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COVER STORY

Lawyers gird for leaks on offshore tax shelters

Daily Journal photo

Jeffrey M. Verdon, an asset protection specialist in Newport Beach, said offshore entities make it difficult for banks to comply with a U.S. law regarding foreign tax compliance.

By America Hernandez
Daily Journal Staff Writer

With news that the full client list of Mossack Fonseca & Co., the Panama-based global law firm focused on offshore entity creation, will be made public in early May, attorneys in the tax and asset protection fields have been preparing to vigorously defend their clients — and their own professions.

Preliminary reports by the International Consortium of Investigative Journalists, the nonprofit which received 11.5 million dossiers going back nearly 40 years, reveal that there are at least 441 direct U.S. clients, and thousands more U.S. companies, shareholders and beneficiaries tied to the entities created by the Panamanian firm.

Publication of the list may shine light on the difficulties financial institutions have faced in recent years complying with transparency and know-your-customer laws aimed at eradicating money laundering and terrorist financing, experts said.

"One of the things this firm did was make it extremely difficult for banks to fully comply with the 2010 Foreign Account Tax Compliance Act," said Jeffrey M. Verdon, an asset protection specialist in Newport Beach.

Under the foreign account act, banks must file records with the Treasury on all accounts with a U.S. beneficiary or face stiff penalties, leading many to stop taking foreign entities with U.S. beneficiaries as clients for fear of finding themselves in noncompliance, Verdon said.

The U.S. Department of Treasury's Financial Crimes Enforcement Network has renewed efforts to track the beneficial owners of accounts around the world. But sniffing those clients out is a complex task, leaving potential for liability.

"When you've got a company in Panama owned by another corporation owned by shareholders, owned by a U.S. corporation with hundreds of executives authorized to sign checks and do business, it gets murky and very difficult to unravel who really 'benefits' under that definition, even with the computer formulas written by banks' compliance departments," Verdon said.

In fact, many high-net worth individuals use those same multilayer entities to shield assets in perfectly legitimate ways.

Steven L. Gleitman, an estate planning attorney in Los Angeles, has designed 23 wealth protection plans for a variety of predatory scenarios, including manipulative second wives and vulnerable heirs after a parent's funeral. All 23 plans have been submitted to the IRS and approved.

The goal is not to evade taxes, but to place assets in jurisdictions that make collection prohibitively expensive and time-consuming, if not outright impossible.

The South Pacific Cook Islands is a particular favorite for its second-spouse laws and non-recognition of certain U.S. family law judgments.

In some cases, Gleitman sees offshore protection as the only way to level the playing field with prosecutors.

"Everyone on Wall Street is best friends when they're all making money," Gleitman said, outlining the basis of one of his protection plans called the 'Anti-Freeze Trust.' "But when one person does something dishonest and they're all sued by the government, suddenly everyone turns on each other like a circular firing squad."

When the Federal Trade Commission requests an individual's assets be frozen, which can be done in court without that person present, he or she is given two options: admit to the charge and pay a fine, or wait 30 days for a hearing with no access to funds, including those of a spouse.

Gleitman sets up trusts in countries outside U.S. jurisdictional reach that hold enough to pay legal fees and personal expenses for 30 days to allow clients their day in court.

He also has would-be clients sign affidavits of solvency stating they are not yet being sued by any government agency, and turns away anyone interested in Lichtenstein or Panama trusts, jurisdictions he considers to have a bad reputation for shielding unreported income.

But former prosecutors and IRS agents agreed that tax evaders will be a low-priority on the Department of Justice's list once the Mossack Fonseca names are published in full.

"The government will look for terror financing first, money laundering from criminals second, politicians, and run all the names against U.S. government databases," said James F. Dowling, former anti-money laundering advisor to the White House Office of National Drug Control Policy and current risk management advisor to non-bank financial institutions like casinos and broker dealers.

Dowling, a special agent with the IRS Criminal Investigation Division for nearly 30 years, anticipates that prosecutions will be years in the future as the agency follows the money trails to prove wrongdoing.

"It's like peeling back an onion," he said, relaying a tale from his undercover days in which drug traffickers flew money to Sacramento, drove it to Nevada, wired the funds to the Isle of Man, then Austria, Turks and Caicos, the Cayman Islands, Costa Rica, and finally back to the U.S. disguised as a loan to be spent domestically.

Just getting information from one locale through a mutual legal enforcement treaty to get to the next may take months, while disguising the money in the first place and sending it around the world takes seconds. "If the Panama Papers list shows the full insider network with organizational charts, that's the absolute jackpot, but law enforcement still has to prove it beyond a reasonable doubt so it's going to be a couple of years down the line," Dowling said.

Clients who know they are on the list still have time to domesticate any unreported foreign income by depositing it into U.S. accounts and back-filing taxes, or by participating in the IRS Offshore Voluntary Disclosure Program, which involves filing reports on the foreign accounts and paying a penalty, but avoiding possible criminal prosecution.

Several attorneys noted wryly off the record that budget cuts to the IRS have resulted in fewer staff to reach for low-hanging fruit — suggesting that low-profile clients wanting to take the risk may not get caught.

"It's time for attorneys to look at themselves, how they conduct business, and who with," Dowling said. "If they don't self-regulate, this will cause outside regulations to come about."

Several attempts have been made by Congress to subject attorneys to the Bank Secrecy Act, which would require filing reports on any suspicious transactions, foreign entities with U.S. beneficiaries created for a client, and cash payments exceeding a certain threshold.

The American Bar Association has lobbied against such measures successfully so far, but some wonder whether public opinion will shift post-Panama to expand exceptions to the attorney-client privilege.

"CBS's 60 Minutes did an amazing story on money laundering lawyers in February where they caught several big-name attorneys in New York City on camera seemingly willing to help a mythical Nigerian oil minister protect his bribery money from the government," Verdon said.