonseca & Co indicates that the media reports portray an inaccurate view of the services that it provides and, on supposition and stereotypes, misrepresents its role in global financial markets. The firm apparently maintains professional associations in Hong Kong, Miami and Zurich and offers various services in Belize, The Netherlands, Costa Rica, United Kingdom, Malta, Hong Kong, Cyprus, British Virgin Islands, Bahamas, Panama, British Anguilla, Seychelles, Samoa, Nevada and Wyoming (USA). ICIJ has *not* asserted any evidence of wrongdoing by Mossack Fonseca & Co or that any of the entities disclosed in the data breach were used for an improper purpose.

Banks, law firms and other offshore professional advisors are generally required to follow legal requirements making sure their clients are not involved in criminal enterprises, tax evasion or political corruption. Major banks, including international giants UBS and HSBC, are referenced by the ICIJ in data creation of nearly 15,600 companies in the British Virgin Islands, Panama and other offshore locations. It is legal and not uncommon for companies to establish commercial entities in different jurisdictions for a variety of legitimate reasons, including conducting cross-border mergers and acquisitions, bankruptcies, estate planning, *etc*.

Once created, the offshore and other companies can be used for purposes beyond those initially contemplated by the professional advisor. Mossack Fonseca & Co has had to defend[5] against suspicions of possible wrongdoing by stating, in part:

> Recent media reports have portrayed an inaccurate view of the services that we provide and, despite our efforts to correct the record, misrepresented the nature of our work and its role in global financial markets.
>
> These reports rely on supposition and stereotypes, and play on the public's lack of familiarity with the work of firms like ours. The unfortunate irony is that the materials on which these reports are based actually show the high standards we operate under, specifically that:
>
> > we conduct due diligence on clients at the outset of a potential engagement and on an ongoing basis;
> >
> > we routinely deny services to individuals who are compromised or who fail to provide information we need in order to comply with "know your client" obligations or when we identify other red flags through our due diligence;
> >
> > we routinely resign from client engagements when ongoing due diligence and/or updates to sanctions lists reveals that a party to a company for which we provide services been either convicted or listed by a sanctioning body;
> >
> > we routinely comply with requests from authorities investigating companies or individuals for whom we are providing services; and
> >
> > we work with established intermediaries, such as investment banks, accountancies and law firms, as part of the regulated global financial system.
>
> We would like to take this opportunity to address some specific misconceptions about our work and clarify the inaccuracies that are rife in the recent media reports … .
>
> We regret any misuse of companies that we incorporate or the services we provide and take steps wherever possible to uncover and stop such use. *If we detect suspicious activity or misconduct, we are quick to report it to the authorities. Similarly, when authorities approach us with evidence of possible misconduct, we always cooperate fully with them.*[6]

Wolters Kluwer CCH

Know your clients as well as those who act as intermediaries with the ultimate client. Even the most diligent advisors can find their fingerprints on a get-away vehicle creating a potential appearance of impropriety or complicity by the advisors. "We only manufacture the guns, we don't load them … ."

Lessons Learned: Individuals

Anyone, located anywhere, who is potentially impacted by the public release of the Panama Papers should consider immediately contacting competent, experienced counsel. Although ICIJ reported that the Panama Papers were not purchased, there are some reports this information has been sold to the German tax authorities and may have been offered to tax authorities in the United Kingdom, the United States and elsewhere.

U.S. individuals (citizens or legal residents) should also contact competent tax counsel. The failure to declare certain interests in foreign financial accounts and assets can potentially bring about significant civil penalties and, in egregious situations, the possibility of criminal problems. The IRS will undoubtedly mine the Panama Papers just as they have mined data disclosed in other scenarios to ascertain relationships, if any between the disclosed offshore entities and U.S. individuals.

Concern should not be limited to those having some possibly remote link to the Panama Papers. The public disclosure of otherwise confidential information from an internal database of a law firm, trust company or otherwise can occur at anytime, anywhere in the world.

The United States maintains an active "Whistleblower Program,"[7] which can net the informant up to 30 percent of the additional tax, penalty and other amounts collected. There is a strong likelihood that financial mercenaries are lurking somewhere within the depths of financial institutions, professional service companies, trust companies, *etc.,* around the world.

