

OFFSHORING TAX ETHICS: THE PANAMA PAPERS, SEEKING REFUGE FROM TAX, AND TAX LAWYER REFERRALS

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“[T]he legal profession has failed. . . [L]awyers have become so deeply corrupt that it is imperative for major changes in the profession to take place [T]he term ‘legal ethics’, . . . has become an oxymoron. Mossack Fonseca did not work in a vacuum despite repeated fines and documented regulator violations, it found allies and clients at major law firms in virtually every nation.”¹

INTRODUCTION

The leak of more than eleven million files in the recent “Panama Papers” scandal revealed the offshore financial, legal, and tax planning facilitated by Panamanian law firm, Mossack Fonseca (“MF”), for more than 214,000 offshore entities with beneficial owners from around the world.² Although MF’s

American client list does not appear to include the sort of high-profile political figures who have emerged from reporting on the Panama Papers in other countries around the world[,] . . . the services offered by Mossack Fonseca . . . were in high demand by the rich and famous in the United States.³

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1. John Doe, explaining why he leaked the Panama Papers, *Panama Papers Source Offers Documents to Governments, Hints at More to Come*, *THE JOURNALISTS INVESTIGATIVE JOURNALISTS*

1: Tip of the Iceberg, 121 P

A. ST. L. REV. 807, 807 (2017); *Giant Leak of Offshore Financial Records Exposes Global Array of Crime and Corruption*, *THE JOURNALISTS INVESTIGATIVE JOURNALISTS* (Apr. 3, 2016), <https://panamapapers.icij.org/20160403-panama-papers-global-overview.html> [https://perma.cc/V7PF-FSJS].

3. Eric Lipton & Julie Creswell, *Documents Show How Wealthy Hid Millions Abroad*, *N.Y. TIMES*, June 6, 2016, at A1.

for potentially aggressive tax planning, a lawyer who does so without very careful reflection “passes the buck” for ethical tax practice onto the next lawyer. Rather than expatriating responsibility for the tax practice ethics of representing the client, each lawyer should internalize more of that responsibility and should not blithely provide referrals.

This Essay proceeds by describing what the Panama Papers reveal about client referrals to MF, after which the Essay briefly explains how the general ethical rules, tax-RA-1(.3(CTI)T(CE.2(o)-1(n)-1())2.760204.2)2.760427.7605e.

Panama Papers database as intermediaries for clients getting advice from MF.¹⁵ Similarly, major financial institutions such as HSBC and UBS served as intermediaries for clients of MF and helped to create thousands of shell companies.¹⁶ Even where the banks, law firms, or accounting firms did not serve as direct intermediaries, they could have referred clients to MF. For example, leaked documents suggest that UBS could have been the source of the referral for at least one of MF's high-profile U.S. clients, the Ponsoldt family.¹⁷

The involvement of these financial institutions, accounting firms, and law firms as client intermediaries (or, more tangentially, as client referrers) does not, however, imply that these organizations or their people (or their clients) have necessarily done anything improper. Even the International Consortium of Investigative Journalists ("ICIJ"), one of the organizations that helped to break the Panama Papers story, explained that: "There are legitimate uses for offshore companies and trusts. We do not intend to suggest or imply that any persons,

regret any misuse of companies that [they] incorporate or the services [they] provide and take steps wherever possible to uncover and stop such use. If [they] detect suspicious activity or misconduct, [they] are quick to report it to the authorities. Similarly, when authorities approach [them] with evidence of possible misconduct, [they] always cooperate fully with them.²⁰

In addition, banks such as HSBC and Credit Suisse have “denied claims that they have helped clients avoid tax through the use of offshore companies” and assert that they provide assistance for clients only for legitimate purposes.²¹ Commentators caution against “rushing to judgment about tax evasion or avoidance, given that the [Panama Papers] reveal little about tax law compliance.”²²

Nevertheless, the Panama Papers led to the resignation of Iceland’s Prime Minister²³ and Spain’s Minister of Industry,²⁴ and other prominent world figures

thirty countries are collaborating in their Panama Papers-inspired tax investigations, including through a recent event that “included the largest ever simultaneous exchange of information” and that focused investigatory attention on “enablers” (i.e., “professional bankers, lawyers, and accountants”) who “enable offshore cash flows” and who are alleged to “mis-use their status to undermine the systems of rules and practices that shape modern societies.”²⁹

