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U.S. Tax-Evasion Crackdown Could Affect Canadians

Date: October 7, 2009

Vern Krishna

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The plotline for the saga started off routinely. Some Americans and Canadians wanted to hide their income from the tax authorities. UBS would oblige by offering to hide money under cover of Swiss banking secrecy laws, which strictly prohibit—under threat of criminal sanctions—the disclosure of banking information.

If everything went accordingly to plan, no one would be any the wiser. The taxpayers would become wealthier, UBS would make more profits and the Swiss government would collect more in taxes.

Everyone was happy until the United States Internal Revenue Service popped the party balloon by invoking the information-exchange requirements of the U.S.-Swiss Income Tax Treaty. The IRS asked UBS—whose net assets are four times Switzerland's gross domestic product—to release the names of 52,000 of its American clients who had accounts with the bank and were potential targets for income tax audits.

UBS initially rejected the request, citing Swiss domestic laws that prohibit the disclosure of banking information. The Swiss government claimed that income tax evasion is not “fraud” under Swiss law and, therefore, the request for information pursuant to the Treaty was outside the scope of its disclosure requirements. A clever argument, to be sure, but one that underestimated the economic clout of the U.S.

UBS has significant assets in the United States and would have been economically exposed if the IRS proceeded with full-scale criminal prosecutions and sanctions against it and bank officials. The Swiss government understood economics and capitulated. They revealed the names of 4,450 wealthy Americans with offshore bank accounts at UBS.

What of the remaining 47,550 names? In a brilliant manoeuvre, the deal will not disclose the methodology of selecting the potential offenders from the list of 52,000 Americans until some time in November 2009—after the deadline of the U.S. amnesty for tax evaders, which expires on Oct. 15. That leaves Americans with undisclosed offshore accounts with a reverse lottery win—guessing as to whether their names will be called up. Faced with the threat of criminal prosecution and severe sanctions (including jail time) if their number comes up, the uncertainty is a powerful incentive to voluntarily confess. By

mid September, more than 3,000 taxpayers had come forward.

The pressure is building. The Americans convicted Bradley Birkenfeld—a former UBS private banker—and sentenced him to 40 months in prison even though he helped and co-operated with the U.S. prosecutors. Indeed, the judge imposed a greater penalty than the prosecution recommended.

What will be the spillover in Canada? Lichtenstein (another haven for evaders) is also under close scrutiny after a bank employee stole an electronic list of depositors and sold it to various governments. Canada has the names of about 100 Canadians with Lichtenstein bank accounts, which the government obtained from the stolen disk. An interesting aspect of the Lichtenstein probe is that the Canadian government is in possession of stolen property. It remains to be seen how the courts will deal with any evidence arising from the stolen property.

As in the United States, Canadian taxpayers are required to annually file a statement of their foreign assets holdings if they exceed \$100,000. Failure to do so can result in penalties and sanctions. Canada, however, has a perpetual amnesty. Canadians can disclose offshore income through a “no-names” voluntary disclosure process and avoid penalties and prosecution. Timing is the key to amnesty. The remedy is not available after the CRA commences its audit.

Perhaps the most Draconian long-term effect of the UBS saga is proposed U.S. legislation that would reverse the onus of proof for taxpayers who have money in accounts in “offshore secrecy jurisdictions.” Taxpayers with such accounts would have to prove that they are not subject to U.S. tax. The proposal lists 34 countries, including the Cayman Islands, Lichtenstein, the Bahamas, and Antigua as secrecy jurisdictions. How far behind can Canada be with copycat legislation?

To be sure, UBS capitulated to the Americans because of the latter’s economic clout. It remains to be seen if they will respond similarly to the Canadian request. As Warren Buffet says: “You don’t know who is swimming naked until the tide goes out.” In the meantime, potential names in Canada should seriously consider voluntary disclosure while the tide is still in.

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