Advising a Client with Secret Offshore Accounts - Current Filing and Reporting Problems

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A practitioner's legal and ethical responsibilities to the client and to the judicial system are tested when the client's past conduct collides with annual reporting and disclosure obligations for foreign bank accounts. Often the only acceptable approach is the explicit assertion of the privilege against self-incrimination, which may itself provide an incriminating lead to an inquisitive investigator.

For a U.S. taxpayer, the act of opening a foreign bank account triggers multiple annual reporting and disclosure obligations. Many people who open such accounts do so without the benefit of competent advice and then wrongfully fail to make the proper disclosures to the IRS and the Treasury. As illustrated by the not atypical hypothetical described below, when such a client later consults a tax advisor, the practitioner must tread carefully in protecting the client's legal interest to the fullest extent possible while at the same time ensuring that the client -- and the advisor as well -- commit no new offenses.

BANKING IN PARADISE

In the spring of 1996, Richard Smith had a marvelous vacation on the tropical island of Azure. While he was there, he attended a free seminar on offshore banking and investing, where he heard about the many benefits of having an Azure bank account, including the island's strict bank secrecy laws. Smith opened an account at an Azure bank and deposited funds over the next three years. The bank invested his money and provided him with a "debit" card to use for "untraceable" cash advances and purchases. While Smith was careful to report all of his domestic income on his tax returns for 1996 and 1997, he did not disclose the existence of the Azure account or report the income earned in the account.

In January 1999, Smith received a routine civil audit notice for 1996 and 1997 from the IRS. Nervous about his Azure account, he consulted his lawyer. She took some comfort in the fact that Smith was not skimming cash out of his business, but she was concerned that the offshore account might surface during the audit. As she considered the agent's initial request for information, Smith sent her a draft copy of his 1998 return. She noted that in response to the standard question asking whether the taxpayer had any foreign accounts, Smith had falsely answered "no."

Smith's lawyer knew that she could not advise him to file a false tax return. She also knew, however, that disclosing the foreign account and reporting offshore earnings on Smith's 1998 return might lead the Service to his false statements and underreporting of income on prior returns. She also was aware that Smith was exposed to criminal sanctions for failing to file annual Treasury Department forms concerning his foreign account. She pondered her options.

The annual reporting requirements for foreign bank accounts and the severe sanctions for noncompliance with those obligations create recurring problems for any tax practitioner who, like Smith's lawyer, encounters a client with a previously undisclosed foreign account. In addition to the client's issues, the practitioner faces the difficult question of what advice ethically can be given to a client who has failed in prior years to disclose a foreign financial account when the time comes to file the current tax return.

DISCLOSURE REQUIREMENTS

The tax and banking laws obligate U.S. taxpayers to disclose any foreign financial account under their control in a variety of ways. First, the Code requires U.S. citizens and residents to report their worldwide income. Thus, if a U.S. taxpayer has a bank or brokerage account in a foreign country and that account earns interest, dividends, or capital gains, that income, and a disclosure of its source, must appear on the Form 1040.

A person who opens an account in a tax haven country with the intention not to report it to the IRS typically attempts to evade this requirement by using a nominee entity. Financial advisors in tax havens often promote "bearer share" corporations for this purpose. Such a corporation belongs to whomever physically possesses the stock certificates, so there is no official record of ownership. In Smith's case, for example, an Azure solicitor created the "RS Corporation" under Azure law, put himself and his office staff on the corporation's board of directors, opened the account in the corporation's name, and then gave Smith the stock certificates.

There is no question, however, that Smith is the "beneficial owner" of the account in the name of the RS Corporation. He is the sole signatory on the account. He presumably filled out a form at the bank identifying himself as the beneficial owner. The money in the account is his to use as he pleases. The debit card issued on the account is in his name. It is beyond dispute under U.S. tax law that the obligation to report income earned on a financial account attaches to the beneficial owner of the funds in the account, regardless of the name in which the account is held.[1] There is no question that Smith should have disclosed the account and reported its earnings on his prior returns.

