



Robert W. Wood

THE TAX LAWYER

Oct. 5 2010 – 8:44 am

Becoming Tax Mr. Clean

Americans like people who come clean, who step up and admit their mistakes, take their medicine, and move on. On the other hand, we also like mavericks who take chances and may color outside the lines. When it comes to taxes, many have an almost pathological fear of the IRS. Comedians from Lucille Ball to Jerry Seinfeld have exploited it, making us laugh nervously about their tax audit travails. For Jerry Seinfeld on tax law, see [Omnipresent Seinfeld Episodes Contain Ample Clues About Tax Policy](#).

We know we must be honest and truthful on our tax returns, but we're also urged to claim everything we're entitled to. In fact, if we don't make [Gordon Gekko Tax Moves](#), we'll probably come up short. Billionaires didn't get to be billionaires by being wimpy about taxes, we'll reason. If it's legal, they go for it. Only Joe Biden thinks paying more tax is [patriotic](#). Tax lawyers and accountants exist because the system is so unfathomably complex that you need someone in your corner not only to read the fine print, but also to read between the lines. See [Five True Tales From A Tax Lawyer](#) and [Five More True Tales From A Tax Lawyer](#).

So how does a foreign bank account or undisclosed foreign income fit into this puzzle? US citizens and permanent residents must report their worldwide income on their US tax returns. That's so even if most of your activity is elsewhere in the world and even if you pay tax in Greece, Bolivia, Japan, or wherever. Plus, you must disclose your foreign accounts on an [FBAR](#). The tax penalties for failure to report your worldwide income can be severe, but the penalties for failure to file FBAR forms are far worse. See [Six Questions About Secret Foreign Bank Accounts](#).

But many foreign bank accounts were inherited, don't pay interest, lay dormant for years, or belong to those living overseas for decades. If you report all your income but simply didn't inform the government you have offshore money, you're still at risk. The IRS has done a good job of making clear that the stakes are high, including jail time or big penalties. There's also been no end of press about coming clean with the IRS. See [IRS Offshore Tax-Avoidance and IRS Compliance Efforts](#).

Unfortunately, the IRS isn't making the process easy. In the face of 4,450 Americans whose names were revealed by UBS, about 15,000 people entered an IRS [voluntary disclosure program](#). Even for someone advising many clients in these circumstances, it's tough to predict how much it will cost to come clean, especially now that last year's prepackaged voluntary disclosure window is [closed](#). Coming forward now is tougher. That's unfortunate. It's making some people who want to get right with the IRS doubt the process and whether it's worth it.

I've been a tax lawyer for 30 years, and traditionally, nearly every client in this precarious situation came forward through their tax lawyer (not their accountant, since you need attorney-client privilege). Almost invariably, you could avoid prosecution and excessive fines. But some clients now think they may be facing worse treatment by coming forward than if they just clam up and are eventually contacted by the IRS. Inevitably they may also be thinking there's a good chance they will never be discovered.

Just how much the IRS can prove and what penalties they can impose if you decide not to ask for mercy is also becoming less clear. One recent case, [J. Bryan Williams](#), suggests the IRS may have a hard time proving "willfulness" when a US taxpayer with a foreign bank account didn't know he had to report the account. Even though Williams checked the "No" box indicating he did not have a foreign bank account and did not file FBARs, the court was not persuaded he was trying to evade taxes.

Some advisors note the unusual facts and believe it hardly signals a get out of jail free card. But some people seem emboldened by the decision and may be reevaluating their situations. There are other far larger-stake cases the IRS has lost, including a racy tax evasion case against Brazilian

race car celebrity [Helio Castroneves](#). No one wants to be prosecuted even if you win, of course, but the whole question of just what it means to be a willful tax evader is a big one that's hard to answer.

Of course, the main reason to come forward in these situations is fear of prosecution. However, if the IRS loses additional cases regarding foreign accounts and offshore income the fear of prosecution may seem reduced, and fewer taxpayers may step forward. Add to that the overall complexity of the tax code and the lack of familiarity even many quite sophisticated people had with foreign account issues up until last year, and some people think a little more sympathy may be in order.

If you're evaluating your options, consider so-called quiet disclosures, pre-clearances, and other creative ideas. See [Six Questions About Secret Foreign Bank Accounts](#). It is still best and safest to come forward. But above all, think carefully, don't act rashly, and get some professional help.

For further reading, see:

[Ten Facts About Tax Expatriation](#)

[Ten Ways to Audit Proof Your Tax Return](#)

[Offshore Accounts: Too Late To Fess Up?](#)

*Robert W. Wood practices law with [Wood & Porter](#), in San Francisco. The author of more than 30 books, including *Taxation of Damage Awards & Settlement Payments* (4th Ed. 2009, [Tax Institute](#)), he can be reached at wood@woodporter.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.*