

# GAO Report Demonstrates That the United States Must Reform Foreign Asset Reporting

by Bruce Zagaris



Bruce Zagaris

Bruce Zagaris is a partner with Berliner Corcoran & Rowe LLP in Washington and a former lecturer with the University of the West Indies Faculty of Law.

In this article, the author discusses a recently released report by the U.S. Government Accountability Office about foreign asset reporting and the impact that an overlapping set of regimes has on U.S. taxpayers living and working abroad.

On April 1 the U.S. Government Accountability Office presented a report to House and Senate committees demonstrating the need for the government to take action — long overdue — on foreign asset reporting. The report is titled “Foreign Asset Reporting: Actions Needed to Enhance Compliance Efforts, Eliminate Overlapping Requirements, and Mitigate Burdens on U.S. Persons Abroad” (GAO-19-180). This article examines the report and the response (or lack thereof) to its recommendations, discussing the report’s implications and some of its notable omissions, such as issues regarding the interplay between the U.S. Foreign Account Tax Compliance Act and the OECD’s common reporting standard (CRS).

## I. The Overlap Between FATCA and CRS

The GAO report makes a material omission in its failure to fully explore the U.S. government’s commitment to join the CRS — and the important policy implications its failure to execute this commitment.

## A. Background: FATCA, CRS, and Reciprocity

In 2010, as part of the Hiring Incentives to Restore Employment Act, Congress enacted FATCA, which requires both individuals and foreign financial institutions (FFIs) to identify and report on some overseas accounts held by U.S. taxpayers. Initially, many governments responded by informing the executive branch of the U.S. government that FATCA violated their fundamental laws and constitutions. On July 26, 2012, after many weeks of such objections from foreign governments, Treasury announced that, along with France, Germany, Italy, Spain, and the United Kingdom (often called the EU 5), it had developed a model agreement to implement FATCA.

A principal reason the EU 5 supported FATCA was the United States’ promise to work toward harmonizing the standards so that governments and the private sector did not have to work with two overlapping regimes. On July 15, 2014, the OECD Council approved the CRS, the universal standard for automatic exchange of information. To facilitate effective and efficient FATCA implementation by FFIs operating in jurisdictions with laws that would otherwise forbid them to comply with its terms, Treasury developed two alternative intergovernmental agreements: model 1 and model 2. The model agreements seek to remove the legal impediments to complying with FATCA reporting requirements and minimize the burdens on FFIs in partner jurisdictions.

Because the EU 5 supported the FATCA initiative to develop one standard for automatic exchange of information, the U.S. government inserted the following in article 5 of the model 1 agreement and similar text in the model 2 agreement:

3. Development of Common Reporting and Exchange Model. The Parties are committed to working with other partners and the Organisation for Economic Co-operation and Development, [and the European Union,] on adapting the terms of this Agreement to a common model for automatic exchange of information, including the development of reporting and due diligence standards for financial institutions. [Footnote omitted.]

The U.S. and EU 5 agreed to insert the text in the FATCA IGAs.

Perhaps some officials and pundits may argue that this agreement is very broad or point out that it does not commit the United States to any timetable. However, the fact that 102 countries participate in the CRS — and have invested significant sums of money to implement it — demonstrates the importance of this commitment. Also, more than six years after drafting the model agreement, the United States has exerted and continues to exert enormous pressure on FFIs and signatories to implement FATCA. Yet the United States has failed to take any steps whatsoever to join the CRS, and neither the executive nor the legislative branch has taken the initiative to make the necessary changes to U.S. law to enable it do so. The government's failure to act shows utter disregard for its commitment and for the resources and energy that foreign tax authorities have devoted to implementing FATCA with the good-faith understanding that the U.S. government would be a real partner in developing a single, unified automatic exchange of information system.

A key omission from the GAO report is its failure to discuss the lack of reciprocity by the United States in exchanging information in accordance with the FATCA IGAs, despite the pressure that the United States placed on its allies to change their laws and regulations, even urging other jurisdictions to purchase and obtain special software to be able to transmit FATCA information quickly and confidentially. In the model 1 IGA, the United States even admits its inability to reciprocate:

Article 6

Mutual Commitment to Continue to Enhance the Effectiveness of Information Exchange and Transparency

1. *Reciprocity*. The [Government of the] United States acknowledges the need to achieve equivalent levels of reciprocal automatic information exchange with [FATCA Partner]. The [Government of the] United States is committed to further improve transparency and enhance the exchange relationship with [FATCA Partner] by pursuing the adoption of regulations and advocating and supporting relevant legislation to achieve such equivalent levels of reciprocal automatic exchange.