The Foreign Bank and Financial Accounts

U.S. taxpayers with an interest in, or signature or other authority over, foreign financial accounts whose aggregate value exceeded $10,000 at any time during 2015 must electronically file *Form 114, Report of Foreign Bank and Financial Accounts* (commonly referred to as the FBAR, previously Form TD F 90-22.1), with FinCen. A U.S. person may have a reporting obligation even though the foreign financial account does not generate any taxable income. Taxpayers also report their interest in foreign financial accounts by (1) completing boxes 7a and 7b on Form 1040 Schedule B; box 3 on the Form 1041 "Other Information" section; box 10 on Form 1065 Schedule B; or boxes 6a and 6b on Form 1120 Schedule N.

The calendar-year 2015 FBAR is due by June 30, 2016, and must be filed electronically through the FinCen BSA E-Filing System website. The calendar-year 2016 FBAR is due by April 15, 2017, with a maximum extension for a six-month period ending on October 15. The failure to timely file the FBAR can be subject to civil penalties and possibly criminal sanctions (*i.e.,* imprisonment). The statutory civil penalties might be $10,000 per year for a nonwillful failure, but a willful failure to file could, by statute, be subject to civil penalties equivalent to the greater of $100,000 or 50 percent of the balance in an unreported foreign account, per year, for up to six tax years. Nonwillful penalties might be avoided if there is "reasonable cause" for the failure to timely file the FBAR.

IRS Offshore Voluntary Disclosure Program

The IRS maintains a special "Offshore Voluntary Disclosure Program"[8] (OVDP) that permits taxpayers to come into compliance and disclose previously undeclared interests in foreign financial accounts and other assets, pay required taxes, interest and penalties, and provide information about their offshore holdings. In return, participants receive protection from criminal prosecution and a reduction in the otherwise potentially applicable tax penalties.

The OVDP is designed for taxpayers seeking certainty in the resolution of their previously undisclosed interest in a foreign financial account. Importantly, however, taxpayers are not eligible for the OVDP unless they approach the IRS before the IRS becomes aware of their potential tax noncompliance. For those who might be considered to have "willfully" failed to timely file an FBAR or similar, the OVDP avoids exposure to numerous additional penalties associated with the income tax returns and various required foreign information reports, a detailed examination and limits the number of tax years at issue while also providing certainty with respect to the avoidance of a referral for criminal tax prosecution.

IRS Streamlined Filing Compliance Procedures

In addition to the OVDP, the IRS maintains other more streamlined procedures[9] designed to encourage nonwillful

Wolters Kluwer CCH

taxpayers to come into compliance. Taxpayers using either the Streamlined Foreign Offshore Procedures[10] (for those who satisfy the applicable nonresidency requirement) or the Streamlined Domestic Offshore Procedures[11] are required to certify that their failure to report all income, pay all tax and submit all required information returns, including FBARs, was due to "non-willful" conduct.

For these streamlined procedures, "non-willful conduct" has been specifically defined as "conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law." For eligible U.S. taxpayers residing outside the United States, all penalties will be waived under the Streamlined Foreign Offshore Procedures. For eligible U.S. taxpayers residing in the United States, the only penalty will be a miscellaneous offshore penalty equal to five percent of the foreign financial assets that gave rise to the tax compliance issue under the Streamlined Domestic Offshore Procedures.

The Panama Papers investigation by the ICIJ represents the largest media collaboration ever undertaken.

Even if returns properly filed under the streamlined procedures are subsequently selected for audit under existing IRS audit selection processes, the taxpayer will not be subject to failure-to-file and failure-to-pay penalties or accuracy-related penalties with respect to amounts reported on those returns, or to information return penalties or FBAR penalties, unless the examination results in a determination that the original tax noncompliance was fraudulent and/or that the FBAR violation was willful. Any previously assessed penalties with respect to those years, however, will not be abated. Further, as with any U.S. tax return filed in the normal course, if the IRS determines an additional tax deficiency for a return submitted under these procedures, the IRS may assert applicable additions to tax and penalties relating to that additional deficiency.

What Happened Last Time?

On June 14, 2013, the ICIJ published a searchable Offshore Leaks Database,[12] containing the names of over 100,000 companies and trusts created in 10 foreign jurisdictions by two offshore service firms. ICIJ received 2.5 million emails and documents from the two firms covering clients located in more than 170 countries and territories over a 30-year period ending in 2010.

On February 8, 2015, the ICIJ published "Banking Giant HSBC Sheltered Murky Cash Linked to Dictators and Arms Dealers"[13] revealing secret documents obtained *via* the French newspaper *Le Monde* revealing the inner workings of HSBC's Swiss private banking arm, relating to accounts holding more than $100 billion on behalf of famed soccer and tennis players, cyclists, rock stars, Hollywood actors, royalty, politicians, corporate executives and old-wealth families.