U.S. taxpayers are also subject to additional requirements, derived from the Bank Secrecy Act of 1970 (BSA), to report their interest in or authority over any foreign financial accounts. When it enacted BSA, Congress was concerned that wealthy Americans with secret foreign bank accounts were able to evade income taxes and conceal assets, that foreign financial accounts were often linked to other serious criminal activity, and that U.S. law enforcement agencies encountered roadblocks when investigating such offenses because "wrongdoers cloak their activities in the shield of foreign financial secrecy."[2] Congress therefore directed the Treasury to adopt regulations requiring disclosure of foreign accounts.[3] Pursuant to this mandate, federal regulations require each person subject to U.S. jurisdiction to make a report on yearly tax returns of any "financial interest

in, or signature or other authority over, a bank, securities or other financial account in a foreign country."[4] The regulations further require the disclosure of information relating to such accounts on a separate form issued by the Treasury.

The result of the BSA's directive is a dual disclosure requirement. First, since the promulgation of the regulations, Form 1040 has contained a question asking about foreign financial accounts. On the 1998 return, the question appears on Schedule B and reads as follows: "At any time during [the calendar year], did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See [the instructions] for exceptions and filing requirements for Form TD F 90-22.1." The form contains boxes labeled "yes" and "no" for the taxpayer's response. If the answer is "yes," the form requires the taxpayer to "enter the name of the foreign country."

The instructions accompanying Form 1040 make plain that, in general, a "yes" answer to the foreign bank account question is required if the taxpayer (1) at any time during the year had *an interest in or signatory or other authority over* a financial account in a foreign country, or (2) owns more than 50% of the stock in any corporation that owns one or more such accounts. There are exceptions to the disclosure requirement, such as for accounts valued at less than $10,000 during the entire year or accounts owned by a publicly traded or otherwise large corporation where the company has disclosed the account.

The second disclosure requirement, alluded to in the question on the Form 1040, is Treasury Department Form 90-22.1, "Report Of Foreign Bank And Financial Accounts" (known as an FBAR, for "foreign bank account report"). That form requires the disclosure of detailed information about the taxpayer's foreign accounts, including the filer's identity and social security number, and a list of all foreign accounts, with account numbers. The FBAR instructions and definitions describe what constitutes a "financial account," a "financial interest," or "signature or other authority," but in the typical case like Richard Smith's the obligation to file the FBAR is clear. Even if Smith's account is technically "owned" by the RS Corporation, his signature authority over the account by itself triggers the disclosure obligation, regardless of the nature of his financial interest, as does his financial interest, standing alone, without regard to the identity of the signatory.

If a taxpayer has a disclosable interest in a foreign account at any time during the tax year, the FBAR describing that account is due on June 30 of the following calendar year, and no extensions are possible. Form 90-22.1 is filed not with the IRS but with the Treasury's computing center in Detroit.

SANCTIONS FOR NONCOMPLIANCE

Both the willful failure to comply with the disclosure requirements for foreign financial accounts and the willful failure to report earnings on such accounts constitute serious criminal offenses and may also trigger severe civil penalties.

The most likely basis for a criminal prosecution against a taxpayer who provides a false answer to the foreign bank account question is Section 7206(1). That statute punishes any taxpayer who "[w]illfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter." A taxpayer who knowingly checks the foreign bank account box "no" when the correct answer is "yes" obviously would violate this provision. The Justice Department lists such conduct in its Criminal Tax Manual as a basis for a prosecution under Section 7206(1), and the government has prosecuted individuals in such cases.[5]

A taxpayer may not avoid these sanctions by failing to answer the foreign bank account question. A willful failure to answer "yes" or "no" could violate Section 7206(1) if the taxpayer signing such a return knew that the return was not "true and correct as to every material matter."[6] There is at least one reported case in which the government prosecuted a taxpayer under Section 7206(1) for failing to respond to the foreign bank account question.[7] Moreover, in other regulatory contexts, the government has obtained false-statement felony convictions against individuals who leave blank a request for information on a federal filing. In such cases, a willful nonresponse is considered a false statement.[8]

Other criminal tax sanctions could apply to the knowing noncompliance with the foreign bank account disclosure requirements. A taxpayer's omission from his return of taxable interest, dividends, or capital gains earned on a foreign account is a separate offense under Section 7206(1) or, if the government can prove a tax deficiency, tax evasion under Section 7201. If more than one individual is involved, the government can--and often does--bring tax-related conspiracy charges.[9]

In addition to criminal tax charges, the BSA imposes criminal penalties for the willful failure to file an FBAR.[10] Any such failure is a felony, and it is a more serious felony if the person fails to file the form "while violating another law of the United States or as part of a pattern of illegal activity involving transactions of more than $100,000 in a 12 month period."[11] Thus, any knowing failure to file an FBAR that occurs in the context of tax, currency, or money-laundering offenses can be prosecuted as a separate felony.[12] The government has prosecuted individuals under the BSA for failing to file the FBAR.[13]

Whether the government brings criminal charges or not, a taxpayer who fails to disclose a foreign financial account or who omits income from such an account on a tax return will be subject to various civil penalties.

