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# The Secret Foreign Bank Account and Legitimate Alternatives

By CHARLES W. ADAMS

The author, a member of the California State Bar and consultant, Euro-Dutch Trust Company, George Town, Grand Cayman, B. W. I., labels the use of the secret foreign bank account "foolish and lazy." He suggests that the taxpayer can reduce his tax bite through tax deferral planning, an area in which legislation has been continued and expanded.

HAVING A SWISS OR FOREIGN BANK ACCOUNT is now a matter of discussion among many taxpayers and not just international businessmen. This is because every U. S. taxpayer must answer as to whether or not he has a foreign bank account. Except for the infinitesimal number of taxpayers who will answer the question on their tax return in the affirmative, almost all American taxpayers will answer in the negative, and that will be the extent of their involvement with foreign bank accounts. Nevertheless, the fact that they must answer the question on their tax return arouses their curiosity. It is apparent that the government would not have gone to the trouble to require this to be answered upon every single tax return unless the problem was believed to be a serious one, from the government's point of view.

Regardless of what reasons may have been advanced for the adoption of the law that requires every taxpayer to disclose his foreign banking activities, the law will probably produce the following results:

First, it will remind those taxpayers who may be tempted to bury income or even assets in a foreign bank account to think twice before they do so. No one wants to invite an audit, and the average taxpayer will assume that an affirmative answer could very well bring a call from a Revenue Agent—a most unhappy thought.

Second, it will probably not only deter people from establishing foreign bank accounts but could very well cause those individuals who may have them to abandon them so they can give a negative answer to the question. There is no doubt that the psychological effect of this question will be in the government's interest. No one knows what irrational thoughts and feelings are going on in the minds of most taxpayers who are tempted to have or who may have foreign bank accounts, and the existence of this question on all tax returns is bound

to have a deterring effect upon them. The result will be to bring home dollars on deposit by Americans in foreign banks, and get Americans out of Eurodollar market.

Finally, it will give the government the basis of judgment for a new tax crime. The representatives of the Treasury have indicated that they have knowledge of foreign bank accounts of many American taxpayers but they have insufficient information to determine whether or not any taxes have been evaded. A false answer can bring prosecution under Section 7206(1)(3) of the Internal Revenue Code, which makes it a crime to make false declarations under penalty of perjury.

The person who has a foreign account with funds which evaded tax has three choices:

First, he can lie and violate Section 7206(1), which is a felony.

Second, he can ignore the question.

Third, he can answer it correctly, but refuse to give any details. If he ignores it or refuses to give details, he should be able to raise the Fifth Amendment defense that any answer would incriminate him.

The accountant confronted with the above problem should not advise his client other than not to lie, and to consult with legal counsel on the best course to follow. There is no privilege in communications between accountant and client, and for an accountant to question a client about matters that are criminal could be a tragic mistake.

From a civil standpoint the government has indicated that the taxpayer who fails to answer the question will be considered to have filed an incomplete return. This means that the government may assess a penalty for failure to file a tax return since a complete return must be filed in order to avoid the penalty for failure to file a return. The courts have in many instances refused to uphold a penalty

asserted by the Internal Revenue Service, so it remains to be seen if the penalty will be upheld by the courts, especially if there is sufficient legal excuse, such as the Fifth Amendment right against self-incrimination.

The foregoing summarizes the significance of the 1970 disclosure laws on having foreign bank accounts. This new law has raised many questions in the minds of practitioners and taxpayers. It is now a subject of frequent discussion at social get-togethers. It will be helpful if the tax practitioner has some solid information concerning the facts and realities surrounding the foreign-bank account—not to impress his friends and associates at a cocktail party—but rather to advise and counsel his client when serious questions are asked concerning foreign bank accounts. The following represents one professional's point of view.

### ***Professional Responsibility***

To advise one's clients to use a foreign bank account to hide unreported income is not only criminal but professionally stupid and lazy. In advising his clients, the professional should do more than saying it is bad. He should be sufficiently informed to discuss the problems the client will encounter, as a practical matter, by pointing out the legal and constructive ways of controlling taxes without resorting to the folly and danger of a foreign bank account.