One result of the United States' refusal to take steps to join the CRS is that wealth structures, intermediaries, and trust companies have moved to the United States based, at least in part, on a desire to insulate themselves from the CRS reporting requirements.<sup>1</sup> The fact that the United States has not ratified the 2010 protocol to the Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters is an additional indication that, by locating in the United States, these structures are less likely to be subject to international evidence-gathering. The failure of the United States to join the 2010 protocol also prevents it from being able to call on other signatories for their increased assistance in such areas as tax collection.

## B. The OECD's 2018 Peer Review

On July 16, 2018, examining adherence to the protocol and compliance with international standards on the exchange of information more generally, the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes issued a report titled "United States 2018 (Second Round): Peer Review Report on the Exchange of Information on Request." This updated the first-round report from 2011 and downgraded U.S. ratings in four areas.<sup>2</sup> It has been 10 months since the forum's report, and still

<sup>1</sup> See, e.g., "The Biggest Loophole of All," *The Economist*, Feb. 20, 2016 (discussing the large movement of wealth to the United States because it does not meet international tax transparency and entity transparency standards).

<sup>2</sup> See Stephanie Soong Johnston, "U.S. Must Step Up Action on Beneficial Ownership, OECD Says," *Tax Notes Int'l*, July 23, 2018, p. 424. See also Bruce Zagaris, "International Tax Enforcement Cooperation in the Trump Administration," *Tax Notes Int'l*, Sept. 3, 2018, p. 1013.

the U.S. government has taken no initiative to ratify its signed information exchange agreements or otherwise address the concerns raised in the report.

### 1. Exchange of Information

The first area in which the OECD downgraded its rating of the United States is the presence of mechanisms for effective exchange of information on request. The OECD changed its rating from compliant to largely compliant, citing the United States' inability to ratify any exchange of information agreements since 2010, including the 2010 protocol and the U.S.-Vietnam tax treaty. The report notes that the United States can enter into a tax information exchange agreement as an executive agreement — that is, without the need for a domestic ratification process — and yet still does not have an information exchange agreement in force with 38 of its 129 information exchange partners. The OECD recommended that the United States quickly ratify those signed agreements to ensure that the relationships are in force and take steps to ensure that it effectively executes those arrangements that are already in force.

Because the CRS and FATCA provide automatic exchange of information to supplement exchange on request, the downgrading of the U.S. on exchange on request, simultaneous with the U.S. failure to join the CRS, makes the U.S. an outlier as a whole regarding exchange of information.

The OECD similarly downgraded the United States from compliant to largely compliant regarding the timeliness and quality of its responses to exchange of information requests. The OECD and EU have stepped up their efforts to strengthen implementation of and compliance with this particular standard after the inception of the CRS. According to the evaluation, the proportion of tax information requests that the United States responded to within 90 days fell from 51 percent at the time of the first review to 30 percent for the second. Since then, the U.S. government experienced its longest shutdown in history — from midnight December 22, 2018, until January 25, 2019 — no doubt exacerbating Treasury's ability to respond to foreign requests.

The importance of the U.S. government's failure to fulfill its commitment to work toward

the CRS is underscored by a warning: The EU will include the United States on a tax haven blacklist unless — by June 2019 — it agrees to exchange the bank account details of non-U.S. citizens with governments around the world. Valère Moutarlier, the EU's head of direct taxation, mentioned this deadline to a new European Parliament tax investigative committee on May 15, 2018.<sup>3</sup>

A new problem that may lead to regulatory and enforcement initiatives against U.S. professionals arose on December 11, 2017, when the OECD issued mandatory disclosure rules to combat the use of offshore structures and the avoidance of the CRS. Another potential risk arose on February 19, 2018, when the OECD issued a consultation document on preventing abuse of citizenship- and residence-by-investment schemes.

Because the U.S. cannot exchange information under the CRS, taxpayers and other persons covered by the mandatory disclosure rules will need to file such disclosures in most cases when they have structures in the U.S. since those structures will meet the hallmarks triggering disclosure.

