

Regulators, Whistleblowers And The Paradise Papers

By **Adam Pollock**

In recent weeks, news outlets around the world have reported on the "Paradise Papers." This 13-million-file trove of documents, spanning some 60 years, was leaked — or stolen — from Appleby Global, which holds itself out as an "offshore law firm."

For more than a century, Appleby has been quietly providing tax and other discreet advice to major corporations and wealthy individuals. These clients apparently include Apple Inc., Facebook Inc. and Uber Technologies Inc., boldfaced names like the Queen of England and Bono and lesser-known wealthy individuals like hedge fund managers.

Appleby services these clients from both relatively-prominent tax havens, such as the Cayman Islands and the Isle of Man, and in lesser-known but perhaps more strategically significant locations such as the Seychelles and Mauritius.

While tax efficiency and avoidance may be lawful strategies, Appleby's clients should now expect that tax authorities — in the U.S., the U.K. and elsewhere — will closely scrutinize the "Paradise Papers" for evidence that they crossed into tax evasion. Moreover, individuals with insider knowledge — like accountants, bankers, information technology staff, colleagues and competitors — can supplement the public knowledge with their own private information in filing whistleblower actions, and may reap a sizable reward for doing so.

Offshore Tax Efficiency, Avoidance and Evasion

Of course, tax efficiency is not inherently unlawful. Many legitimate reasons exist for individuals and companies to hold "offshore" entities, trusts and bank accounts.

For example, the New York Times ran a lengthy examination of Appleby's assistance to Apple in setting up a "double Irish" tax shelter, moving monies from Ireland, to the Channel Island of Jersey and back to Ireland in order to reduce taxation on profits earned abroad.[1] In another article, the Times examined the practice, by normally tax-exempt universities, of investing their endowments in offshore funds so as to avoid incurring tax in the funds' growth.[2]

But other tax "strategies" use offshore entities for evasion. Some companies artificially and fraudulently assign expenses to low- (or no-) tax jurisdictions in order to reduce their tax burdens in high-tax jurisdictions, such as the United States.

Individuals, likewise, find creative means to both remove their money from high-tax jurisdictions (like the United States) to jurisdictions where it can grow both tax-free and without reporting to the U.S. Internal Revenue Service. Then, when such individuals need access to the capital, they employ deceptions to return the monies, such as sham loans to themselves.[3]

Leaked Tax-Related Documents Lead to Enforcement Actions

American taxpayers would be wrong to believe that federal and state prosecutors will shy away from bringing enforcement actions based on stolen and, in some cases, privileged materials. On the contrary, past precedents show that authorities will aggressively use these materials in bringing



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criminal and civil enforcement actions.

In 2007, Bradley Birkenfeld, an American who had previously worked for UBS, the giant Swiss bank, handed over a huge cache of documents about the bank's clients. UBS eventually paid a \$780 million fine to the U.S. authorities. Meanwhile, the government separately prosecuted dozens of UBS accountholders.

Since then, a torrent of documents has emerged from the world's tax havens. In 2008, an employee of HSBC's Swiss private banking subsidiary gave French authorities a giant hoard of documents, which eventually found their way as to journalists, as "HSBC Leaks," in 2015. The government reportedly has been pursuing investigations based on these documents.[4]

Also, in 2013, 2.5 million files emerged from the Bahamas and Jersey as the "Offshore Leaks," and, a year later, the "Luxembourg Leaks" materialized based on PricewaterhouseCoopers documents.

Then, last year, an enormous set of documents "leaked" from Mossack Fonseca, a previously obscure Panamanian law firm that specializes in setting up effectively anonymous offshore shell companies. The "Panama Papers" revealed that some of these corporations functioned, in many instances, as shelters through which legitimate companies and wealthy individuals could stash funds, far away from prying tax eyes.

The 11.5 million leaked documents — including communications arguably subject to the attorney-client privilege and other confidential materials — detailed more than 200,000 such shell companies.

The Panama Papers apparently named 200 U.S. citizens, immediately prompting a DOJ investigation, and what appears to be a second investigation which was soon launched by the United States Attorney's Office for the Southern District of New York.[5] Meanwhile, investigations commenced worldwide.

This latest massive dump of documents — the "Paradise Papers" — also includes millions of privileged and confidential documents that detail a global network of tax avoidance.[6] And, as press reports have begun to detail, the documents 'raise questions as to whether the Appleby firm's clients engaged in tax evasion. Based on past precedents, taxpayers can expect these disclosures to lead to a new round of enforcement actions.