The Treasury can impose a civil penalty for each willful failure to file an FBAR equal to the greater of the balance in the foreign account (not to exceed $100,000) or $25,000.[14] The IRS can invoke the full panoply of civil tax penalties that may apply when a taxpayer omits income from a return, including the negligence or substantial understatement penalties of 20% or the fraud penalty of 75%.[15]

ADVISING THE CLIENT ON CURRENT FILINGS

Before he consulted his lawyer, Richard Smith violated a number of federal statutes. He made false statements on his 1996 and 1997 tax returns by checking "no" in response to the foreign bank account question. He omitted interest, dividend, and capital gains earned on the Azure account from the taxable income reported on those returns. He failed twice to file the required FBAR.

There is little that Smith's lawyer can do about her client's prior conduct. Filing amended 1996 and 1997 returns or the delinquent FBARs after the initiation of an IRS audit for those years would constitute an admission of Smith's prior false statements and create evidence that the IRS could use against him in the audit and, more important, in a criminal investigation.[16] Smith and his lawyer can hope that the revenue agent will complete the audit without coming across information that would lead to discovery of the Azure account. If, however, the agent asks the right questions, Smith has only two lawful avenues open to him--either he can respond truthfully to the agent's inquiries, which would presumably result in providing information about or leads to the foreign account, or he can assert his Fifth Amendment rights and otherwise decline to cooperate with the audit. Either course may prompt the agent to refer the case to the Criminal Investigation Division.

Smith's lawyer faces an equally daunting challenge in how to advise Smith with respect to his current filing obligations. Smith must file a timely, truthful and complete 1998 tax return, and he is required to file a current FBAR. His lawyer cannot ethically advise him to disregard those legal obligations. Nevertheless, providing the government with the information required by these forms could be criminally incriminating for Smith. The tensions among Smith's current filing requirements relating to the foreign account, his self-interest in avoiding disclosure of past violations, and his lawyer's professional responsibility, create a delicate and troublesome set of tactical issues for Smith and his lawyer.

The Form 1040

If Smith makes a full disclosure on his Form 1040, he will be providing the IRS with a clear lead to his Azure account. The revenue agent conducting the audit is likely to ask for a copy of the 1998 return, and the disclosure of a bank account in a tax haven will surely prompt further inquiry. There is no question that the government could use any disclosures made on the return against Smith.[17] With the extensive powers of U.S. law enforcement authorities to obtain foreign evidence, even in tax haven jurisdictions, the details of the account may well be discovered.[18] To the extent consistent with her ethical responsibilities, Smith's lawyer

ought not recommend a full disclosure on the return.

Yet, Smith's lawyer cannot advise him to check "no" in response to the foreign bank account question, or to leave the answer blank.[19] If she did that, she might be entering into a conspiracy with Smith to violate Section 7206(1), and she might have aided and abetted his conduct by doing so. Not only would this compound Smith's legal problems, but his lawyer might be subject to potential investigation, criminal prosecution, incarceration, and disbarment.

Thus, Smith must answer the question, and his counsel must advise him on an answer that does the least amount of damage without having him engage in additional criminal conduct. After exhausting all available extensions (perhaps Smith's audit will have ended by October), the only acceptable vehicle for such an approach is Smith's Fifth Amendment privilege against self-incrimination.

Smith may decline to answer the foreign bank account question by claiming his Fifth Amendment privilege. An individual taxpayer may assert the privilege against self-incrimination to avoid making particular disclosures on the tax return.[20] To be valid, a claim of privilege must be explicit on the face of the return and in response to specific questions or line items when the requested information would provide testimonial self-incrimination.[21] Thus, Smith's lawyer could advise him to place an asterisk next to the foreign bank account question, footnote his answer with an explicit claim of privilege, and then leave the "yes" and "no" boxes blank.