### 2. Entity Transparency and Gatekeeper Regs

Another reason for the movement of wealth and financial intermediaries to the United States is that it lags far behind the rest of the world in meeting international standards on entity transparency, beneficial ownership, and regulation of gatekeepers. The gap between U.S. and international standards means high-net-worth individuals can shift money into the United States to obtain confidentiality and avoid disclosure of beneficial ownership to their own tax authorities.

Availability of ownership and identity information is the third area in which the OECD downgraded the United States, this time from largely compliant to partially compliant. The evaluation does note that the OECD broadened the requirements for beneficial ownership in its 2016 terms of reference. The OECD evaluation observes that, as of December 31, 2016, single-

<sup>3</sup> Joe Kirwin, "U.S. on Course to Land on European Tax Blacklist: EU Official," *Bloomberg* (May 15, 2018).



member limited liability companies must register with the IRS, report their legal owners, and keep appropriate records. However, even when entities must maintain beneficial ownership information, the United States lacks appropriate procedures to ensure the information is adequate, accurate, and up-to-date. To cite another example, the OECD standard requires that companies maintain ownership information for five years, but U.S. tax law requires that information be kept only three years, and not all states enforce a five-year requirement. Thus, the OECD recommends that the United States strengthen its retention requirements.

Yet the GAO report is silent on the gap between U.S. and international standards for record retention.

The OECD report identifies gaps in U.S. laws regarding obtaining and maintaining beneficial ownership information, as well as in the implementation of those laws that do exist. The evaluation directs the United States to report on the steps it is taking to address the recommendations by June 30, 2019, and continue to inform the global forum thereafter in accordance with the procedures that the OECD identified in the 2016 terms of reference. Though the deadline draws near, neither the U.S. executive nor legislative branch has taken serious action.

There are some favorable prospects in the House of Representatives. On March 8, Rep. Maxine Waters, D-Calif., introduced H.R. 206, the Encouraging Small Business Innovation Act. It does the following:

- (1) acknowledges that the lack of sunlight and transparency in financial transactions poses a threat to our national security and our economy's security;
- (2) supports efforts to close loopholes that allow corruption, terrorism, and money laundering to infiltrate our country's financial system;
- (3) encourages transparency to detect, deter, and interdict individuals, entities, and networks engaged in money laundering and other financial crimes;
- (4) urges financial institutions to comply with the Bank Secrecy Act and anti-money laundering laws and regulations; and
- (5) affirms that

financial institutions and individuals should be held accountable for money laundering and terror financing crimes and violations.

Although H.R. 206 is only hortatory and does not require any action, the House passed the resolution March 13.

Also in March, the House Financial Services Committee unveiled the Corporate Transparency Act of 2019, which seeks to ensure that "persons who form corporations or limited liability companies in the United States disclose the beneficial owners." While it would have broad application, the bill does not include in the definition of "formation agents" — those who assist in creating legal entities — in the definition of financial institutions subject to the Bank Secrecy Act of 1970. A 2017 version would have taken that step. Nevertheless, passage of the bill would be a step toward strengthening entity transparency.

Looking at the beneficial ownership information that companies (including LLCs) and partnerships file when they register with the IRS, the OECD evaluation observes that taxpayers do not need to identify all beneficial owners to meet the IRS standard. When they initially register, partnerships and LLCs must file Form SS-4 and identify the entity's responsible party. However, the definition of "responsible party" does not capture all individuals who exercise control using different mechanisms: The person identified as the responsible party may not ultimately have effective ownership or control. The report recommends that the United States take further measures to ensure — in line with international standards — that all beneficial owners of all relevant entities and arrangements are identified. To date, the U.S. legislative and executive branches have not taken action on the recommendation.

Yet the GAO report omits any mention of this gap in requiring information of the persons exercising control.

Through a combination of state law, federal law, and common law obligations, the United States requires the identification of the settlor, trustee, beneficiary, and any person who exercises control over a trust. However, those obligations do not extend to identifying all beneficial owners

of a trust as is required under the OECD standards, which also require identifying any natural persons who exercise ultimate effective control over the trust through a chain of entities or arrangements.

The OECD evaluation also observed that the IRS had made inadequate efforts to ensure that beneficial ownership information is accurate and current. Although the evaluation suggests the United States strengthen its measures, the IRS has not prioritized this task. As Congress continues to decrease the resources of the IRS, the IRS is hard-pressed to devote resources to this recommendation.