Tax Whistleblowing

In addition to direct government investigations, taxpayers should expect whistleblower complaints to drive enforcement actions.

Whistleblowers, through their attorneys, can file complaints to various federal agencies, including the U.S. Internal Revenue Service (tax fraud), the U.S. Securities and Exchange Commission (fraud by companies issuing securities, including but not limited to public companies), the U.S. Commodity Futures Trading Commission (fraud involving commodities) and the U.S. Attorney's Office (fraud involving banks disclosed under the FIRREA whistleblower provisions). For certain tax frauds, for example a scheme by a publicly-traded bank, one could envision lodging multiple complaints, with multiple agencies, stemming from the same fraud.

Under the IRS's program, tax whistleblowers are eligible for an award of 15 to 30 percent of proceeds ultimately collected by the IRS, including penalties and interest.[7] As for Bradley Birkenfeld, who had provided the UBS documents, the IRS Whistleblower Office eventually paid him a \$104 million award. And IRS whistleblowers are even eligible for an award of up to 10 percent by contributing additional information to already publicly disclosed allegations.[8]

Moreover, whistleblowers can file qui tam complaints alleging that the federal or state governments were defrauded. These are "Big C" Complaints which, unlike the multitude of complaints made daily to government, are actually filed in court under false claims acts.

Although the federal False Claims Act explicitly carves out tax fraud,[9] New York state's false claims act was amended in 2010 to expressly include tax fraud.[10] Indeed, in introducing the legislation, then state senator and now state attorney general Eric Schneiderman explained that the provision

was specifically “aimed at illegal offshore tax shelters.”

Under false claims acts, states can recover triple damages plus penalties.[11] The whistleblower, known as a qui tam relator, generally stands to receive 15 to 25 percent of these proceeds, or up to 30 percent if the state declines to intervene in the lawsuit and the relator successfully litigates the matter.[12]

Since the change to New York’s false claims act, the state has collected approximately \$80 million in settlements stemming from qui tam suits and false claims act investigations originating from alleged violations of the tax laws.[13] Meanwhile, the New York Attorney General is pursuing a tax-based false claims act case against Sprint Nextel Corporation, where the damages could rise past \$400 million,[14] and relators are pursuing other tax-based cases in which the state declined to intervene.[15]

A handful of other states have, at least implicitly, extended their false claims acts to tax-based claims by removing the explicit exclusion.[16] While we are not aware of any resolved case alleging international tax fraud, relators have sought redress for a variety of tax frauds under states’ false claims acts.[17]

Government Enforcement and Whistleblower Actions to Come

With respect to the Paradise Papers, expect government enforcement to soon be examining the leaked documents — if it hasn’t already — and will use it to develop cases. While it may seem especially unseemly to build cases from materials that are both stolen and privileged, one would be mistaken to think that the documents’ origin will cause consternation.

Further, even materials otherwise subject to the attorney-client privilege will lose their status if they further, facilitate or conceal fraudulent or criminal activity.[18] Seen from this vantage point, Appleby’s own files may well be used to prosecute its clients.

Additionally, even though the Paradise Papers saga has been thoroughly disclosed in the news media, whistleblowers may still earn rewards by materially adding to already-public knowledge.[19] As explained by the Third Circuit, “a relator materially adds to the publicly disclosed allegation or transaction of fraud when it contributes information — distinct from what was publicly disclosed — that adds in a significant way to the essential factual background: ‘the who, what, when, where and how of the events at issue.’”[20]

Accordingly, insiders who can add to the already disclosed allegations, and help to make cases, stand to be amply rewarded. Meanwhile, as for companies and individuals holding offshore accounts and formerly anonymous entities, their time may be due (or overdue) to proactively take steps to minimize liability.

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[1] Drucker & Bowers, After a Tax Crackdown, Apple Found a New Shelter for Its Profits, New York Times, Nov. 7, 2017, at A1.

[2] Saul, Endowments Boom as Colleges Bury Earnings Overseas, New York Times, Nov. 9, 2017, at A1.

[3] See Pollock & Carroll, Using The New York FCA To Combat Offshore Tax Evasion, Law360, Apr. 14, 2015, available at <https://www.law360.com/articles/641837/using-the-new-york-fca-to-combat-offshore-tax-evasion>.

[4] See Weinberger, HSBC Under Fresh Scrutiny Over Client Tax Evasion, Law360, Feb. 9, 2015, available at <https://www.law360.com/whitecollar/articles/619603/hsbc-under-fresh-scrutiny-over-client-tax-evasion>.

