An Update on International Tax Enforcement

By Jason B. Freeman, JD, CPA | Column Editor

International tax enforcement remains one of the nation's top tax priorities. Indeed, a number of important developments over the past year signal that offshore enforcement issues remain firmly in the government's crosshairs. Notably, the past year saw the Treasury Department implement several key regulations that impose new reporting obligations, and that are designed to increase transparency and promote its ability to exchange information under the nation's tax agreements – agreements like the Foreign Account Tax Compliance Act (FATCA). Data leaks, such as the infamous Panama Papers scandal, provided a reminder that privacy is being supplanted by transparency in this age of information and globalization, and sparked new insights into the soft spots in our system.

The past year also saw the government continue to capitalize on information it has received from initiatives like the Offshore Voluntary Disclosure Program (OVDP), the streamlined filing compliance procedure and the Swiss Bank Program – programs that have been instrumental in the government's offshore tax compliance initiative, but have uncertain futures. And, in large part due to these developments, recent statistics indicate that international compliance rates are significantly increasing, signaling a growing awareness of filing obligations.

FBAR Filings are on the Rise

The number of FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR) filings has been on the rise in recent years. More than a million FBARs are now being filed annually and the number of FBAR filings has grown an average of 17 percent per year over the past five years. Those are astounding figures for a reporting requirement that has been around since the 1970s.

The increase in the number of FBAR filings is an indicator that taxpayers and tax professionals are increasingly becoming better educated about their filing obligations. The trend is the product of several initiatives over the past few years that have raised taxpayer awareness – perhaps most prominent among them, FATCA and the OVDP.

How Much Longer will the OVDP Be Around?

The IRS' OVDP has perhaps been the primary offshore initiative responsible for increasing awareness of filing obligations. The OVDP is a program that the IRS offers to qualifying non-compliant taxpayers that allows them to come forward proactively and disclose their prior foreign reporting deficiencies in exchange for reduced penalties and criminal amnesty. In addition, the IRS introduced a streamlined filing compliance procedure, a sort of adjunct to the OVDP, allowing qualifying non-compliant taxpayers whose prior reporting deficiencies were not willful to correct those deficiencies at a significantly reduced cost (and without penalty in some cases). Both the OVDP and the streamlined procedure are open-ended initiatives that could end at any time.

In October of 2016, the IRS issued new statistics indicating that 55,800 taxpayers have now come into the OVDP, paying in more than $9.9 billion in taxes, penalties and interest since its adoption in 2009. In addition, another 48,000 taxpayers have used the streamlined filing compliance procedures since their adoption in 2012 (the vast majority of them since the procedures were expanded in 2014), paying in approximately $450 million.

All told, these figures represent major milestones with more than 100,000 taxpayers coming into compliance and the government collecting more than $10 billion. However, perhaps the most interesting aspect of these figures is their year-over-year changes. The OVDP, it turns out, experienced markedly slowed growth: a year before these statistics were released, 54,000 taxpayers had come into the OVDP, implying that there have only been 1,800 new entrants in the past year. The streamlined procedures, on the other hand, grew rapidly, with approximately 18,000 new entrants. In light of past IRS signals, these statistics could indicate that the OVDP's days are limited.

The Swiss Bank Program Reaches Resolution with Final Swiss Banks

In August of 2013, the Department of Justice instituted the Swiss Bank Program. The program provided eligible Swiss banks with the ability to resolve potential criminal and civil exposure by fully cooperating with the United States' ongoing investigations into the use of foreign bank accounts to facilitate tax evasion. This unique, landmark initiative has been incredibly successful. In roughly a year, the program led to non-prosecution agreements with some 80 Swiss banks and the collection of more than $1.3 billion in penalties. The final Swiss bank resolutions under the program were inked in late 2016, bringing that portion of the program to a close. The greatest fruits of the program, however, have been the vast amounts of data and information obtained from cooperating banks. Indeed, the government has now entered a phase of digesting and mining that data. This "legacy" phase, as the government has referred to it, is likely to produce a wave of new examinations and investigations.

In addition, the past year saw the Department of Justice's first criminal convictions of non-Swiss financial institutions (Cayman National Securities Ltd. and Cayman National Trust Co. Ltd.) for conspiring with U.S. taxpayers to evade tax. This movement outside of Switzerland, and the winding down of the Swiss Bank Program, indicates that the government is now turning its attention more and more towards other "trouble" jurisdictions. This is likely to be a

trend. We may even ultimately see similar programs – programs built on the Swiss Bank Program model – instituted in other countries.

FATCA Spurs New Regulations Seeking Increased Transparency

Under FATCA, foreign financial institutions are generally required to report accounts held by U.S. customers on an annual basis or face a 30 percent withholding tax on certain U.S.-source income. The United States now has FATCA-related intergovernmental agreements (IGAs) with more than 100 partner countries. The effort has been a phenomenal success in terms of fostering and promoting global transparency and the exchange of information among taxing authorities.

However, as this author and other commentators have noted, U.S. law has hindered the Treasury's ability to fully comply with the information-exchange obligations under its FATCA IGAs. Perhaps most notable has been the Treasury's inability to provide partner countries with information about underlying beneficial owners of U.S. entities. Prominent data breaches and leaks, such as the Panama Papers leak, have exposed these shortcomings and created political pressure to address them.

In reaction to these factors, the Treasury has enacted several new regulations that are part of a multipronged effort to increase financial transparency and improve the IRS' access to tax information. For instance, the Treasury finalized regulations under section 6038A of the code, providing that domestic disregarded entities that are wholly owned by a foreign owner will now be required to obtain an EIN and to file Form 5472, *Information Return of a 25 Percent Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*, to report certain transactions. Prior to these new regulations, such entities generally did not have tax filing obligations. This will be a major change that goes into effect in 2017.

The section 6038A regulations bolster Treasury regulations that were introduced during 2016 under the Bank Secrecy Act and that impose new customer due diligence requirements on certain financial institutions, requiring the collection of information about the identity of beneficial owners of legal entities. The Treasury, recognizing that "information held by banks and other financial institutions about the beneficial ownership of companies can be used to assist law enforcement in identifying the true owners of assets and their true tax liabilities," adopted the rules in large part, it said, to promote compliance with "international standards for transparency and information exchange [and] to combat cross-border tax evasion and other financial crimes." In particular, the Treasury noted that the new rules will promote its ability to comply with FATCA agreements with partner countries. In this respect, the customer due diligence regulations will work hand in hand with the section 6038A regulations.

Another important FATCA-related reporting regulation also took effect this past year. The Treasury enacted final regulations under section 6038D of the code, which was enacted as part of FATCA, that require certain "specified domestic entities" to file a Form 8938 to report certain foreign assets, a requirement that had previously only applied to individuals. The requirement extends to certain closely held U.S. entities that are "formed or availed of" to hold, directly or indirectly, specified foreign financial assets. These new reporting regulations, combined with already increasing levels of compliance, will surely increase the flow of offshore-related information to the government.

A High Priority

International tax enforcement will remain high on the nation's list of priorities for tax administration in the coming years and it is, perhaps, positioned better than it has ever been to enforce such reporting requirements. An array of new reporting obligations will impact many taxpayers with foreign assets and holdings.

In addition, developments with several key offshore initiatives show signs that they may significantly change the landscape. For instance, as the Swiss Bank Program enters its "legacy" phase, the government is likely to expand its focus into new "trouble" jurisdictions. This may raise the stakes for many taxpayers who have thus far stayed off the radar, as it is quite possible that the OVDP, with its slowed growth, could be narrowed or even closed. Any such changes would represent major shifts in the offshore tax compliance initiative. ■

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