Notwithstanding the growing gap between the OECD beneficial ownership standards and those in the EU fifth money laundering directive, which requires obtaining beneficial ownership information of trusts, the GAO report is silent about this gap.

Further, the OECD evaluation suggests that the United States should monitor the implementation of the relatively recent requirement that single-member, foreign-owned LLCs report and maintain ownership information that includes persons who were previously not required to register. Similarly, the evaluation recommends that the United States monitor the accounting information that foreign-owned LLCs maintain to ensure accounting records and underlying documentation are available.

Again, the GAO report omits any mention of the two OECD suggestion and recommendation on monitoring the implementation of the LLCs report and ensuring accounting records and underlying documentation are available with respect to the LLCs. A problem has been that the criminals use single-member LLCs to commit crimes. When foreign law enforcement authorities request help from the U.S., the U.S. responds that such information does not exist and hence it cannot help.

Finally, the OECD downgraded the United States from compliant to largely compliant regarding the availability of banking information. While U.S. rules require that banks identify a trustee whose account is opened in the name of the trust, the evaluation says this fails to ensure that banks will identify all beneficial owners of trusts. For example, beneficial ownership

information might not be available for existing accounts if the account holders' identities have not been updated. The evaluation recommends that the United States, in line with the OECD standard, require banks to identify all the beneficial owners of trusts who have accounts with U.S. banks. Treasury did not go as far as the OECD wanted it to when it promulgated final customer due diligence regulations (31 C.F.R. sections 1010, 1020, 1023, 1024, and 1026) on May 11, 2016.

U.S. law does not require the identification of all beneficial owners of account holders that are trusts (or other arrangements considered to be trusts). Covered financial institutions must verify the identity of the trustee (or person considered the trustee), but they are not required to verify the identity of settlors, protectors, beneficiaries, classes of beneficiaries, or other trustees or natural persons who exercise control over the trust property. Also, the terms of a particular trust can override a bank's disclosure obligations. The OECD evaluation recommends that the United States monitor the customer due diligence rules that took effect July 11, 2016.

In spite of the gap in the availability of bank information regarding beneficial owners of trusts who have accounts with U.S. banks, the GAO report is silent on that point.

### C. The GAO Report and the Future of FATCA

In its recent report, the GAO observes that while better aligning FATCA and CRS is possible to some extent, anything short of the United States' fully adopting CRS in lieu of FATCA would fail to fully eliminate the burden of overlapping requirements that FFIs must meet under the two systems. However, such a shift would not result in any additional benefits for the IRS in its efforts to obtain information on U.S. accounts. Further, the change could generate additional costs and reporting burdens for U.S. financial institutions that would need to implement new systems to meet CRS requirements. The extent of these costs is unknown.

Further, the adoption of CRS would create situations in which foreign accounts held by U.S. citizens who are tax resident in a partner jurisdiction — including citizens who have U.S.

tax obligations — would not be reported to the IRS.

Viewing the decision of whether to meet its commitment to work toward a uniform automatic exchange of information mechanism solely based on the impact on U.S. revenue does not properly take into consideration the resources other countries have invested to comply with FATCA, nor the commitment of scarce legislative and regulatory resources that would be necessary to enact new legislation and promulgate regulations. Foreign governments had to review 500 pages of technical FATCA law and regulations before they could even start on legislation.

## II. Overlapping and Burdensome Duties

The GAO notes that the IRS's efforts to match forms 8938, "Statement of Specified Foreign Financial Assets," and 8966, "FATCA Report" — that is, to link account information collected from FFIs to the account owner — have often been impeded by incorrect or missing taxpayer identification numbers. In July 2018 the Treasury Inspector General for Tax Administration reported that almost half of new forms 8966 filed by FFIs did not include a TIN or included an invalid TIN.<sup>4</sup>

The IRS is waiting until 2020 before it tries to strengthen its efforts to enforce compliance with FATCA reporting requirements.

The GAO reports that some U.S. taxpayers appear to file Form 8938 when they don't have to, noting that these taxpayers reported specified foreign financial assets with aggregate values at or below the relevant reporting thresholds as of the last day of the tax year. In 2016 there were approximately 61,900 such filings from U.S. persons living in the United States and about 11,600 filings from U.S. persons living abroad.