Obviously, Smith's assertion of his Fifth Amendment privilege in response to the foreign bank account question will be a "red flag" if the 1998 tax return is audited or surfaces during the ongoing examination. But Smith's counsel can offer no other ethical alternative to having her client admit to his control over the Azure account, which would be more than just a "red flag"-- it would constitute an admission that could be used against Smith in a criminal prosecution. If the examining agent asks for the return, it is far better for Smith that it contains no information that could prejudice him in the event such an inquiry is (or has already) begun.

Smith's right to assert his Fifth Amendment privilege to avoid disclosure of his foreign bank account is subject to a potentially important limitation. Most courts considering the issue have held that while a taxpayer can assert the Fifth Amendment privilege in response to a line item, such as his occupation or the source of income, the taxpayer may not use the privilege to withhold the amount of his taxable income.[22] Thus, while Smith may decline on Fifth Amendment grounds to disclose his authority over or interest in his Azure account, most courts would hold that he must report the amount of income earned on the account on his 1998 tax return. He can rely on his privilege against self-incrimination as a basis for declining to identify the source of that income.[23]

The FBAR

As discussed above, the Form 1040 is not the only annual reporting requirement relevant to Smith's Azure account. He and his counsel still must deal with his obligation to file Form 90-22.1.

The FBAR presents different, yet just as problematic, issues for Smith's counsel. It would be extremely risky to have Smith fill out a truthful and complete form. Although the FBAR goes to a Treasury Department computing center in Detroit rather than the IRS, the disclosure of Smith's Azure account on the form would give the government a clear road map to details about the account, including the account number and evidence of the account balance. These leads would permit an investigator or prosecutor to seek records relating to the Azure account, and the form itself could be used as evidence against Smith. Because Smith is a potential target of a criminal investigation, his lawyer certainly should not advise him to supply the information called for on the FBAR. Even if a criminal investigation were not yet pending, there would be too great a risk that the FBAR would be uncovered.

Since Smith would be ill advised to file a complete, accurate, and truthful FBAR, his lawyer must consider other options. She may consider that Smith's Fifth Amendment privilege can be invoked to justify declining to file the form altogether, or that Smith can assert the privilege on the FBAR to prevent the government from obtaining evidence that can be used against him.

One could argue that Smith's Fifth Amendment privilege should excuse him from the filing requirement because the mere act of filing the FBAR could constitute testimonial self-incrimination. Only those people with the requisite authority or interest in a foreign bank account must file an FBAR. Thus, the mere act of filing constitutes what the courts call a "testimonial act"- -that is, a nonverbal admission that the person who filed the form is in fact required to do so because he has a foreign financial account. The act of filing the form, without regard to its contents, would provide a lead to a prosecutor or investigator about Smith's connection with a foreign account. Depending on what other information the government might have obtained, Smith's filing of an FBAR by itself could well be an important "link in the chain" of evidence necessary to charge him with a crime.

Yet, two courts of appeals have rejected the Fifth Amendment privilege as a basis for the nonfiling of Bank Secrecy Act forms. In *Sturman,* 951 F.2d 1466 (CA-6, 1991), *cert. den.,* the government charged the principal defendant with, among other offenses, three felony counts of failing to file the FBAR as to otherwise undisclosed foreign accounts. In *Dichne,* 612 F.2d 632 (CA-2, 1979), *cert. den.,* the defendant failed to file the BSA-required form reporting currency that he carried across the U.S. border.[24]

Both defendants argued that the applicable filing requirements violated their Fifth Amendment privilege because the information provided on the forms would incriminate them with respect to other crimes. They asserted that the BSA filing obligations were unconstitutional, relying on Supreme Court cases that struck down, on Fifth Amendment grounds, selected reporting obligations that compelled a targeted group to acknowledge its participation in a criminal offense. The most prominent such case in the tax area is *Marchetti,* 390 U.S. 39, 21 AFTR2d 539 (1968), in which the Supreme Court invalidated federal requirements that gamblers disclose their unlawful wagering activity by posting a stamp at their principal place of business, filing additional forms, and reporting their wagering income. At the time, gambling was unlawful in nearly every state, and the Court found that "every portion of the [reporting and payment] requirements had the direct and unmistakable consequence of incriminating" those required to comply with them.[25] As in *Marchetti,* the defendants in *Sturman* and *Dichne* argued that, merely by filing BSA forms, they would be providing evidence that might incriminate them in various crimes.