Advising a client to have a foreign bank account to hide income is like having a football coach advise his players to use their fists and carry weapons. They might get the ball in the end zone but the play will be called back, penalized, and the team and coach held up to public scorn. All tax practitioners want to score by reducing or controlling taxes by the rules of the game. One can score as often as possible by the rules, but using a foreign

bank account to hide income is un-sportsmanlike conduct. It usually ends the drive and puts one out of the game.

The alternative to illegal devices like the foreign account is tax control through proper planning. I use the word "controlling" taxes, rather than avoiding them. The term avoidance is ambiguous. It generally means not to pay taxes by legal means. There aren't many true avoidance means available today. Most taxes are deferred, not avoided.

Today the accent is on controlling taxes. Congress has taken a number of steps to permit people to reduce taxes by utilizing certain devices which defer and hence control taxation. The installment sale provisions permitting the allocation of income and gains over the life of the contract was an early example. The profit-sharing and pension laws have been expanded, not contracted. The corporation, irrevocable trusts, and income averaging are laws which help the taxpayer to "control" his tax burdens. Perhaps the most laudatory step taken by Congress in decades is the anticipated 50 per cent maximum tax on earned income. A few years ago where the maximum tax was 91 per cent, it was small wonder that people with high income panicked and sought out all kinds of schemes to avoid the tax collector. Such a tax rate was more a kind of confiscation than a fair tax.

Unconscionable taxes have historically driven people to illegal action, and the American Revolution of 1776 is our most outstanding example. History is full of similar events. Tax rebellions are as common as political rebellions. The foreign bank account is a kind of private rebellion. It is a rebellion against both the tax collector and the tax planner.

Taxes have always been able to be controlled under the U. S. system, and unless the taxpayer feels a special

need to "rebel" and thus refuse to play the system, the use of foreign accounts to evade taxation must be labelled as foolish and lazy. I do not mean to suggest one can accomplish the same thing with legal planning, but one can reduce the tax bite through tax deferral planning. Furthermore, the coming 50 per cent maximum rate should make all income taxation tolerable even without planning. It is hoped that the 70 per cent rate in other income areas will be brought in line with the 50 per cent rate on earned income.

### **Uses of Foreign Bank Accounts**

For people who will do business abroad or who live abroad the existence of a foreign account is often a necessity. In general, one has to have money where one is living, and if residence and business operations are abroad, the foreign bank account would be a normal, natural thing.

The foreign bank account has been used for protection from creditors here in the United States or as a means of removing assets by a spouse with a bad marriage. Money held by a debtor in a foreign bank account could not be deemed a fraudulent conveyance since there is in effect no conveyance at all. Foreign bank accounts for these purposes are generally of no concern to our taxing authorities so long as taxes are not being illegally evaded.

A foreign bank account can permit, with considerable ease, the evasion of income taxes by the deposit of items which should be included in one's gross income. Cash can be transported out of the country and deposited in an account, or items of income from foreign operations can be sent directly from foreign companies to foreign bank accounts, to be held for U. S. persons, without ever entering the United States. This device appears to have been used not infrequently and, with the exception of informers or

through other leaks or clues, the chances of discovery are not good, from the government's point of view.

It is not the purpose of this article to present various tricks employed through the use of foreign bank accounts. Any businessman or tax consultant who has any experience in the international area will run into some clever schemes by which income is diverted to foreign bank accounts. Our government does not have the power to audit foreign companies except for U. S. controlled foreign corporations, and the cooperation rendered by foreign governments under tax treaties is minimal. In general, one sovereign will not aid another sovereign in the collection of tax, and this policy between nations has rendered the provisions requiring reciprocal support and assistance to be of little effectiveness and help to our Internal Revenue Service. Also, only matters "readily available" are transmitted between the tax treaty countries. Audits are not performed. With respect to foreign bank accounts, our Treasury Department cannot send a list of names to Switzerland (with whom we have a tax treaty), to request the government to obtain financial data from Swiss banking institutions on American people.

### **Bank Secrecy**

With the exception of several states, there is no bank secrecy of any kind in the United States. One's financial affairs at his bank can be public records if the bank desires to make them so. Your banker can give out whatever information he wants and there is nothing you can do about it; he has violated no law, nor has he exposed himself to civil liability. As a matter of policy, bankers generally refrain from giving out information but certain agencies and companies are able to gain a great deal from

one's banker if they make the right approach.

