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International Tax ADVISORY ■

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The United States, Australia and the United Kingdom Gang Up on International Tax Evasion

In a news release on May 9, 2013, the tax authorities of the United States, Australia and the United Kingdom announced a plan to share tax information regarding numerous trusts and other entities holding assets on behalf of residents throughout the world. The three countries have obtained a substantial amount of data, including information about the identities of individual owners and the advisors who helped them establish the structures. The announcement comes amid a flurry of anti-evasion activity spawned in large part by the Foreign Account Tax Compliance Act (FATCA).

Enacted by the HIRE Act of 2010, FATCA essentially requires foreign financial institutions (and certain other entities) to document and report to the IRS information on their U.S. accountholders (or substantial U.S. owners) or be subject to a 30 percent withholding tax on U.S. source income received (including FDAP, gross proceeds and foreign passthru payments). The U.S. Treasury and Internal Revenue Service (IRS) published a comprehensive set of final regulations in January 2013 and are currently finalizing key aspects of implementation, such as registration (by paper and online portal), withholding certificates and other forms, and coordination with other withholding regimes under the Code. Meanwhile, the U.S. Treasury has pursued intergovernmental agreements (IGAs) to facilitate FATCA implementation and compliance around the globe. To date, IGAs have been signed with Denmark, Ireland, Mexico, Norway, Switzerland and the United Kingdom, and many more are being negotiated.

The recent announcement by the United States, Australia and the United Kingdom also accompanies the concerted effort by much of the European Union (EU) to adopt a FATCA-like information-sharing regime. How to further discourage and combat international tax fraud and evasion, especially as facilitated by entity structures and bank secrecy laws, is expected to be a major focus at the upcoming EU council meeting and G8 summit. Even countries with notoriously formidable bank secrecy laws, such as Switzerland, Lichtenstein and Luxembourg, have bowed to the pressure and entered into bank account disclosure agreements.

The United Kingdom in particular has taken considerable steps in the anti-evasion fight, including passing its own "FATCA" legislation and challenging large multinationals on their aggressive tax avoidance. The United Kingdom has also pushed its overseas territories, including notable tax havens such as Bermuda, the British Virgin Islands and the Cayman Islands, to sign agreements to share bank account data not only with the United Kingdom, but also with France, Germany, Italy and Spain. A number of British territories are also negotiating IGAs with the United States.

Cross-border cooperation is the hallmark of the post-FATCA, anti-evasion environment and will enhance data processing and tax law enforcement efforts. The recent announcement by the United States, Australia and the United Kingdom is just one more wake-up call to taxpayers that have been utilizing offshore accounts and entities to hold assets and thereby evade tax, not only in the three countries, but also in other jurisdictions. As the tax authorities gather and process more data through FATCA reporting, IGAs and other cooperative agreements, including with notorious tax havens and bank secrecy stalwarts, noncompliant taxpayers (and the advisors who helped them) may find themselves with few alternatives to hefty penalties and potential criminal prosecution. Initiatives like the IRS's continuing Offshore Voluntary Disclosure Program (OVDP) may be rendered unavailable to certain taxpayers as the IRS obtains more information about specific structures, entities, banks, accountholders and advisors. The time is especially past ripe for noncompliant U.S. taxpayers to assess their exposure, seek counsel and consider resolution through the OVDP (if possible).

Offshore Voluntary Disclosure Program Not a Guaranteed Pass; "Quiet Disclosures" Continue (Sometimes Undetected)

The IRS has typically restricted participation in its voluntary disclosure initiatives to taxpayers who come forward before the IRS otherwise learns about them. Now it appears that taxpayers may not even be able to rely on formal acceptance into the OVDP, as there have been several recently reported cases where the IRS has disqualified taxpayers from the program *even after* they were formally accepted.

In the current OVDP, a taxpayer discloses past noncompliance, files correct tax and information returns, and pays any tax due, plus interest and penalties (including a one-time penalty of up to 27.5 percent on the highest aggregate value of the taxpayer's offshore accounts and assets). In return, the IRS agrees to consider compliance with the OVDP's terms in determining whether or not to recommend a case to the Department of Justice (DOJ). Thus, the OVDP has never been a guarantee of immunity but, rather, just a way to minimize the risk of criminal prosecution. Still, as a practical matter, the majority of disclosures have been resolved without criminal consequences. A DOJ tax official recently confirmed that less than five percent of taxpayers pre-cleared for the OVDP have been subsequently rejected.

The reported cases of disqualification from the OVDP may largely be explained by ongoing data collection and processing efforts by the IRS. For example, the IRS may have inadvertently accepted a taxpayer into the OVDP, yet subsequently realized it already had incriminating information from a third party (e.g., a foreign bank or the DOJ) regarding the taxpayer. As discussed above, FATCA and similar tax information-sharing schemes only make it more likely that taxpayers will become ineligible for or disqualified from the OVDP. The DOJ official stressed that DOJ is not compiling a list of names independently of the IRS's work and clarified that other reasons taxpayers are booted from the OVDP include taxpayers' applying to the program despite knowledge of an ongoing investigation or failing to make timely filings through the program once pre-cleared.

Some taxpayers, wary of the cost and risk of "noisy" disclosure through the OVDP—including ineligibility or disqualification, have taken their chances making "quiet" disclosures (i.e., filing amended returns for a number of years, in some cases paying the additional tax due and hoping the IRS did not notice). A March 2013 report of the Government Accountability Office (GAO) declared that, indeed, the IRS had probably failed to detect many quiet disclosures during the period covered by the 2009 voluntary disclosure initiative, suggesting that the quiet disclosure route may have been a smart gamble. The GAO report implored the IRS to look into methods to better detect and pursue quiet disclosures, and the IRS is analyzing ways to do so.

The voluntary disclosure process, whether formal or quiet, is never risk-free. With the United States' continued focus on fighting offshore evasion through third-party and multijurisdictional information reporting, the landscape becomes more fraught with potential peril. Disqualified and quiet disclosers are far more likely to face criminal charges than most taxpayers participating in the OVDP. Moreover, their "failed" disclosures could likely put them at a marked disadvantage on defense. In contemplating how to resolve prior noncompliance, taxpayers must not only weigh the costs of disclosure versus non-disclosure or "noisy" versus "quiet," but also the potential risks and consequences of a failed disclosure. The good news, at least, is that, so far, disqualification from the OVDP has been relatively rare and, in some instances, within the taxpayer's control (e.g., coming forward sooner, avoiding delay between acceptance and filings).

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