Before publicly releasing the HSBC Swiss data, the ICIJ reached out to many individuals (and their representatives) somehow identified within the data seeking an explanation of the holdings. At that time, initial ICIJ inquiries stated:

> I am a reporter with the International Consortium of Investigative Journalists, an independent network of reporters with headquarters in Washington, DC. Our investigations appear regularly in leading media organizations including BBC, The Guardian, Le Monde, Washington Post and many others.
>
> You can check our work here www.icij.org. We are writing because the International Consortium of Investigative Journalists, in concert with other media outlets, is currently conducting a detailed investigation of Swiss bank accounts, past and present.
>
> It is not illegal to have Swiss accounts. But as you may know, it is a topic of considerable public debate, and several governments have been investigating the owners of such accounts.
>
> There are a number of ways such accounts and also offshore trusts have been used to avoid taxes imposed by national governments. Such accounts have also been used to launder money.
>
> We have seen records identifying you as a Swiss banking client. The account related to you, with the corresponding maximum amount in US dollars held in 2006/2007, is as follows: …
>
> We are particularly concerned to answer four questions: 1. Why did you hold a Swiss bank account? 2. Do you currently hold any bank account in Switzerland? 3. What was the nature of your relationship with [the account]? 4. How much back tax have you settled with tax authorities following their investigation of your affairs, assuming there was such investigation?

Wolters Kluwer CCH

ICIJ and its media partners intend to publish the results of this investigation shortly in the US, the UK, France and several other countries.

As responsible journalists acting in the public interest, we would first like to give you the opportunity to comment.

If we do not hear from you by 18:00 on Friday 23rd January 2015 (preferably by email to this address), we shall proceed on the basis that you do not wish to comment on or amend our information.

We have approached you in a straightforward fashion and hope you will take this opportunity to respond if you wish. Your substantive responses to each of our four numbered points will be carefully considered and published if appropriate.

(For the avoidance of doubt, we do not normally regard any generalized assertion of 'inaccuracies' as a substantive response; nor any generalized statement that the holders acted on advice. Neither will we regard as substantive any comment that only refers to the present State of affairs and not to the past.)

We are, of course, happy to discuss directly any concerns you may have. We would be most grateful if you would acknowledge receipt of this letter. This will save us from chasing.

"As responsible journalists acting in the public interest … ." The ICIJ site published profiles of 61 people allegedly associated with the HSBC Swiss data in some manner but confirmed that it did not reveal any of such individuals. In fact, the ICIJ journalists were responsible journalists and did not disclose information regarding individuals who provided an appropriate explanation.

And, if I Do Nothing?

To avoid the appearance of an impropriety, China can shut down certain Internet search functions and a Prime Minister can resign in Iceland. However, any U.S. person having an undeclared interest in a foreign financial account or assets should take note that such information can find its way to government authorities through nonofficial channels—whistleblowers and informants waiting to claim financial rewards for similar information might be resident within any financial institution or another entity holding otherwise confidential or secret information.

If the initial contact is by the IRS, a purely civil tax resolution is no longer certain and significant civil penalties are likely. If the initial contact is by the Department of Justice, a purely civil tax resolution is anything but certain and is perhaps unlikely. A few years back, many individuals came home to find a letter from the U.S. Department of Justice stating:

Most individuals (and their professional advisors) will sleep better if they get it right, somehow get into compliance and move on in life.

Re Investigation of undeclared Foreign Financial Accounts. The Department of Justice is conducting an investigation of U.S. taxpayers who may have violated federal criminal laws by failing to report they had a financial interest in, or signature authority over, a financial account located in a foreign country. We have reason to believe that you had an interest in a financial account in India that was not reported to the IRS on either a tax return or FBAR, [FinCEN Report 114], report of Foreign Bank and Financial Account. You are advised that the destruction or alteration of any document that may relate to this investigation constitutes a serious violation of federal law, including but not limited to obstruction of justice … . You are further advised that you are a subject of a criminal investigation being conducted by the Tax Division [of the Department of Justice]. (Italics added.)

What to Do?

Those having any undeclared interest in an offshore entity or in a foreign financial account or asset are the only ones capable of determining their potential nonwillful status. If such status is not supported by sufficient objective facts, consider other methods of coming into compliance, including the OVDP, with the applicable reporting and filing requirements.