In many countries, and Switzerland is the most notorious, a man's banking affairs are confidential and private. As the Swiss explain themselves, they believe that a man's privacy includes his banking activities, and they make it a serious criminal offense for anyone to violate that privilege. The offense becomes even harsher and more serious if the person seeking the unauthorized information is an agent of a foreign government. The crime is called "economic espionage." These laws were enacted during the Nazi period to prevent German agents or the German government from obtaining information concerning German citizens who had Swiss accounts. These laws were a codification of what had been a long-established practice of secrecy. The bank secrecy does not extend to protect a person from activities which are criminal by Swiss standards. Through proper judicial process and through a valid showing, Swiss secrecy can be set aside where the banking privilege is used to carry out criminal activities. Swiss secrecy will be withdrawn to protect stolen funds, which is a common crime, but it would protect an individual if the activities amount to tax evasion since tax evasion is not a crime under Swiss law.

There is something to be said for the Swiss concept of bank secrecy. The Swiss defend it vigorously, and when one realizes that our bankers can release any information at any time to anyone, it is a bit disturbing. To require a court order and to establish a just and reasonable cause before examining one's bank account seems to be a wise policy. A proper balance between the privacy and rights of the individual and the rights of third persons, who may have a legitimate interest in a person's financial affairs, would support the adoption of some

rules and laws for the protection of the privacy of one's banking activities. The Swiss rule is really the continental or civil law rule. Throughout Western Europe civil law prohibits the banker from providing any information about his customers' financial situation or relations without their express permission, unless there are specific legal provisions obliging him to do so.

The numbered account as compared to the name account has no greater protection under Swiss law. The protection comes from the fact that the owner of the account is known to but a few extremely responsible bankers, and the chances of leaks or violation of banking privacy is greatly reduced.

### **The Swiss Banker**

We do not have in the American society bankers who measure up to the stature and the ability of those in Switzerland and in many European countries. The banker in Europe and Switzerland performs functions far beyond those that American bankers are experienced or trained to undertake. The brightest and most outstanding young men in Switzerland will often strive to enter the world of banking. There is a heavy drain from the Swiss banks of Swiss talent because of their excellent training, competence, and strong tradition for unwavering integrity. The Swiss banker generally shows a great expertise in handling monies and in being informed about world financial markets. He is generally able in the securities and bond markets, and gives fine judgment and counsel concerning investments; in short, there is an *esprit de corps* among the Swiss bankers which has no counterpart in the United States.

The Swiss banker will show competence in the fields of law, accounting, investments, finance and economics,

which in our country would require a half-dozen professionals. And finally the maintenance of secrecy as an expression of trust constitutes one of the banker's professional duties. He thus stands with the lawyer, doctor and clergyman as one who can be trusted.

### **Tax Control Through Foreign Entities**

Our income tax system is one of technicalities. Like our machines it has become increasingly more technical and more complicated. While we all hope for the utopia of a simple and fair tax law, we must live with the realities of the technical system we now have. Siphoning unreported earnings to a foreign bank account is contrary to our tax system. However, our system does offer substantial tax controls through the use of foreign entities in the form of the widely recognized principle of tax deferral. While Congress has been quite busy closing loopholes, which permitted complete avoidance of tax, legislation has been continued and expanded, which permits tax deferral. Taxes can be brought under control by affirmative action and planning on the part of the American taxpayer if he plays the rules of the game.

The proper use of foreign corporations and foreign trusts offers excellent tax control to United States persons having investments and business activities abroad. While the average tax practitioner cannot be expected to know all the labyrinth of the foreign tax field, he must be alerted to those circumstances where the use of foreign entities can offer substantial tax control to his clients. The two primary vehicles for foreign tax planning are foreign corporations and foreign trusts. None of them offers any unlimited avoidance but they do offer substantial and significant tax deferrals

in most international business transactions if properly used.

The purpose here is to point out briefly those areas where foreign entities can be used for better tax control when doing business abroad. The foreign corporation and the foreign trust have rules that are quite different from one another, and when one entity is not available for effectiveness, the other should be considered. A summary of their usefulness is as follows:

### **Foreign Corporations**

In general, foreign corporations will offer substantial tax control through the deferral of taxable income to U. S. shareholders on most bona fide business activities abroad. There are few limits on the kinds of foreign commercial and industrial profits that can be earned by foreign corporations and deferred from tax by the U. S. shareholders. Also, gains derived from investments in almost everything except securities can also be deferred from U. S. taxation through the use of foreign corporations. This includes gains derived abroad from the sale of land, mines and minerals, intangibles, personal property, licenses, and other property rights from which royalties can be derived.