Based on focus groups and other interviews, the GAO report identified several possible reasons for these unnecessary filings. Confusion headed the list, regarding both the IRS's instructions for completing Form 8938 and the information on the IRS website. Taxpayers also were confused about whether and how to report

information regarding investment and retirement accounts, as well as compulsory savings plans managed by their country of residence.

IRS officials told the GAO that they have not tried to determine whether a pattern of unnecessary Form 8938 filings exists that they could address. Instead, officials suggested that resources should be devoted to FATCA implementation generally, notwithstanding that the GAO identified tens of thousands of cases in which U.S. persons may have unnecessarily filed forms 8938. The GAO said the IRS is missing opportunities to help taxpayers understand their reporting and filing obligations and minimize their compliance burdens while still meeting their tax obligations. Moreover, the IRS may be missing opportunities to save the government the expense of processing forms that taxpayers did not need to file.

The GAO report lists five categories in which the Form 8938 and Treasury's Financial Crimes Enforcement Network Form 114, "Report of Foreign Bank and Financial Accounts," overlap. The duplicative reporting of foreign financial asset data on two different forms also adds costs for Treasury and IRS because they must process and store the same or similar information twice, and they need to enforce compliance with both requirements.

What the GAO report does not mention is that, since enacting FATCA, Congress has continued to reduce the IRS's budget. Starting in 2011 — one year after the enactment of FATCA — budget cuts have slashed the IRS's enforcement staff by a third, and the audit rate has fallen even more. The rate at which the IRS audits tax returns has plunged by 42 percent since the budget cuts started. Criminal referrals have fallen from 589 in 2012 to 328 in 2016. With the government conducting about 1.2 million audits in 2016, that amounts to one criminal referral for roughly every 3,600 audits. According to interviews with current and former IRS officials, the quality of the referrals is also down.<sup>5</sup> The enactment of FATCA created a lot more work for the IRS at a time when the enforcement officials were already struggling to manage the offshore voluntary disclosure

<sup>4</sup>TIGTA, "Despite Spending Nearly \$380 Million, the Internal Revenue Service Is Still Not Prepared to Enforce Compliance With the Foreign Account Tax Compliance Act," 2018-30-040 (July 5, 2018).

<sup>5</sup>Jessie Eisenger and Paul Kiel, "After Budget Cuts, the IRS Work Against Tax Cheats Is Facing Collapse," *ProPublica* (Oct. 1, 2018).



program. Simply put: The IRS has not had the resources to effectively manage Form 8938, and Congress has not been willing to reform the law to eliminate duplicative, burdensome, and confusing new mandates for taxpayers.

Penalties for failing to report specified accounts on one or both forms can be significant — even if the taxpayer owes little or no taxes on the relevant accounts. Taxpayers often hire counsel and taxpayers' blood pressure rises as stress builds.

In 2012 the GAO recommended that Treasury direct the Office of Tax Policy, IRS, and FinCEN to determine whether the benefits of implementing a less duplicative reporting process would exceed the costs, and if so, to begin that process. Treasury did not implement these recommendations.

The government should implement the GAO's (reiterated) recommendations and harmonize the Form 8938 and FBAR statutes, so that the regimes are fully consistent. This would benefit both the IRS and the law enforcement community. For instance, a taxpayer must report financial assets such as foreign hedge funds or foreign private equity funds on Form 8938, but need not do so on an FBAR. In contrast, the taxpayer must report other specified foreign financial assets such as indirect interests in foreign financial assets through an entity on an FBAR, but not on 8938. Congress should revise the legislation to address the overlaps and conflicts so that the IRS and FinCEN can coordinate efforts to collect and use foreign financial asset information, which would also reduce the duplicative reporting burdens on U.S. persons.

### III. U.S. Taxpayers' Lost Opportunities

As the GAO report explains, U.S. taxpayers living abroad risk losing access to foreign financial services and may experience difficulties opening bank accounts with FFIs after the enactment of FATCA. Some FFIs have closed U.S. persons' accounts or denied them the opportunity to open new accounts. The disproportionate costs that FFIs incur to implement FATCA are a significant issue that, in turn, creates increasing obstacles for U.S. persons looking to access foreign financial services. One advocacy group told GAO investigators that some FFIs have found that it is less burdensome to close U.S. persons'