For those comfortable in certifying their "non-willful conduct," consider coming into compliance through the Streamlined Filing Compliance Procedures. The IRS has indicated it will review each certification of nonwillful status seeking participation in the streamlined procedures. The source of funds held in the foreign account may be an important factor. If the source of funds in the account was from unreported income, the situation can become

Wolters Kluwer CCH

somewhat problematic. Deposits and withdrawals to the foreign account can reveal intentions and knowledge of various individuals involved.

In reviewing the "non-willful" certification, the government can be expected to inquire about the manner in which deposits and/or withdrawals were made to/from the foreign account(s); the mechanics of how deposits/withdrawals were made; the form in which deposits/withdrawals occurred (*i.e.,* cash, check, wire, travelers' check, *etc.*); amounts of each withdrawal/deposit; when such deposits/withdrawals occurred; where such deposits/withdrawals occurred; whether there were limitations on the amounts that could be deposited/withdrawn; and documents received when a deposit/withdrawal occurred (*i.e.,* receipt, credit memo, debit memo, *etc.*).

Additional considerations regarding someone being "non-willful" often include whether the existence of the account was disclosed to the return preparer or others; whether the account was at some point moved to another foreign financial institution; whether the taxpayer's advisors had some degree of knowledge about the account; the perceived degree of financial and business sophistication and education of the taxpayer; whether foreign entities were involved as accountholders; documents provided to open the account [*i.e.,* U.S. or foreign passport(s), identification card, *etc.*—note that it might not be a good fact for a taxpayer having dual passports to open an account with their non-U.S. passport]; communications, if any, with others that occurred regarding bank secrecy, taxation and/or disclosure of any foreign accounts; and failure to seek independent legal advice about how to properly handle the foreign bank account and instructions or advice received regarding holding or receiving mail from the bank, *etc*. Further questions often lay within the responses to each of the foregoing questions.

Lastly, in reviewing the nonwillful certification under the streamlined procedures, resident taxpayers should anticipate the government inquiring as to whether the foreign accounts remain open and if not, where the funds were transferred when the account(s) were closed. Some resident taxpayers closed accounts and transferred the funds directly to a domestic account. Others closed accounts and transferred the funds through various means to other foreign accounts. Further questions often lay within the responses to each of the foregoing questions. An interview by an IRS agent (in person or by phone) should be anticipated and is more likely with respect to resident taxpayers.

Nonresident taxpayers might be better positioned to achieve their goal of a nonwillful, no-penalty resolution under the streamlined procedures. Their "foreign" account is actually in their own neighborhood; it is only "foreign" in the sense that it is located outside the territorial boundaries of the United States. The existence of the account does not, by itself, somehow represent an acknowledgment of tax noncompliance by the nonresident taxpayer.

The Panama Papers investigation by the ICIJ represents the largest media collaboration ever undertaken. Most individuals (and their professional advisors) will sleep better if they get it right, somehow get into compliance and move on in life. For those linked to the Panama Papers, there are likely a thousand explanations … and for some, sleepless nights ahead.

ENDNOTES

1 *See https://panamapapers.icij.org/20160403-panama-papers-global-overview.html.*
2 *See www.mossfon.com/.*
3 *See https://panamapapers.icij.org/the_power_players/.*
4 *See http://mossfonmedia.com/.*
5 *See http://mossfonmedia.com/wp-content/uploads/2016/04/Statement-Regarding-Recent-Media-Coverage_4-1-2016.pdf.*
6 *Id.*
7 *See www.irs.gov/uac/Whistleblower-Informant-Award/.*
8 *See www.irs.gov/uac/2012-Offshore-Voluntary-Disclosure-Program.*
9 *See www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures.*
10 *See www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-Outside-the-United-States.*
11 *See www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-in-the-United-States.*
12 *See www.icij.org/about/press-releases/icij-releases-offshore-leaks-database-public.*
13 *See www.icij.org/project/swiss-leaks/banking-giant-hsbc-sheltered-murky-cash-linked-dictators-and-arms-dealers.*

This article is reprinted with the publisher's permission from the Journal of Tax Practice & Procedure, a bi-monthly journal published by CCH, a part of Wolters Kluwer. Copying or distribution without the publisher's permission is prohibited. To subscribe to the Journal of Tax Practice & Procedure or other CCH, a part of Wolters Kluwer Journals please call 800-449-8114 or visit CCHGroup.com. All views expressed in the articles and columns are those of the author and not necessarily those of CCH, a part of Wolters Kluwer or any other person.