On the negative side, foreign corporations are not effective in deferring certain forbidden kinds of income if they are Controlled Foreign Corporations (CFC). Both elements must be present. They are summarized as follows:

(1) A CFC is a corporation in which 50 per cent or more is owned by U. S. shareholders who have blocks of ownership representing at least 10 per cent in the corporation, and the corporation is in existence at least 30 days during the tax year.

(2) Forbidden income is called Subpart F income, which is income

usually derived from the following sources:

(a) rents, royalties, dividends, and interest (passive investor income);

(b) personal services from a 25 per cent shareholder;

(c) insuring U. S. risks;

(d) gains derived from the sale of securities and commodities;

(e) income from sales or services derived from commercial transactions with related companies if at the situs of the corporation, little or no activity is performed by the foreign corporation.

Finally, the tax deferral will be lost with respect to deferred income in a controlled foreign corporation if that income is invested in U. S. property not related to the business operations. There is no excuse for falling into this trap.

In summary, foreign corporations owned by U. S. persons offer full tax deferral if it doesn't partake of the forbidden fruit.

### **Foreign Situs Trusts**

Properly drafted foreign trusts are exempt from U. S. taxes except for U. S. source income. The beneficiaries of a foreign trust are taxed under the following circumstances:

(1) Direct or indirect distribution when the trust has income (same as domestic trusts).

(2) When the trustee holds shares in a CFC which has Subpart F income or income invested in U. S. property.

(3) When the trustee derives gain from the sale of stock in a CFC.

A foreign trustee can thus have earnings derived from all kinds of commercial activities, passive investments (rents, royalties, dividends and interest), and from the sale of securities, including investments in U. S. securities, and the tax on these gains is not assessable against the U. S. beneficiary unless there is a distribution.

## Conclusion

It would seem obvious that for those people with foreign activities it is sheer madness to siphon income into a foreign bank account for the purpose of evading U. S. taxes. To the creative mind almost unlimited opportunities for tax deferral and tax control are available through the use of foreign corporations and foreign trusts. It is such a tragedy that so many U. S. taxpayers have resorted to the dangerous and illegal foreign account scheme when Congress under our present Tax Code, has provided legitimate and laudable tax deferral methods through the proper use of foreign corporations and foreign trusts. There is no doubt that many U. S. persons, doing business abroad, are not able to get competent professionals to assist them in legitimate and proper

foreign tax deferral planning. Furthermore, foreign businessmen have frequently offered to take the initiative to establish and fund a foreign bank account for U. S. persons as a business incentive. In effect they are soliciting and promoting the adoption of this kind of tax evasion.

Strong criticism can be directed to the Bar and to the accountancy profession for idly standing by and saying nothing where they have reason to believe that their clients are siphoning funds into foreign bank accounts and exposing themselves to disaster. It seems doubtful that any competent, intelligent businessman would divert unreported earnings to foreign bank accounts if he were fully informed of what could be accomplished through the creative use of legitimate foreign entities. [The End]

## FIRST QUARTER 1971 EXCISE COLLECTIONS RISE

The Internal Revenue Service collected \$487 million more in excise taxes for the first quarter of 1971 than it did for the same period in 1970. This fact was revealed in the statistics recently released by the IRS.

As in the past, collections for alcohol and tobacco taxes continued to rise. Alcohol taxes showed a gain of over \$20 million and collections of tobacco taxes were up by more than \$81 million.

However, decreases were reflected in the amounts collected for the taxes on passenger automobiles, trucks, busses and tires and tubes. Passenger auto tax collections were down by \$186 million from the same period in 1970. Truck and bus collections decreased by \$56 million and collections of taxes on tires, tubes and tread rubber were down by almost \$17 million.

Another decrease was reflected in collections of taxes on telephone and wire services. Collections here fell by more than \$34 million.

However, several categories showed substantial increases in collections. Collections of taxes on transportation of persons by air were up by more than \$60 million. Diesel and special fuel tax collections rose by over \$2 million. Collections of lubricating oil taxes were up over \$2 million and highway use tax collections rose by over \$2 million while interest equalization tax collections dropped by \$7 million.