accounts or require that the account holders move their accounts to an SEC-registered affiliate than it is to comply with FATCA. Believing that they stand to gain only a small margin of profit from U.S. persons, some FFIs have apparently considered charging them additional fees for access to financial services to cover FATCA implementation costs. According to the GAO's interviews with banking associations, some FFIs engage in a multifactor determination of risk, which might include the value of a client's assets or the country where the potential client resides or possesses citizenship. In some cases, an FFI may choose to do business with a U.S. person only if the potential account involves more than \$500,000 in assets. In other cases, FFIs simply decline to do business with U.S. persons because of concern about potential penalties for failure to comply — either willfully or inadvertently — with FATCA reporting requirements. Notably, other factors such as language barriers and concerns about U.S. anti-money-laundering laws and regulations may also contribute to U.S. persons finding that they have limited access to brokerage accounts overseas.

The GAO report also found that foreign-owned companies and nonprofit organizations are reluctant to hire or promote U.S. individuals because they do not want to expose to the U.S. government information about their organizations' accounts or client trust accounts for which the U.S. person would have signature authority. A U.S. person must include such foreign financial accounts on Form 8938 if the individual has a financial interest in the account. Thus, U.S. individuals are more limited in the opportunities they have to serve on corporate boards, participate in nonprofit organizations, and maintain business relationships more generally. FATCA implementation has been partly responsible for dissuading foreign-owned corporations in some Asian countries from considering U.S. persons for corporate leadership positions such as directorships. FATCA has created additional paperwork burdens and operating costs for organizations onboarding U.S. employees because the organizations must help them meet Form 8938 reporting requirements. Two advocacy groups that represent U.S. persons living abroad told the GAO that it is also more

difficult for U.S.-based companies to pay to relocate U.S. persons overseas because they must help their employees meet Form 8938 reporting requirements while also fulfilling other tax filing requirements.

#### IV. FATCA and Expatriations

The GAO report cites State Department data showing that the number of requests approved for renunciation of U.S. citizenship increased almost 178 percent over a six-year period after FATCA was enacted. They rose from 1,601 in 2011 to 4,449 in 2016, the last year for which complete data on renunciations were available. U.S. embassy documents and information that focus group participants and interviewees provided to the GAO demonstrate that FATCA was the reason for — or at least a contributing factor in — some of these renunciations. In particular, the citizens cited reduced access to foreign financial services, fewer employment opportunities or limited promotion potential in foreign-owned companies, and the burden of meeting FATCA requirements.

#### V. Analysis

The GAO report illustrates that Congress should quickly amend the IRC, the Bank Secrecy Act of 1970, and other statutes to address the overlap in foreign financial asset reporting requirements for tax compliance purposes as well as the detection and prevention of financial crimes.

Although many of the recommendations the report makes to the IRS commissioner — such as crafting a comprehensive plan to manage the use of FATCA data in compliance efforts — are valid in normal times, the enormously underresourced IRS may properly believe that its limited resources are better used elsewhere.

While not discussed in the GAO report, another continuing burden on U.S. persons abroad is the extraterritorial reach of U.S. sanctions, especially secondary sanctions. For example, U.S. sanctions against Myanmar not only prohibit U.S. persons from investing directly, but also prevent them from approving, financing, facilitating, or guaranteeing a transaction by a foreign person in Myanmar if the transaction would be prohibited if performed by a U.S.

person or within the United States.<sup>6</sup> Because of these sanctions, foreign subsidiaries of U.S. companies exclude U.S. nationals from corporate boards so that the U.S. parent can show it does not have control of the foreign subsidiary and should not be held responsible for sanctions violations. Also, foreign companies are concerned that U.S. nationals might act against the companies' best interests so that they can comply with U.S. sanctions. The inability to hire or promote U.S. nationals hurts U.S. companies' ability to compete abroad.

The growing gap between U.S. law and international tax transparency, gatekeeper regulation, and entity transparency standards — especially amid the U.S. executive branch's apparent indifference to the emoluments clause, the downgrade in the U.S. standing on Transparency International's Corruption Perceptions Index,<sup>7</sup> ongoing threats of trade wars between the United States and other countries and the EU,<sup>8</sup> and the criticism of international organizations by President Trump himself — put the U.S. government and the private sector at risk of becoming the target of international action. The increasing volume of comments from civic organizations about these gaps,<sup>9</sup> along with the above-mentioned initiatives that the OECD (mandatory disclosures on CRS avoidance), EU (threats to blacklist the U.S. for not joining the CRS and its AML blacklist), and Joint Chiefs of Tax Enforcement (prioritizing the targeting of enablers) have undertaken on violations by enablers and taxpayers, increase the risk of enforcement actions against U.S. enablers.