[5] See Barrett et al., U.S., France Probe Panama Documents for Potential Evidence of Crime, Wall St. J., Apr. 4, 2016; Neate, Panama Papers: US launches criminal inquiry into tax avoidance claims, Guardian, Apr. 19, 2016 (posting letter from then-U.S. Attorney Preet Bharara).

[6] See Taylor, Tax Dodge Papers 'A National Disgrace,' UK Lawmaker Says, Law360, Nov. 14, 2017, available at <https://www.law360.com/articles/984923/tax-dodge-papers-a-national-disgrace-uk-lawmaker-says>; Mark Taylor, EU's 'Dirty Money' Fight Under Fire After Tax Papers Leak, Law360, Nov. 6, 2017, available at <https://www.law360.com/articles/981984/eu-s-dirty-money-fight-under-fire-after-tax-papers-leak>.

[7] 26 U.S.C. § 7623(b)(1). See, e.g., *Smith v. Comm'r of Internal Revenue*, No. 25605-15W, 2017 WL 2472375, at *8 (T.C. June 7, 2017).

[8] 26 U.S.C. § 7623(b)(2)(A).

[9] 31 U.S.C. § 3729(d).

[10] N.Y. State Finance Law §§ 187 et seq; see generally Pollock & Fox, FCA Cases: Protect Claims by Relying on NY's Favorable Pleading Standard, N.Y.L.J., Dec. 9, 2014, at 4.

[11] See, e.g., N.Y. State Fin. Law § 189(4)(a).

[12] See, e.g., *id.* § 190(6)(a).

[13] See, e.g., Orden, Harbert Management Reaches New York Settlement: Attorney general's office announces \$40 million settlement stemming from tax issues, Wall St. J., Apr. 18, 2017; see generally Fox, 6 Years of Tax Qui Tams in New York, Tax Notes, June 8, 2016.

[14] See *People ex rel. Schneiderman v. Sprint Nextel Corp.*, 26 N.Y.3d 98, 105 (2015); Fox, Tax Fraud And The FCA: 4 Takeaways From NY's Sprint Ruling, Law360, Nov. 3, 2015, available at <https://www.law360.com/articles/720902/tax-fraud-and-the-fca-4-takeaways-from-ny-s-sprint-ruling>.

[15] See, e.g., *New York ex rel. Campagna v. Post Integrations, et al.*, Index No. 100516/2014 (Sup. Ct., N.Y. Cty.).

[16] 6 Del. Code §§ 1201 et seq. (implicitly allowing tax claims); Fla. Stat. §§ 68.081 et seq. (implicitly allowing tax claims); 740 Ill. Comp. Stat. § 175/3(c) (explicitly excluding income tax); Ind. Code § 5-11-5.5-2(a) (explicitly excluding income tax); Nev. Rev. Stat. §§ 357.010 et seq. (implicitly allowing tax claims); R.I. Gen. Laws § 9-1.1-3(c) (explicitly excluding claims based on personal income tax); Wash. Rev. Code §§ 74.66.005 et seq. (implicitly allowing tax claims).

[17] See, e.g., Michael J. Bologna, Settlement Data Reveals Lawyer's False Claims Freight Train, Bloomberg BNA, Oct. 19, 2016, available at <https://www.bna.com/settlement-data-reveals-n57982078846/>.

[18] See *In re Richard Roe, Inc.*, 68 F.3d 38, 40 (2d Cir. 1995); see, e.g., *United States v. Tucker*, 254 F. Supp. 3d 620, 622 (S.D.N.Y. 2017).

[19] 26 U.S.C. § 7623(b)(2)(A) ("taking into account the significance of the individual's information and the role of such individual and any legal representative of such individual in contributing to such action"); 6 Del. Code § 1206(c)(2) ("knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions"); Fla. Stat. § 68.087(3)(c) (same); 740 Ill. Comp. Stat.

§ 175/4(e)(4)(B) (same); Ind. Code § 5-11-5.7-7(e) (same); Nev. Rev. Stat. § 357.026(2); N.Y. State Fin. Law § 188(7)(b) (same); R.I. Gen. Laws § 9-1.1-4(e)(4)(B) (same); Wash. Rev. Code § 74.66.080(2)(b)(ii).

[20] U.S. ex rel. Moore & Co. v. Majestic Blue Fisheries LLC, 812 F.3d 294, 307 (3d Cir. 2016).