Tax Evasion & Tax Avoidance – An IRS Perspective

The global finance industry has faced more pressure than ever before to and address and deal with financial crime. Multiple new threats and failure to manage existing crimes have exacerbated the integrity of many institutions.

The United States is one of the world's major financial hubs and a hotspot for commercial activity on a daily basis. The nation's Internal Revenue Service has had extensive involvement in leading financial crime prevention initiatives across the board, especially in the tax domain.

Ahead of the **Financial Crime Asia Summit**, we caught up with **Greg Monahan, Special Agent at the IRS-Criminal Investigation**, to find out how the line between tax evasion and tax avoidance is being addressed, because this issue has become front-of-mind for many large institutions as they grapple with changing regulations. Mr Monahan also shed light on the near-future direction for the IRS.

Greg Monahan
Special Agent
IRS-Criminal Investigation

IQPC: What trends are you seeing related to the issue between tax evasion and tax avoidance? And why are they so important to address for both regulators and banks?

Monahan: In the United States, tax evasion is the failure to pay or a deliberate underpayment of taxes, which is a felony offense; whereas tax avoidance is an action to lessen tax liability and increase after-tax income within the legal framework.

Tax evasion effectively defrauds the government of legally due tax revenues, thereby reducing the government's ability to provide public services, while increasing the nation's debt burden. Non-compliance shifts real resources from honest taxpayers to dishonest evaders, and tax liabilities from present to future generations. Such inequities precipitate greater discontent with the government and further erode public revenues.

As it relates to annual estimates of real dollars lost as a result of tax fraud, the IRS uses an estimate called the ‘tax gap.’ The tax gap is the difference between taxes owed and taxes paid, which takes into account mistakes, tax fraud, late payments and so on.

The Internal Revenue Service estimates that over the past thirty years the tax gap has ranged from 16 to 20 per cent of total tax liability.

For 2001, the IRS estimates the gross tax gap at $345 billion, or slightly over 16 per cent of tax liability, of which $55 billion will eventually be recovered through voluntary late payments and enforcement activities, leaving a net tax gap of about $290 billion.

Tax Fraud investigations are the backbone of IRS-Criminal Investigation's enforcement program and have a direct influence on the taxpaying public’s compliance with the Internal Revenue Code. Compliance with the tax laws in the United States depends heavily on taxpayer self-assessment of the amount of tax, voluntary filing of tax returns and remittance of any tax owed. This is frequently termed “voluntary compliance.”

There are individuals from all facets of the economy, whether corporate executive, small business owner, self-employed or wage earner, who through willful non-compliance do not pay their fair share of taxes.

It is quite clear that IRS-CI cannot bridge the gap through enforcement efforts alone. The task requires a full complement of law enforcement, regulators and financial institutions working together, communicating and hardening the environment for criminals to operate.

With regard to current trends, IRS-CI continues to investigate identity theft fraud (relating to refund/tax fraud), transfer pricing schemes, bogus loan arrangements such as back-to-back loans, nominee and offshore company arrangements and the use of safe-haven jurisdictions.

We have noted a precipitous increase in identity theft fraud as it relates to refund/tax fraud over the last several years.

IQPC: How can banks and large institutions legally engage in tax avoidance and prevent fines or criminal investigations?

Monahan: In the US, avoidance of tax is not a criminal offense. Taxpayers have the right to reduce, avoid, or minimise their taxes by legitimate means. One who avoids tax does not conceal or misrepresent but shapes and pre-plans events to reduce or eliminate tax liability within the parameters of the law.

Tax evasion involves some affirmative act to evade or defeat a tax, or payment of tax. Examples of affirmative acts are deceit, subterfuge, camouflage, concealment, attempts to color or obscure events, or make things seem other than they are.

IQPC: How is the IRS working with organisations to help not only prevent financial crime, but also identify the sources?

Monahan: In the US, IRS-CI works closely with financial institutions and FinCEN to identify illegal money flows/proceeds of crime for criminal prosecutions, asset seizure/forfeiture and to conduct prospective trend analysis. Outreach to the private sector is equally important.

IRS-CI plays an active role in many US-based taskforces such as the National Joint Terrorism Taskforce (NJTTF); Counter-Narcoterrorism Operations Center (CNTOC); US Special Operations Command (SOCOM); Organized Crime Drug Enforcement Taskforce (OCDETF); Special Operations Division (SOD); and the El Paso Intelligence Center (EPIC) to name a few.

The intelligence sharing within the taskforce members is pivotal in identifying criminal activities, organised syndicates and the flow/source of proceeds.

IRS-CI maintains Liaison Officers (LO) who are assigned to international posts around the globe. These LOs work closely with the host country's law enforcement and intelligence community, FIUs and financial institutions to obtain intelligence to on-going domestic and international investigations. These relationships are critical, as most investigations have an international component.

IQPC: How can technology play a greater role in corporate processes to prevent crime?

Monahan: In the US, identity theft (IDT) as it relates to refund/tax fraud has seen a precipitous increase over the last several years (where IRS is the target). IRS estimated it prevented $24.2 billion in fraudulent IDT refunds in 2013, but still paid $5.8 billion later determined to be fraud.

Because of the difficulties in knowing the amount of undetected fraud, the actual amount could differ from these point estimates. IDT refund fraud occurs when an identity thief uses a legitimate taxpayer's identifying information to file a fraudulent tax return and claims a refund.

The prevention of IDT/refund/tax fraud is a direct result of both technological applications along with human intervention. There has been a significant increase in the number and quality of IDT screening filters that spot fraudulent tax returns before refunds are issued.

The IRS has dozens of IDT filters now in place. Also, the IRS is collaborating with more than 130 financial institutions to identify IDT fraud schemes and block refunds from reaching the hands of identity thieves. This effort has protected hundreds of millions of dollars so far.

IQPC: What can delegates take away from your session at the conference?

Monahan: IRS-CI's highest priority is to enforce US tax laws and support tax administration to ensure compliance with the law and combat fraud.

Some of my case summaries will includes the diversity and complexity of our investigations such as tax-related identity theft, money laundering, public corruption and terrorist financing. Our investigations touch almost every part of the world.

IRS-CI had a very successful year, which included investigations of Credit Suisse, Bank Leumi, BNP Paribas, Liberty Reserve and Silk Road. In the largest criminal tax case ever filed, Credit Suisse pleaded guilty to conspiracy to aid and assist US taxpayers in filing false income tax returns and agreed to pay a total of $2.6 billion.

Following the Credit Suisse investigation, IRS-CI led the case against Bank Leumi Group, a major Israeli international bank that admitted conspiring to aid and assist U.S. taxpayers to prepare and present false tax returns.

This unprecedented agreement marks the first time an Israeli bank has admitted to such criminal conduct. Bank Leumi Group will pay the U.S. a total of $270 million and cease to provide banking and investment services for all accounts held or beneficially owned by U.S. taxpayers.

I believe the delegates will gain a better understanding of what IRS-CI does, that is 'follow the money,' learn about some of the complexities of financial investigations and the importance of international relationships, cooperation and communication.

*Don't miss the chance to meet Greg Monahan at the **Financial Crime Asia Summit**, (27 - 29 January 2016, Singapore) where he will conduct an in-depth case study on understanding tax evasion versus tax avoidance to avoid fines and allegations.*

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