Both the *Sturman* and *Dichne* courts rejected the defendants' arguments because, in contrast to *Marchetti,* the conduct disclosed by filing the required form was not itself illegal. The Sixth Circuit in *Sturman* recognized that the FBAR filing requirement "applies to all persons making foreign deposits, most of whom do so with legally obtained funds." The court concluded that the required disclosures did not subject the defendants to a "real danger of self-incrimination," and therefore held that the FBAR did not meet the *Marchetti* test because not "every element" of the reporting requirement would have incriminated the defendant. Similarly, in *Dichne* the Second Circuit observed that there is nothing unlawful in transporting currency in excess of the reporting requirement. Other courts have reached similar results.[26]

While the analysis in *Sturman* and *Dichne* is questionable in some respects,[27] the courts have plainly decided to tolerate some potential for self-incrimination rather than sanction a system where i ndividuals may simply ignore the BSA filing requirements. In light of these authorities, Smith's lawyer would be wise to find a mechanism to try to protect her client's interest other than simply failing to file the FBAR.

While the cases are clear that one who fails to file an FBAR risks potentially serious penalties, they do not foreclose the option of claiming the Fifth Amendment on the FBAR itself. As noted above, where a particular disclosure on a federal tax return might incriminate a taxpayer, it is permissible for the taxpayer to decline to provide the information and to assert the Fifth Amendment privilege on the face of the return. The FBAR should be no different. Thus, while Smith is required to file an FBAR, he should not have to provide details on the form that might lead to the discovery of, or provide evidence of, other criminal offenses. This raises the question of how Smith could validly assert his privilege against self-incrimination on the face of the FBAR.

The FBAR asks for specific information relating to the taxpayer and his account, including name, address, social security number, and the name of his bank, the bank account number, and an approximate balance in the account. One approach would be for Smith to file a blank FBAR accompanied by a statement that identifies him, provides his social security number, and asserts his Fifth Amendment privilege as to whether he is even required to file the form. Another approach would be analogous to the one used on Smith's 1998 tax return, providing his identifying information but asserting his privilege in response to particular questions about his foreign accounts.

Either form clearly would comply with the filing requirement by identifying Smith and providing his social security number. An FBAR that asserts Smith's privilege as to the underlying obligation to file provides the broadest possible protection. Claiming the privilege as to the obligation to file the FBAR would be no different than refusing on Fifth Amendment grounds to respond to an inquiry from an auditor or investigator as to whether Smith had a foreign account. Moreover, such a "Fifth Amendment" FBAR could not be used as evidence against Smith in a subsequent prosecution--a court could not properly allow the government to introduce the form against Smith in a criminal case as evidence of his control over a foreign account when he explicitly claimed his privilege against self-incrimination as to that very fact.[28]

For Smith's lawyer, advising her client to file a Fifth Amendment FBAR in this manner is more sensible than advising him not to file the form on Fifth Amendment grounds. While she may find it tempting to relitigate the Fifth Amendment issue, the dispute would arise in the context of a prosecution of her client in which she would likely be a witness -- on her client's claim of reliance on professional advice -- or a codefendant. Moreover, her advice as to the FBAR is part of the overall strategy of dealing with current filing issues; Smith still must file a tax return, and he cannot simply fail to answer the foreign bank account question. He has no choice but to assert his Fifth Amendment privilege on his tax return as to his control over a foreign account and as to the source of the income earned on the account. The tax return will provide just as much of a lead (and probably one more likely be discovered) as the filing of a Fifth Amendment FBAR. Because Smith eventually must file a tax return, his lawyer clearly would be taking an unnecessary risk for herself and her client by instructing him to ignore the filing requirement for the FBAR.[29]

There is no question that even a Fifth Amendment FBAR discloses information to the government that it may not otherwise have obtained. It clearly provides an incriminating lead by acknowledging that Smith has enough of a relationship with a foreign account that he felt compelled to file the FBAR, even if the form itself cannot be used as evidence against him. Although the Fifth Amendment assertion on a tax return or the FBAR may do nothing more than confirm the suspicion of an IRS auditor or criminal investigator that Smith has an offshore account, in certain cases that might be significant. It may seem unfair to require Smith to file the form in this context, but the case law compels the conclusion that he must do so. Under existing precedent, however, no prosecutor or court could legitimately quarrel with a decision to file the FBAR with the broadest possible assertion of Smith's Fifth Amendment privilege.

