Paradise Papers:
U.S. Citizens and Residents Required to Report on Offshore Assets

November 6, 2017

The German newspaper *Süddeutsche Zeitung* and the International Consortium of Investigative Journalists (ICIJ) followed up the release of the "Panama Papers" in 2016 with what they are referring to as the "Paradise Papers." The release contains information exposing details of the offshore holdings of at least 31,000 U.S. citizens, entities, or persons with U.S. addresses. Although the Panama Papers have yielded many grand jury subpoenas, no agency has brought a headline-grabbing case. ICIJ published a letter from the whistleblower behind the Panama Papers in June, 2016, stating that he was "willing to cooperate with law enforcement" and warning of leaks to come. The Paradise Papers likely represent the promised future leak. The U.S. Department of Justice (DOJ), the Southern District of New York, and others are likely attempting to mine the leaked documents and may consider granting immunity to the leaker in exchange for access to information. ***U.S. persons and companies with complex offshore holding structures, whether affected by the data breach at this time or not, could benefit immensely from having an objective review of their U.S. tax reporting positions.***

Any person or company who might be listed in the Paradise Papers must quickly determine whether they are confident in their U.S. tax reporting or face the consequences of the latest breach of confidential data. The Paradise Papers include approximately 13.4 million documents with a data volume of 1.4 terabytes. The most detailed of these documents are comprised in 6.8 million records obtained from the international law firm Appleby, whose headquarters are in Bermuda, which has provided advice for over a hundred years to high-net-worth investors doing business offshore. These documents also include those obtained from Estera which began the "fiduciary" arm of Appleby prior to a management buyout in 2016. The Appleby/Estera documents include loan agreements, financial statements, e-mails, trust deeds, and other documents going back almost 50 years. Also included in the Paradise Papers are documents from Singaporean company Asiaciti Trust and from company registries in 19 so-called "secrecy jurisdictions," ranging from simple corporate registries that do not disclose the names of company shareholders and directors, to complex corporate transaction sheets and dollar-by-dollar payment ledgers. The "secrecy jurisdictions" include Antigua and Barbuda, Aruba, the Bahamas, Barbados, Bermuda, the Cayman Islands, the Cook Islands, Dominica, Grenada, Labuan, Lebanon, Malta, the Marshall Islands, St Kitts and Nevis, St Lucia, St Vincent, Samoa, Trinidad and Tobago, and Vanuatu.

One must expect that the Internal Revenue Service (IRS) and the Department of Justice will mine these documents to investigate whether the persons or entities contained in the Paradise Papers have properly reported their offshore holdings to the U.S. government. A searchable database has not yet been released, but ICIJ has committed to releasing the structured data within the next few weeks. This creates an important window to assess one's exposure, as entry into certain IRS disclosure programs is predicated on coming forward prior to the government obtaining information alerting it to specific non-compliance. Though undoubtedly many persons or companies named in the Paradise Papers may well have pursued offshore investments for legitimate reasons, the U.S. government could nonetheless pursue various compliance issues. For example, there are multiple international information returns, the non-filing of which by a U.S. person can lead to civil and criminal exposure.

The required information returns may include, but are not limited to, Foreign Bank Account Reports (FBAR/FinCEN Form 114), annual reports of ownership in a foreign trust (Form 3520-A), and statements of specified foreign financial assets (Form 8938). U.S. taxpayers who may not have filed the requisite forms, or may have failed to disclose certain holdings on such filings, are urged to consult with U.S. legal counsel to apprise them of their options before being contacted by the IRS or DOJ. Taxpayers should be mindful of the short window of time available to proactively rectify prior non-compliance, as the opportunity to do so greatly diminishes after the IRS or DOJ makes contact.

Since 2009, the IRS and DOJ have aggressively pursued U.S. persons who may have failed to report foreign assets, particularly in "tax haven" jurisdictions, on tax and information returns. The information released thus far from the Paradise Papers focuses on the actions of Appleby and the companies, trusts, and other structures it established to potentially shield assets of high-net-worth persons from taxation in their respective countries of residence. U.S. citizens and residents (including green card holders) are subject to taxation on their worldwide income, regardless of whether it is earned and/or held outside U.S. borders. The omission of income or failure to file required information returns, if willful, could be a criminal tax offense. Even innocent or negligent non-compliance can subject a taxpayer to the assessment of tax, interest and severe civil penalties.

The IRS has introduced a number of so-called "voluntary disclosure" programs whereby individuals can rectify former non-compliance, whether it be accidental, negligent, or criminal. Persons who have held assets, either individually or through a structure, in jurisdictions affected by the Paradise Papers, particularly the Cayman Islands, Bermuda, British Virgin Islands, Jersey, Guernsey, Mauritius, and Hong Kong, should consult legal counsel regarding their disclosure options. Even taxpayers who did not directly engage with Appleby or Asiaciti Trust should seek counsel, as leaked documents have shown that half of Appleby's top 20 clients in 2014 were major international banks and investment firms. The risk is even greater for a U.S. person whose structures and assets touched any of the 80 Swiss banks who participated in the DOJ's Swiss Bank Program. On November 3, 2017, the IRS Large Business and International Division announced that it intended to mine information received from Swiss banks participating in the Swiss Bank Program as one of its compliance campaigns. With various sources of data available to the U.S. government, any person who has engaged in offshore investing (directly or through a company or trust) should consider themselves at risk. Despite this breach and forthcoming public exposure, the IRS policy does not disqualify a taxpayer from making a voluntary disclosure until it has that taxpayer's name and specific information about the taxpayer's non-compliance, or has already opened an examination or investigation.

It is not just account holders who must consider their options. If past practice holds, which we expect, the U.S. government will most assuredly use the leaked information as a "first step" to ultimately identify third parties, such as banks, investment advisors, trustees, lawyers, and bank employees, who may have helped Americans shield their foreign assets from the IRS. These third parties may have opportunities to minimize their own exposure to the DOJ, and they should consult with U.S. counsel to determine the right course of action. In addition, the leaked information could be used by the DOJ as the basis for investigations for violations of Anti-Money Laundering rules promulgated under the Bank Secrecy Act or the Foreign Corrupt Practices Act (FCPA).

Attorneys in Caplin & Drysdale's Tax Controversies Group have handled thousands of voluntary disclosures and tax investigations and examinations, both civil and criminal, as well as more general white collar investigations related to money laundering and the FCPA. Further, we have decades of expertise in unwinding complex structures and advising U.S. persons of their proper tax and reporting obligations. For more information, please visit this link for a list of Caplin & Drysdale attorneys who handle voluntary disclosure matters.

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