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Tax Tips From Cooperating Witness In Record \$2B Tax Evasion Case

No one wants to be in the crosshairs of the IRS, or even worse, the Department of Justice. Yet billionaire Robert Brockman was indicted last fall, and there are many questions emerging about [the billionaire behind the biggest U.S. tax fraud case](#) ever filed against an American. The 39-count indictment are still unproven accusations, but most such cases do not end well for the accused. The Chairman and CEO of The Reynolds and Reynolds Company was charged with conspiracy, tax evasion, failing to file foreign bank account reports, wire fraud, money laundering, evidence tampering, and destruction of evidence. The charges stem from an alleged decades-long scheme to conceal approximately \$2 *billion* in income from the IRS, as well as defraud investors in Reynolds and Reynolds debt securities. The case also ensnared [Robert Smith](#), also a billionaire, the chief executive of Vista Equity Partners. Smith signed a non-prosecution agreement and is paying \$139 million as part of his cooperation deal. The deal covers an array of alleged tax evasion spanning 15 years. The \$139 million is expensive, but big payments are better than criminal charges. Surprisingly, most criminal tax cases come

out of regular old civil tax audits. When the Criminal Investigation Division of the IRS becomes involved, the target may not even know. If this happens in a regular civil tax audit, your access to information and give and take from the IRS is likely to evaporate. The Brockman case involved a team of IRS and Justice Department personnel that lead up to the indictment of Mr. Brockman for tax evasion over what the feds allege was a \$2 billion tax fraud scheme.



Why not Mr. Smith too? Mr. Smith's cooperating witness deal may be expensive, but the \$139 million price tag and his cooperation mean no indictment or jail. According to the feds, from 2000 through 2015 he participated in an illegal scheme to conceal income and evade millions in taxes by using an offshore trust structure and offshore bank accounts. Smith admitted his involvement in the illegal scheme and agreed to cooperate with ongoing investigations and to pay back taxes and penalties in full. In 2000, Smith formed the Excelsior Trust in Belize, and Flash Holdings, a shell

company in Nevis. Although he used third-parties to conceal his ownership and control, he controlled both offshore structures and made all decisions. He hid investments and earnings, and hid foreign accounts in the British Virgin Islands and Switzerland to hide income from the IRS. In all, Smith failed to report over \$200 million of partnership income. He also failed to report owning foreign bank accounts.

Untaxed money can come in handy, and Smith used millions to buy and improve real estate. In 2005, he used approximately \$2.5 million in untaxed funds to buy and renovate a vacation home in Sonoma, California. In 2010, Smith again used untaxed funds to purchase two ski properties and a piece of commercial property in France. In 2011 and 2012, Smith used approximately \$13 million of untaxed funds to build and improve a residence in Colorado and to fund charitable activities at the property. Smith agreed to continue cooperating with the Department of Justice in other related investigations, and to pay approximately \$56 million in taxes and penalties. But there's another whopping \$82 million in penalties from his concealment of his offshore bank accounts. In all, Smith will pay more than \$139 million in taxes and penalties.

Smith also agreed to abandon his \$182 million IRS refund claims that were all about claimed charitable contribution deductions, and not claim them again. What can we learn from the deal?

Cooperating with the IRS Can Be Wise. Whether it is the FBI or the IRS asking questions, don't lie to the government. And don't engage in evasive and obstructionist behavior during an IRS audit. Many taxpayers in a civil audit seem to think they can outsmart the IRS or manipulate the government to come out ahead. That doesn't mean you have to *agree* with everything the IRS says in an audit. You don't, but there is an established way of proceeding, and

an above-board way to communicate with the IRS. Deception and obstruction are not the way. A key for Smith may have been more information and details about the even *bigger* target, Robert Brockman, who was indicted in the biggest tax evasion case in history.

Report Your Income, don't file falsely. You must file a tax return each year with the IRS if your income is over the requisite level. And remember, the U.S. taxes all income wherever you earn it. Filing false returns is even worse than failing to file. You have to file, but make your return as complete and accurate as you can make it.

Hiding is Bad. This is a key principle. Hiding things nearly *always* looks bad, the coverup often being worse than the crime. You might have good reasons to hide things from competitors or an ex-spouse, but don't hide from the *government*. Remember political fixer Paul Manafort? Secret deals lead to his conviction. And soccer greats Ronaldo Messi and Cristiano Ronaldo's tax problems were made much worse by shell entities. Even if there is a good reason to hide ownership from the public, make sure the ownership is not hidden from the *government*.

Don't Be Willful. Accountability and transparency are nearly universal lessons. Willfulness means you acted with knowledge that your conduct was unlawful. Smith's agreement required him to admit that he was *willful*, he knew it was wrong. According to the IRS, willfulness is a voluntary, intentional violation of a known legal duty. Even willful blindness, a kind of conscious effort to *avoid* learning about reporting requirements, can be enough.

Report Foreign Accounts and Assets. Most of Robert Smith's penalties—a whopping \$82 million—were from foreign accounts. It is easy for the IRS to track these down with FATCA and other tools. If you have an interest in any

foreign bank, securities, or other financial accounts, pay attention. Even a signature power is enough, even if it is not your money. For all of these, you must file an annual FBAR if the aggregate value of the accounts at any time in the year tops \$10,000. Penalties are huge. The Swiss bank controversy netted the IRS over \$10 billion, and much of it came down to these little forms. FBAR penalties can swallow 100% of accounts, and criminal penalties can be up to 10 years in prison.

The IRS requires worldwide reporting and disclosure, and the consequences of noncompliance can be severe. [FATCA](#), the Foreign Account Tax Compliance Act, requires foreign banks to reveal American accounts holding over \$50,000. Some asset disclosures may be duplicative with FBARs, but it is best to over-disclose. There is never a penalty for going overboard in disclosures. With a treasure trove of data, the IRS now has the ability to check.

Avoid Lavish Spending. Skirting your tax obligations is not wise, but, if you are doing that and simultaneously living lavishly, it can look even worse. It didn't help that Smith used \$2.5 million to buy a vacation home in Sonoma. Buying untaxed ski properties and commercial property in France looked bad too. Then there was \$13 million to build a place in Colorado.

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