INTERNATIONAL

FATCA Update

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Nearly six years after its implementation, the Foreign Account Tax Compliance Act ("FATCA") is continuing forward. The landscape of financial institution reporting is a maze of forms, intergovernmental agreements, dates, deadlines, and information. Here are some updates for 2017.

Intergovernmental Agreements

A large part of FATCA is the intergovernmental agreements ("IGAs") that the US negotiated with other countries and jurisdictions. These IGAs help to implement FATCA rules by overruling local laws that prohibit institutions and entities from complying with FATCA rules. In countries where an IGA was signed and is in force, local rules and guidelines have been established to comply with the IGA. As of 18 January 2017, there were 95 signed IGAs and 76 IGAs in force. An additional 18 countries have agreed with FATCA in substance but do not have a signed IGA. It is unclear what the US Treasury will do with the 19 countries/jurisdictions which have signed IGAs but have not put them in force. Also, with US current political climate, it is also unclear how these countries/jurisdictions will respond.

Foreign Financial Institutions and Foreign Entities

When FATCA first came into force, there was a lot of uncertainty. Now, the US is fully enforcing the registration process, and some of the FATCA transition rules expired as of 1 January 2017. Additionally, the US continues to clarify and address questions. For example, certain foreign financial institutions ("FFIs") and branches were part of an expanded affiliated group ("EAG") but could not become participating FFIs or deemed-compliant FFIs because they were in a country that prevented them from doing so. These FFIs and branches are called limited FFIs and limited branches. In 2015, the IRS recognised this dilemma and issued an extension and other rules to help limited FFIs and limited branches transition to FATCA. During 2016, all limited FFI and limited branch registrations were simply listed as "registration incomplete status" while they completed and edited their registrations. The transition rules expired as of 31 December 2016, and there are no longer extensions for limited FFIs and limited branches.

The deadline for sponsoring entities to register their sponsored investment entities and sponsored controlled foreign corporations was also 31 December 2016. Sponsoring entities must also register their sponsored registered deemed-compliant FFIs and sponsored direct

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reporting non-financial foreign entities ("NFFEs"). It is recommended that sponsoring entities should register and obtain Global Intermediary Identification Numbers well ahead of time to give withholding agents sufficient time to complete the verification requirement.

As these questions are answered and uncertainty is cleared up, there will be less understanding given to entities that are not in compliance. If an issue is encountered that has not been addressed, it is imperative for an entity to move forward under the most compliant option and continually look for updates to see if a solution is presented. Currently, there are 274,230 FFIs and sponsored entities that have registered, and more are registering every day. It is clear that FATCA is not going anywhere, and anyone falling under its scope must take appropriate measures.

Individuals

For individual taxpayers, not much has changed in regard to foreign financial asset/account reporting for 2017. At this time, it is not clear how the information from FATCA is being used, if at all, or even how valuable it has been to tax enforcement. However, the growing compliance by FFIs and governmental jurisdictions is making the worldwide financial arena much more transparent. Additionally, the knowledge that the US has this information available is driving many taxpayers to be proactive in becoming compliant.

First, despite much opposition, as mentioned, there are no indications that FATCA is going anywhere. The IRS has been generating a significant amount of revenue from FATCA-related withholdings and tax compliance. Without FATCA, US international tax reporting would become very difficult to enforce. FATCA has helped the Treasury by bringing in a significant number of past non-compliant taxpayers and establishing many new compliant taxpayers. Furthermore, with the spawning of a worldwide Common Reporting Standard, a FATCA clone that involves over 100 countries outside the US, FATCA appears to be a part of a worldwide movement toward transparency, and it no longer seems an overreaching programme by the US.

Compliance Update: FBAR Deadline

The FinCEN 114 Form, or Report of Foreign Bank and Financial Accounts ("FBAR"), is technically unrelated to FATCA. However, it is often grouped with FATCA because it is one of the most common and oldest foreign financial reporting requirements for a US person. As such, it is one of the main filing obligations FATCA seeks to enforce. While FATCA used the FBAR as a template to create the Treasury's own form, Form 8938, the FBAR is not a tax form and is administered by a different set of laws. Since the FBAR was never a tax form and was not regulated by the Treasury, it had its own unique due date of 30 June without extensions. This created numerous issues for taxpayers, especially when, with extensions, tax returns are not due until 15 October. Beginning in 2017, this has changed. For 2016 (due in 2017) and subsequent FBAR reports, the FBAR's due date will be consistent with the US Federal Income Tax Return due date, which is generally 15 April of the next year, with an automatic extension to 15 October. No specific request for an extension is required as yet for the FBAR. Therefore, for the 2016 fiscal year, the FBAR is due on 18 April 2017 because 15-17 April lands on a weekend and a holiday. Although the change is not significant in substance, it does provide some procedural relief for taxpayers. It is also important because while a formal extension is not required this year, there could be one in the future.

Amnesty Programmes

Although it is not explicit, it is obvious that one of the primary purposes of FATCA is to scare taxpayers into compliance, and it is proving to be very effective in this regard. Many taxpayers are going through various amnesty programmes or choosing other methods to come forward. Each programme potentially carries some penalty and risk, which varies depending on the facts and culpability. For some taxpayers, it is an easy choice; for others, the choices do not seem like choices at all. We will briefly highlight the different options for taxpayers and then review how tax treatment is adapting as new facts and circumstances arise concerning taxpayers.