CONCLUSION

Because of annual disclosure requirements, taxpayers engaged in ongoing concealment of foreign accounts are forced to "return to the scene of the crime" every year. This provokes a tricky set of issues for tax practitioners advising these clients, especially those already under IRS scrutiny. In such cases, lawyers must reconcile their professional responsibility to protect the client's interest with their legal and ethical obligations not to counsel, condone, or join in an unlawful cover up. Although there are no ideal answers, through the judicious and careful use of the taxpayer's Fifth Amendment privilege, the practitioner can recommend a course of action that complies with the tax and BSA reporting requirements, while disclosing the least amount of information that could damage the client.

Footnotes

[1] See, e.g., Chu, TCM 1996-549; Hang, 95 TC 74 (1990); Serianni, 80 TC 1090 (1983), *aff'd* 765 F.2d 1051, 56 AFTR2d 85-5559 (CA-11, 1985); Hook, 58 TC 267 (1972).

[2] See H. Rep't No. 91-975, 91st Cong., 2d Sess., reprinted in U.S. Code Cong. & Ad. News 4394, 4397-8 (1970).

[3] 31 U.S.C. section 5314.

[4] 31 C.F.R. section 103.24.

[5] U.S. Department of Justice, Criminal Tax Manual, §12.08[6][g]. See, e.g., Mueller, 74 F.3d 1152, 77 AFTR2d 96-893 (CA-11, 1996); Harvey, 869 F.2d 1439, 63 AFTR2d 89-1212 (CA-11, 1989); Franks, 723 F.2d 1482, 53 AFTR2d 84-595 (CA-10, 1983), *cert. den.* See also Hajecate, 683 F.2d 894, 51 AFTR2d 83-1282 (CA-5 *en banc,* 1982), *cert. den.* (dismissing charges under 18 U.S.C. section 1001 for false answer to FBAR question under now defunct "exculpatory no" doctrine but holding that government was free to prosecute under Section 7206(1)).

[6] The failure to answer the foreign bank account question would also be a violation of Section 7203, which makes it a misdemeanor willfully to fail to supply any information required under the Code. The government usually prosecutes such an offense as a felony, however, where the individual involved engaged in other allegedly fraudulent activity. See Spies, 317 U.S. 492, 30 AFTR 378 (1943).

[7] In Polidori, TCM 1996-514, the taxpayer "left the blocks corresponding to" the foreign bank inquiry blank. The taxpayer eventually pled guilty to a violation of Section 7206(1), and the court upheld the civil fraud penalty because the taxpayer had concealed his interest in the foreign accounts. See also Franks, *supra* note 5 (disclosing some but not all foreign accounts is a violation of Section 7206(1)).

[8] See Mattox, 689 F.2d 531 (CA-5, 1982) (failing to answer a question on the form for federal workers' compensation benefits equivalent to making a false statement); Irwin, 654 F.2d 671 (CA-10, 1981), *cert. den.* (similar holding); McCarthy, 422 F.2d 160 (CA-2, 1970), *cert. dism.* (similar holding).

[9] 18 U.S.C. section 371.

[10] 31 U.S.C. section 5322.

[11] *Id.,* section 5322(b).

12 The fact that Form 90-22.1 is referred to in the foreign bank account question on Schedule B of Form 1040 is sufficient evidence to permit a jury to infer willfulness. See Sturman, 951 F.2d 1466 (CA-2, 1991), *cert. den.*

[13] See Clines, 958 F.2d 578 (CA-4, 1992), *cert. den.*; Sturman, *supra* note 12.

[14] 31 C.F.R. section 103.47(g)(2).

[15] Sections 6662, 6663.

[16] If the IRS had not yet contacted Smith, his counsel may have more comfortably advised him to disclose the foreign bank account on his 1998 return because he might have been eligible for the Service's voluntary disclosure policy. Under that policy, the IRS usually does not recommend prosecution of a taxpayer who has filed false returns in the past, or failed to file returns, and who comes forward, prior to the initiation of an IRS inquiry and otherwise without prompting, to correct his tax affairs. The policy applies only to taxpayers with

legal source income, and it requires making reasonable efforts to pay the outstanding liability and continuing cooperation by the taxpayer in any subsequent inquiry. The policy is not legally binding on the IRS, and it does not cover FBARs. See Internal Revenue Manual section 9781, Special Agent's Handbook section 342.142.

