



Waiting for the Other Shoe to Drop, Compliance Pros Can Take Steps to Limit Tax Evasion

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By [Kieran Beer](#)

In the wake of an extensive proposal forwarded by the Obama administration to stem tax evasion, anti-money laundering compliance departments are looking again at what they can and must do to fight the crime.

The proposal, introduced on May 4, would pressure foreign financial institutions to become "qualified intermediaries," a legal designation that would mandate greater information sharing with U.S. investigators. Under the plan, U.S. banks would have to withhold 20 to 30 percent of payments tied to financial institutions that haven't agreed to share data.

Lawmakers are considering how to best move forward on the proposal as a tug-of-war between the United States and Switzerland heats up over whether U.S. investigators can access information on 52,000 American clients of UBS AG suspected of avoiding tax payments. The Swiss bank has already paid \$780 million to avoid prosecution for allegedly defrauding the IRS.

The focus by lawmakers and leaders on reigning in tax evasion has left many bank compliance officers questioning how to best avoid the ire of federal prosecutors and prepare for any upcoming new duties, according to Michael McDonald, a former IRS special agent.

But the degree that U.S. financial institutions are accountable, even now, for detecting and reporting suspected tax evasion is unclear, according to McDonald.

Allowing transactions tied to tax evasion does not technically violate the Bank Secrecy Act, but "if a bank believes an account holder is not going to pay taxes on or after April 15 of next year, how should they treat this?" said McDonald, who runs a Boca Roton, FL., based anti-money laundering (AML) consultancy. "This is the problem with tax evasion."

And the legal lines are also murky when it comes to individuals who use U.S. accounts to evade paying taxes in foreign countries, according to McDonald. The United States has been "very reluctant" to clamp down on suspected foreign tax evasion, in part because it is hard to define and prove, particularly in cases when a

foreign country considers it a civil offense only, he said.

Despite the difficulties banks may have catching tax evaders, compliance officers should consider taking a number of steps to avoid later trouble with regulatory examiners, said McDonald. That starts with filing suspicious activity reports (SARS) on individuals who clearly are hiding money from the IRS, said McDonald, who is quick to add that it is hard to actually "know."

Red flags that a client may be avoiding taxes include cashing corporate checks or, in the case of small businesses, cashing checks payable to the business and pocketing the cash rather than depositing the checks in a manner that would leave a record, according to McDonald.

In many cases, detecting tax evasion means performing the checks already performed in AML programs, according to David Caruso, chief executive officer of Dominion Advisory Group, a consulting firm based in Centreville, VA.

"It's all the same as the AML signs in which you're looking for suspicious cash activity and structuring," said Caruso. Unusual wire transactions to bank secrecy havens and parties that appear to use shell companies should already trigger a SAR filing for banks, he said.

While filing SARs for suspected tax evasion is a common practice, it is difficult for banks to really track lots of small transactions that utilize shell companies, he said. For example, it is particularly hard to track transactions that start out in dollars and move to Latvia and then to an Austrian bank and finally to a bank in Panama or the British Virgin Islands, he said.

"Banks can usually easily see larger amounts, but not \$10,000 or \$20,000, when they're dealing with six million wires a month," said Caruso. But by breaking up wire activity, "you can get a \$100 million overseas in the course of year," he said.

Although his organization has pushed hard for legislation that will curtail tax evasion and the cross-border flow of illicit funds, Raymond Baker, the director of Global Financial Integrity, also sees a limited role for banks.

Banks can't really identify tax evasion, "only law enforcement can," he stated in an e-mailed response to questions. "But banks have a lot of room to improve their Know-Your-Customer and due diligence practices, which if more rigorous would cut down significantly on money laundering as well as tax evasion."

"What [banks] need to do is to understand the legitimate economic basis or purpose for a transaction," according to Jim Stubbs, a managing director of BDO Consulting who is based in New York.

In addition to red-flagging suspicious money going to offshore tax havens, bankers should be examining whether transactions “make sense as a sound economic or commercial transactions,” said Stubbs. “Such transactions should result from diversification of a portfolio or political risk in cases involving money coming in or returning from offshore,” he said.

It’s not sufficient for banks to take comfort in the fact that tax evasion is not a predicate crime, said Susan Galli, an independent anti-money laundering and banking consultant in Miami.

“The issue may be more complex because it can be a predicate in a foreign jurisdiction and, if you are assisting a foreign client, you may be abetting them with a crime,” according to Galli. “The problem is that banks may not know that they’re dealing with a person trying to avoid detection.”