Offshore Voluntary Disclosure Program (OVDP)

This term generally refers to the full-scale disclosure programme. Taxpayers entering the OVDP must file eight years of returns and FBARs, provide substantial information related to offshore accounts and assets, and pay a penalty of 27.5 per cent on undisclosed assets generating revenue. In past years, it seemed that complete sets of information along with a check for taxes, interest, and penalties was sufficient to avoid a detailed review; however, recent submissions have had more thorough reviews, including a second wall of technical reviewers. Items under more scrutiny include proper inclusion of assets in the penalty calculations, valuations of businesses and properties, and determination of taxable income. Increased scrutiny is not a problem on the face of it given that everyone should be aware that when they submit to the OVDP they are subject to a full review. The problem is with the potential unexpected changes: For example, if a taxpayer suddenly learns that the IRS has made changes and the penalty is now higher than originally calculated, the taxpayer may not be prepared for such a payment, may not have the resources for such a payment, or possibly may not have entered the programme with this information. With nothing more than a set of FAQs to rely on for guidance, it is difficult for tax professionals guiding these taxpayers to be prepared for all possibilities. The worst part is that the OVDP is not an audit with appeal rights and a backstop of a Tax Court. If a taxpayer disagrees with a determination, the only option is to opt out (i.e. quit the programme) and venture into the unknown territory of an audit.

The programme also has a penalty increase from 27.5 to 50 per cent if the non-compliance involves a blacklist of financial institutions. This list has grown substantially with time and now includes many individuals and not just financial institutions. The IRS is clearly casting a wider net in an attempt to levy a harsher punishment on the more blatant offenders. As the IRS continues to work with banks and individuals to collect information, it should be assumed that this list will continue to increase, making it imperative for taxpayers considering the OVDP to act quickly.

One of the more interesting developments during 2016 was a voluntary disclosure submission that was rejected and turned into a Tax Court case. In the case of *United States v. August Bohanec*, the taxpayers' voluntary disclosure submission was denied and they were handed a 50 per cent penalty for wilful violations. The most likely reason for the OVDP rejection was that the taxpayers had made misrepresentations, under penalty of perjury, regarding their submission, which proved to be untrue as they had omitted information. This case shows that the IRS is not just simply accepting any submissions. Submissions must be accurate and complete. The penalty for an incomplete or inaccurate submission can be severe.

Streamlined Program

Taxpayers who can certify that the reporting violations were non-wilful have the option to use the Streamlined Program. Under this programme, penalties are greatly decreased, to zero in some cases, and only three years of returns and six years of FBARs must be filed. The most important filing with this option is the certification which details the facts and circumstances under which the taxpayer became non-compliant. Many people were under the impression that with the IRS facing a work overload, these certifications may not get a thorough exam. However, this is not the case. With the incentive of less reporting and lower penalties, the IRS is aware that taxpayers may choose this option even when their errors were not due to a non-wilful mistake. As such, the IRS is reviewing these statements with greater scrutiny to ensure that submissions into this programme are appropriate. Additionally, the IRS is now requesting more information on the tax professionals who were involved in the non-compliance. It is unknown if the IRS is planning to pursue these tax professionals, but one can assume that at the very least they are looking for repeat offenders. Also, the IRS has yet to bring forward a case where it penalises a taxpayer attempting to fraudulently enter the programme. This makes it very possible that they are looking for the test case to make an example of an invalid submission. Lastly, the information regarding international reporting is widespread at this point. The likelihood that the IRS will accept that a taxpayer had no knowledge of their reporting requirements is quickly diminishing. This means taxpayers need to be more cautious than ever before entering the Streamlined Program. It is essential that taxpayers have very good facts and can substantiate that their non-compliance is a true, non-wilful mistake.

Late Filing Procedures

There are a few programmes where taxpayers can simply file late forms with no penalties or additional reporting needed. For bank accounts that earn no income it is straightforward. However, for other reports, such as reporting foreign controlled corporations, the filing must contain a reasonable cause statement. It is this option that is a bit confusing. Prior to the OVDP, taxpayers always had the option to file reports late and not pay any penalties if they had an accepted reasonable cause statement to show why they were not at fault. It is not clear why the IRS chose to restate this option as part of the OVDP. The problem is that many believe it has created an unspoken belief among some IRS auditors and employees that this must be a different standard. The fear is that it could result in a higher standard to meet reasonable cause than before, both inside and outside the programme. The IRS may have had good intentions by explaining this option under the programme, but it appears it has caused more confusion among taxpayers and even among some of its own employees.

Other Options

Although it was never a real option to do nothing, this is truer now than ever before. The information from FATCA is already moving, the world is changing to more open reporting, and the IRS has safeguards in place to try to catch taxpayers attempting to circumvent the system. For some taxpayers, the path and programme for becoming compliant is clear given their specific facts, but for others, none of the options are a perfect fit. The good news is that at this point in the FATCA/OVDP lifecycle, more and more people are coming forward with unique facts and circumstances that don't quite fit any typical taxpayer model. This is causing the IRS to change and/or institute new policies and creating opportunities for strategic planning to become compliant while minimising risk and exposure. Nevertheless, a changing landscape can also add to the fear and anxiety of taxpayers. For now, one thing is clear: if you are not compliant on international tax filings and reporting, now is the time to be discussing a course of action with your tax professional. T