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How Will They Catch Me? Let Me Count the Ways (Part One)

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How will they catch me? This question frequently comes up when counseling U.S. citizens living abroad who have neglected to become or remain U.S. tax compliant. It is a fair question based upon the taxpayer's experience. In almost every instance the client does not know anyone who has ever been prosecuted for failing to file a U.S. tax return; nor does the client know anyone who has ever been contacted by the Internal Revenue Service regarding an unfiled tax return. In fact, in most circumstances the only person the client knows who ever paid a tax to the United States was someone who "foolishly" participated in one of the rounds of voluntary disclosure programs the IRS has proffered to non-compliant taxpayers since 2009.¹ Lack of enforcement has contributed to a false sense of security among U.S. citizens living abroad that they are immune to prosecution and/or collection of unpaid tax obligations owed to the United States.

Part One of this article briefly summarizes the information sources from which the IRS may identify non-compliant U.S. citizens living abroad and their foreign accounts and assets.

Part Two will review in slightly greater detail the collection alternatives available to the U.S. govern-

¹ See generally Robert E. Ward, *2012 Offshore Voluntary Disclosure Program: Issues and Opportunities*, 41 Tax Mgmt. Int'l J. 548 (Oct. 12, 2012) and *Offshore Voluntary Disclosure Program Round Four: IRS Announces Further Changes to Encourage Better Compliance*, 43 Tax Mgmt. Int'l J. 604 (Oct. 10, 2014).

ment to recover delinquent taxes, interest, and penalties from its non-resident citizens.²

TIEAs

For decades information regarding non-resident citizens has been available to the United States through its system of international agreements.³ The United States has had a multilateral Tax Information Exchange Agreement in effect since January 4, 1995, with the OECD/Council of Europe and currently has bilateral TIEAs with at least 31 countries, as well as agreements under negotiation with Belize, El Salvador, Nicaragua, and Singapore.⁴ In addition, many of the tax treaties into which the United States has entered with other countries contain provisions for the exchange of information between the contracting states.⁵

FATCA

More recently, pursuant to its implementation of the Foreign Account Tax Compliance Act, the United States has entered into intergovernmental agreements ("IGAs") through which foreign financial institutions either directly or indirectly provide information regarding the foreign financial accounts of U.S. citizens. The first IGA the U.S. entered into was with Spain in December 2013. Currently there are IGAs in force with at least 66 other countries, including The Holy See, and many more IGAs in effect awaiting final ac-

² A collection alternative not discussed are prevent departure orders as they apply only to non-citizens. See generally IRM 5.21.3.4 (01-07-2016).

³ See generally IRM 4.60.1.1 (09-19-2014).

⁴ See "Current Status of U.S. Tax Treaties International Tax Agreements," Part III, appearing in this issue.

⁵ See, e.g., Article XXVII of the Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital ("Canada-U.S. Tax Treaty").

tion or not yet signed but treated as in effect.⁶ Starting March 31, 2015, the United States began receiving information from its Model 2 IGA partners and non-IGA jurisdictions. Foreign financial institutions in Model 1 IGA jurisdictions began reporting September 30, 2015.

Information Returns and Voluntary Disclosures

More targeted information regarding foreign assets and accounts is available to the U.S. government through individual taxpayer reporting of equity interests in foreign corporations (Form 5471), interests in foreign partnerships (Form 8865), interests as settlors or beneficiaries of foreign trusts (Forms 3520 and 3520A), equity interests in passive foreign investment companies (Form 8621), and ownership of foreign financial accounts (Form 8938 and FinCEN Report 114). Information about the institutions and entities through which foreign accounts and assets are held has also been provided to the IRS through various iterations of the Offshore Voluntary Disclosure Program since 2009. While the information provided through information returns and voluntary disclosures concerns compliant taxpayers, the IRS has used that information to identify foreign financial institutions used as depositories by its citizens.

Information from You

Upon identifying a delinquent taxpayer and the financial institutions at which that taxpayer has funds on deposit, the IRS can issue an information document request to the taxpayer for bank records or other information regarding the taxpayer's foreign assets. Section 982(a) allows the Secretary of the Treasury to make a "formal document request" to obtain "foreign-based" documentation which is not forthcoming in response to customary procedures for the production of documents.⁷ Failure to substantially comply with a formal document request allows the Secretary of the Treasury to seek a motion to bar the delinquent taxpayer from using the requested documents in any civil proceeding addressing the tax treatment of disputed items to which the documents relate.