[17] See, e.g., Garner, 424 U.S. 648, 37 AFTR2d 76-1042-A (1976); Hornstein, 176 F.2d 217, 38 AFTR 292 (CA-7, 1949); Dinnell, 428 F.Supp. 205, 40 AFTR2d 77-5764 (DC Ariz., 1977), *aff'd without opn.* 568 F.2d 779 (CA-9, 1978).

[18] Notwithstanding Azure's bank secrecy laws, the U.S. government likely could obtain access to the records relating to Smith's account. The government has been increasingly active in negotiating treaties or information exchange agreements that provide for the disclosure of information for use in tax cases notwithstanding local bank secrecy. See, e.g., Income Tax Treaty Between Switzerland and the United States, Art. XXVI. If the bank at which the account is held has a branch in the U.S., moreover, a grand jury subpoena can reach the records. See, e.g., Bank of Nova Scotia, 691 F.2d 1384 (CA-11, 1982), *cert. den.* (upholding enforcement of subpoena), contempt sanction upheld 740 F.2d 817 (CA-11, 1984), *cert. den.* The government also can compel Smith to consent to the disclosure of the bank records. See Doe, 487 U.S. 201, 62 AFTR2d 88-5784 (1988); Criminal Tax Manual, *supra* note 5, §41.06.

[19] It also is not an option for a taxpayer to avoid filing Schedule B, with its foreign bank account question, by having no reportable interest or dividends. The tax return instructions make plain that a taxpayer must file a Schedule B even if there is no interest or dividend income but the taxpayer nonetheless would be required to answer " yes" to the foreign bank account question. Moreover, Smith cannot avoid criminal exposure by giving a partial answer, i.e., answering "yes" and simply not putting down the country, thereby avoiding the disclosure of an account in a tax haven. Such an approach would amount to intentionally withholding required information and would be just as much an offense as no answer at all. It also could prompt further inquiry.

[20] See Verkuilen, 690 F.2d 648, 50 AFTR2d 82-5937 (CA-7, 1982); Neff, 615 F.2d 1235, 45 AFTR2d 80-1217 (CA-9, 1980), *cert. den.* The privilege will not justify the failure to file a tax return, or any false, incomplete, or misleading statements on the return. See, e.g., Sullivan, 274 U.S. 259, 6 AFTR 6753 (1927); Raborn, 575 F.2d 688, 41 AFTR2d 78-1077 (CA-9, 1978); Milder, 459 F.2d 801, 29 AFTR2d 72-1084 (CA-8, 1972), *cert. den.* See generally Timbie and Michel, "Strategies for Filing a Tax Return While Under a Criminal Tax Investigation," 2 J. Asset Protection 34 (Sep/Oct 1996).

[21] See Garner, *supra* note 17; Jordan, 508 F.2d 750, 35 AFTR2d 75-524 (CA-7, 1975), *cert. den.*

[22] Compare Goetz, 746 F.2d 705, 55 AFTR2d 85-390 (CA-11, 1984), Brown, 600 F.2 d 248, 43 AFTR2d 79-1004 (CA-10, 1979), *cert. den.,* and Johnson, 577 F.2d 1304, 42 AFTR2d 78-5624 (CA-5, 1978) (Fifth Amendment privilege not available as to amount of income), with Verkuilen, *supra* note 20, and Barnes, 604 F.2d 121 (CA-2, 1979), *cert. den.* (suggesting that privilege may be asserted as to amount).

[23] Another option open to a taxpayer under scrutiny as to an issue that flows into a current filing year is to avoid both an incriminating admission and an explicit assertion of the Fifth Amendment privilege by filing an admittedly incomplete return. Such a return would identify the items that are incomplete and explain that the taxpayer is currently under investigation and cannot provide the information without damaging his adversarial position.

A lawyer's good faith advice that a client file such a return probably could not be the basis of a criminal prosecution, but since neither the courts nor the IRS have ever approved this strategy, it carries some risk that the advice may be considered unethical. (It also may not work--a broad disclaimer may draw more scrutiny than a narrow assertion of the Fifth Amendment as to a specific item.) Moreover, while the strategy might be useful in finessing the reporting of income earned on a foreign account, it does not solve the problem presented by the foreign bank account question, which still must be answered. If the taxpayer declines to check the foreign bank account box in the context of such a disclaimer, that would provide just as much of a lead as his explicit assertion of the Fifth Amendment privilege.