II. WHAT RESPONSIBILITY DID REFERRING LAWYERS HAVE?

To the extent that MF clients might have been engaging in tax avoidance or evasion using MF’s services, it raises a question about the ethical obligations of the people, particularly the U.S. lawyers, who connected these clients with MF. As big as the Panama Papers leak was (and at 2.6 terabytes, it was the biggest leak in history as of the date of the leak),³⁰ this question is relevant for a much bigger audience than just the U.S. lawyers/law firms revealed in the leak. This is for at least two reasons.

First, the leak identifies only the U.S. law firms who served as intermediaries for such matters, but it does not reveal those lawyers who merely referred matters to MF and did not remain involved.³¹ The number of referrers may be much larger than the number of firms with ongoing roles as intermediaries.

papers.icij.org/blog/20161201-impact-graphic.html [<https://perma.cc/669M-ZM87>]; see Trautman, *supra* note 2, at 838-40 (describing the international reaction including enforcement efforts around the world). In addition to enforcement actions, various jurisdictions, including Panama, have also made changes to (or have initiated studies about the possibility of changing)

is because Rule 1.2(d) contemplates “active assistance”⁴⁷ where the lawyer is representing the client,⁴⁸ as opposed to the mere referral context, in which the lawyer ~~declines~~ to represent the taxpayer. This conclusion is supported by case law,⁴⁹ which suggests that even if a referring lawyer knows that a client wants to use a foreign lawyer’s assistance to violate the law, the lawyer who merely makes a referral to a reputable foreign lawyer should not be disciplined for an ethical violation, as long as the referring lawyer (a) does not directly engage the foreign lawyer on the client’s behalf or otherwise involve himself with the fees paid to the foreign lawyer,⁵⁰ and (b) ceases to be involved in the representation after making the referral,⁵¹ leaving the client to engage the referred lawyer if the client so chooses.

2. Circular 230

Circular 230, which articulates standards of practice applicable to tax professionals who practice before the Internal Revenue Service (“IRS”), also does not explicitly address referrals.⁵² Instead, Circular 230 takes an approach

230 if the lawyer declines the representation and merely provides a referral to a foreign lawyer who might assist with the aggressive offshore tax planning. This is for at least two reasons.

First, providing a referral, even to an aspiring tax evader, is unlikely to constitute the type of action covered by this rule. Specifically, a referral is unlikely to constitute “assisting” or “counseling” the client in violating the law, as discussed above with respect to the Model Rules. Further, providing a mere referral in response to a request is unlikely to constitute either “suggesting” an illegal plan to evade taxes or “encouraging” a prospective client to violate the law. That said, a referring lawyer may want to affirmatively discourage aggressive taxpayers in order to avoid the risk that the referral could be construed to be implicit encouragement.⁵⁴

Second, providing a mere referral is unlikely to reflect the “willful” or “knowing” intent required for a lawyer’s actions to be sanctionable under Circular 230. “Willfulness,” which requires “a voluntary, intentional violation of a known legal duty,”⁵⁵ would be quite hard to establish if a lawyer declines a representation.⁵⁶ “Knowing” requires that the lawyer “

competent to handle the matter. The referring lawyer should ensure that the referred lawyer is licensed in the relevant jurisdiction and should be alert to adverse public information about the referred lawyer. The referring lawyer

D. Adverse Reputational Consequences Could Apply

empowers the taxpayer to pursue matters that the lawyer believes should not be pursued (or at least with respect to which he is unwilling to assist).⁸⁸

CONCLUSION

For a lawyer who wants to be more cautious than required when responding to a request for a referral for assistance with offshore tax planning, options include declining to provide a referral and complying with additional good practices that were developed in other contexts, such as for matters that could involve money laundering or financing of terrorist activities.⁸⁹ Although a comprehensive discussion about exactly what steps should be taken by this lawyer is aCCryCuch a4(f)3.4tU.n211.4(t)5.3(a56n r)3d (C)T-0.007 Tc 0.011 Tw 7.313n00.(di)5.3(t)5.3(a