Summons and Subpoena Powers

U.S. courts have broad summons and subpoena powers which can be invoked to gather information regarding foreign taxpayers and their assets for purposes of tax enforcement. The Secretary of the Treasury has broad authority to examine any documents or data relevant or material for purposes of "ascertain-

ing the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect to any internal revenue tax, or collecting any such liability. . . ."⁸ In addition, pursuant to the authority granted to the Secretary under §7602, taxpayers may be summoned to testify or produce documents and data for such purposes. The IRS and the Department of Justice have used their summons and subpoena powers to demand production of foreign bank account records.

Although the Fifth Amendment protects against self-incrimination, the required records doctrine allows a court to compel production of records. The Supreme Court has held that in order for the required records exception to apply three tests must be met: "first, the purposes of the United States' inquiry must be essentially regulatory; second, information is to be obtained by requiring the preservation of records of a kind which the regulated party has customarily kept; and third, the records themselves must have assumed 'public aspects' which render them at least analogous to public documents."⁹ The required records exception was used in *United States v. Chabot* to compel production of foreign bank account records required to be maintained under the Bank Secrecy Act.¹⁰

Summons and subpoena powers can also be exercised to obtain account information from the foreign financial institutions at which non-resident taxpayers bank. Records related to correspondent accounts including those maintained outside the United States can be subpoenaed under 31 U.S.C. §5318(k)(3) by service on the U.S. bank that maintains the correspondent account for the taxpayer's foreign bank. Using "Bank of Nova Scotia" summonses, the IRS is able to obtain court orders compelling domestic branches of foreign banks to produce records located in the financial institution's home country.¹¹

In contrast to taxpayer-specific summonses, the IRS can also exercise its subpoena authority under §7609(c)(3) and §7609(f) to obtain a John Doe summons directed at an unidentified person or an ascertainable group or class of persons.¹² The IRS can obtain a John Doe summons only through a U.S. district court in an ex parte proceeding and must demonstrate that the summons relates to an investigation of a par-

⁸ §7602(a).

⁹ *Grosso v. United States*, 390 U.S. 62, 67–68, 88 S. Ct. 709, 19 L. Ed. 2d 906 (1968).

¹⁰ 793 F.3d 338 (3d Cir. 2015). See 31 C.F.R. §1010.420.

¹¹ *In re Grand Jury Proceedings Bank of Nova Scotia*, 740 F.2d 817 (11th Cir. 1984), cert. denied, 469 U.S. 1106 (1985); IRM 34.6.3.7 (02-01-2011).

¹² IRM 25.5.7.2(1) (02-18-2016).

ticular person or an ascertainable group or class of persons, there is a reasonable basis to believe that the subject of the summons may have failed to comply with the United States revenue laws, and the information sought to be obtained from the summoned records is “not readily available from other sources.”¹³

Information from Other Sources

Information obtained through the Justice Department’s Swiss Bank Program has provided “detailed information on an account-by-account basis for accounts in which U.S. taxpayers have a direct or indirect interest.”¹⁴ The information provided by the 78 banks in exchange for nonprosecution agreements included accounts closed after August 2008 and moved to other financial institutions.¹⁵ Further information is provided by the occasional whistleblower (for example, Bradley Birkenfeld/UBS) and data breaches (for example, Mossack Fonseca/Panama Papers). In the case of substantial tax violations by individuals or

¹³ IRM 25.5.7.5(2) (02-18-2016).

¹⁴ www.justice.gov/tax/swiss-bank-program (02-06-2017).
Laura Saunders, *U.S. Mining Swiss Bank Data to Find Tax Cheats*, Wall St. J. (June 30, 2016).

¹⁵ Jeremy H. Temkin, *Accessing Records with Bank of Nova Scotia Summons*, 255 New York L. J., No. 97 (May 20, 2016).

companies, the United States has working arrangements for the conduct of simultaneous Criminal Investigation Programs with Canada, Italy, France, Mexico, and South Korea.¹⁶

Collection

U.S. citizens living abroad may believe they are immune from collection if none of their assets are in the United States. This belief is misplaced. Using the summons and subpoena power referred to above, account information of non-resident taxpayers can be obtained by the IRS and Department of Justice if those accounts are maintained at foreign financial institutions with U.S. branches or correspondent accounts at U.S. banks. In the case of non-resident taxpayers who do not have U.S. assets, IRS personnel are specifically instructed not to close their accounts as unable to locate (UTL(3)) or unable to collect (UTC(12)) if their foreign address is known and there are indications of assets outside the United States that suggest the taxpayer has the ability to fully or partially pay tax obligations.¹⁷

Specific collection alternatives will be the subject of the second part of this article.

¹⁶ IRM 9.4.2.6.3 (03-09-2012).

¹⁷ IRM 5.16.1.2.10(1) (08-25-2014).