[24] At that time, anyone transporting more than $5,000 in currency into or out of the U.S. was required to file an appropriate form. This provision was amended in 1986 to increase the amount to $10,000. P.L. No. 99-570, section 1358(c), codified at 31 U.S.C. section 5316(a)(1).

[25] See also Grosso, 390 U.S. 62, 21 AFTR2d 554 (1968), the companion case to Marchetti, 390 U.S. 39, 21 AFTR2d 539 (1968). The Marchetti reporting requirements violated the Fifth Amendment because "the very filing itself necessarily admitted illegal gambling activity." Selective Service System v. Minnesota Public Interest Research Group, 468 U.S. 841 (1984).

[26] See, e.g., Mickens, 926 F.2d 1323 (CA-2, 1991), *cert. den.* (currency reporting requirements upheld because information disclosed on reporting form did not necessarily reflect criminal activity); Kimball, 711 F.Supp. 1031 (DC Nev., 1989) (similar holding); Scanio, 705 F. Supp. 768 (DC N.Y., 1988) (similar holding); San Juan, 405 F. Supp. 686, 37 AFTR2d 76-810 (DC Vt., 1975), *rev'd on other grounds* 545 F.2d 314 (CA-2, 1976) (sustaining conviction for failing to file BSA-required currency reports over Fifth Amendment claim in part because of traditional tolerance of broad government authority to regulate trans-border conduct).

[27] The Sixth Circuit found, in part, that the FBAR does not carry a risk of self-incrimination because it does not disclose the source of the funds in the account. Sturman, 951 F.2d 1466 (CA-6, 1991), *cert. den.* Yet, even if a taxpayer has legal source funds in a foreign account, his mere filing of an FBAR could incriminate him if he has falsely answered the foreign bank account question on a tax return or failed to report income from a foreign account.

[28] While such a case would present an issue of first impression, the courts generally prohibit the government's use of a defendant's prior assertion of his Fifth Amendment privilege as evidence of guilt. See Grunewald, 353 U.S. 391, 51 AFTR 20 (1957); Monteleone, 804 F.2d 1004 (CA-10, 1986), *cert. den.*; Vandetti, 623 F.2d 1144 (CA-6, 1980); Long, 153 F. Supp. 528, 52 AFTR 222 (DC Pa., 1957), *rev'd on other grounds* 257 F.2d 340, 1 AFTR2d 2011 (CA-3, 1958). If the defendant takes the stand, some courts have allowed the government to impeach him by using prior assertions of the privilege, but even this is subject to constitutional limitations. See Grunewald, *supra*; Savory v. Lane, 832 F.2d 1011 (CA-7, 1987).

[29] Similar to the "admittedly incomplete return" (see note 23, *supra*), Smith's lawyer might consider some communication with the Treasury Department short of filing a Fifth Amendment FBAR that might resolve her dilemma. Plainly, however, such a communication could not identify Smith as her client, because that would provide just as much of a testimonial admission as if Smith were to file the form. Thus, such an approach would necessarily entail describing her advice to an unspecified client not to file the FBAR. Even if adopted in good faith, such a strategy carries serious risks for Smith's counsel, because she would be admitting that she counseled a client to disregard a statutory filing requirement.

Moreover, the courts have rejected the Fifth Amendment privilege in an analogous context as a basis for a lawyer's refusal to identify a client on required forms. Sindel, 53 F.3d 874, 75 AFTR2d 95-1894 (CA-9, 1995); Blackman, 72 F.3d 1418, 77 AFTR2d 96-313 (CA-9, 1995), *cert. den.* The government has imposed serious civil penalties in at least one case on a lawyer who failed to disclose client-identifying information on a required form. Lefcourt, 125 F.3d 79, 80 AFTR2d 97-6523 (CA-2, 1997), *cert. den.*

Practice Notes

A client comes to you with a problem: the IRS has started an audit, and the client has secret foreign bank accounts that he has never reported on his tax returns. Now it's time to file his current tax return, and if the client makes a full disclosure on that return, he will provide evidence of his prior misconduct. How can the client use the Fifth Amendment privilege to protect himself as much as legally possible? What ethical advice can the practitioner provide?

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