The OECD has repeatedly shown willingness to act on the avoidance front. On May 5, 2017, it established a facility that enables interested people to report schemes that may be attempts to circumvent the CRS, thus helping to increase the CRS's effectiveness. On December 11, 2017, the

<sup>6</sup> See 31 C.F.R. section 537.305 (2008) (prohibiting the exportation or re-exportation of financial services).

<sup>7</sup> "US Drops Out of Global Corruption Index Top 20, Scores Four Points Lower Than 2017," Transparency International (Jan. 29, 2019).

<sup>8</sup> See, e.g., Ana Swanson, "U.S. Loads Tariff Gun in Its Duel With Europe," *The New York Times*, Apr. 10, 2019.

<sup>9</sup> See, e.g., *Undercover in New York*, Global Witness (Sept. 2016) (reporting on a 2016 undercover sting operation targeting the use of anonymous shell companies).



OECD issued a consultation document seeking input on mandatory disclosure rules. The draft rules target promoters and service providers who are materially involved in the design, marketing, or implementation of a CRS avoidance arrangement or offshore structure. The OECD's vision is to craft rules that would require intermediaries to disclose information about avoidance schemes to their local tax authorities. Further, the OECD issued a consultation document on February 19, 2018, targeting the misuse of residence-by-investment or citizenship-by-investment schemes to circumvent CRS. OECD member countries must enact laws and regulations to enforce OECD disclosure facilities.

One example of a law implementing the anti-CRS avoidance facility is the U.K.'s Criminal Finance Act that took effect in September 2017. The law only criminalizes acts by a legal entity like a company or partnership — not by an individual — wherever incorporated or organized. Hence, non-U.K. firms (including U.S. firms) can commit offenses, especially since the law has extraterritorial effect criminalizing both U.K. and foreign offenses. The law includes two new failure-to-prevent offenses: the failure to prevent facilitation of domestic tax evasion and the failure to prevent facilitation of foreign tax evasion.

A relevant body incorporated or located anywhere outside the United Kingdom can be liable for the U.K. offense if an associated person outside the United Kingdom has facilitated U.K. tax evasion. The nexus for a foreign criminal offense is narrower: The foreign offense can be committed if either the relevant entity is incorporated or situated in the United Kingdom or if an act facilitating the foreign tax evasion occurs in the United Kingdom. The U.K. link can be as small as passing money through a U.K. bank account.

The bill includes a “reasonable prevention procedures” defense:

If a relevant body can demonstrate that it has put in place a system of reasonable

prevention procedures that identifies and mitigates its tax evasion facilitation risks, then prosecution is unlikely as it will be able to raise a defense.

Another example of a new international regime that presents potential risks to U.S. professionals is Unexplained Wealth Orders (UWOs), which was also part of the Criminal Finances Act. UWOs permit U.K. enforcement authorities, including HM Revenue & Customs, to request orders to investigate the acquisition of specific property. UWOs were primarily designed to prevent tax evasion and money laundering in the United Kingdom. However, the orders can also apply to suspects residing outside the United Kingdom and to any properties located abroad. Before the UWOs were introduced, British law enforcement powers were limited, unless the person under suspicion was convicted in his or her country of origin. If authorities suspect that the sources of funds used to buy property was illegal, UWOs permit British authorities to request that the owners prove whether the source of funds to buy the property were legitimate. If the owners fail to provide sufficient and convincing information, the property can be seized through the Proceeds of Crime Act.<sup>10</sup> It is possible that U.S. gatekeepers could represent a person subject to a UWO, including the target or one of his associates, such as U.S. persons and the gatekeeper herself. The gatekeeper may be involved if she helped the owner to launder money and hence may be subject to a money laundering prosecution.

The GAO report illustrates how well-intentioned legislation to plug gaps can get carried away and adversely affect a large segment of Americans and U.S. companies. The problem is that putting Humpty Dumpty back together again is neither quick nor easy. ■

<sup>10</sup>“Unexplained Wealth Orders: UK to Enhance Extraterritorial Enforcement of Property,” De Brauw Blackstone Westbroek (Mar. 15, 2018).