



# Panama Papers Update

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# THE WOLFE LAW GROUP

Gary S. Wolfe has over 34 years of experience, specializing in IRS Tax Audits and International Tax Matters including: International Tax Planning/Tax Compliance, and International Asset Protection.

As of July 2016, Gary Wolfe has internationally published 15 books and 28 articles. Gary has received 14 international tax awards from five different Global expert societies in LONDON/UK including being voted one of the 100 leading world's law firms with votes from over 150,000 voters in over 160 countries with the following award: Global 100 (2016) (KMH Media Group) - CA/US International Tax Planning Law Firm of the Year.

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## **Panama Papers Update – October 2016**

The Panama Papers were released in April 2016, outing the world's wealthiest people, including celebrities, politicians and business leaders for hiding their wealth through Panama Law Firm, Mossack Fonseca, setups in world tax havens (currently 90 known world tax havens). The explosive revelations subsequently have included:

1) Up to \$34 Trillion in Wealth, owned by the world's richest people, held offshore in tax havens beyond the reach of tax authorities. As revealed 0.1% of the world's population use offshore tax havens to skip out on payment of up to \$300B per year in taxes worldwide.

2) Developing countries: Russia, China, Africa & So. America are "kleptocracies." Their leaders embezzle trillions of dollars of their country's assets, line their pockets (and friends, families and colleagues) and steal up to an estimated \$14 Trillion in wealth which they hide offshore behind a maze of companies, trusts, and foundations including "purported charities".

3) Offshore tax dodging includes up to \$200 billion more in annual lost revenue from multi-nationals that "park assets" and "intellectual property" in tax free zones like: Ireland, Bermuda, Luxembourg and the Netherlands not paying any taxes and paying themselves tax-free royalties.

In the United States it is estimated that up to \$184B per year is lost in federal/state/local tax revenues by wealthy US individual taxpayers who park money in tax havens and hide behind anonymous shell companies, nominees or "straw persons" and fail to disclose their assets or report the

income from the assets which are tax crimes (i.e. felonies for willful evasion of tax, obstructing tax collection and conspiracy to commit tax evasion, when done in tandem with others).

In an 8/28/16 interview for the Real News Network, economist, lawyer, journalist James S. Henry told the RNN (Dharna Noor) that the reason ongoing efforts to address tax havens are failing is that “only international schemes and the organizations of ordinary people can counter interests of the most powerful global industries.

In the words of James S. Henry:

“So this is a problem that’s a complicated political mess (involving) some of the largest most powerful industries in the world. The banking industry, accounting profession, law firms, they’re deeply involved in this.... its a global haven industry for big business and they have a lot of political influence.”

Henry proposed a solution:

“The only way to organize around this is to cross-border to have pressure from international commissions, clean up the global haven industry... organizing around ordinary people, to understand how outrageous this situation has become...

Every movement that I can remember that made any social progress, from demolishing slavery to the progressive income tax itself, civil rights, these have all been created not by top-down politicians imagining these movement themselves, but from the bottom, from the grass roots up.

When ordinary people get involved they can work miracles”.

## **US Tax Compliance & Foreign Entities**

The Panama Papers revealed up to 3000 US taxpayers with offshore accounts held thru foreign entities for purposes of anonymity. If the foreign entities were used for Tax evasion or money laundering the US taxpayer may be subject to multiple felonies for tax evasion (i.e. Tax crimes) and if the funds were wired (or interstate telephones Were used) or mailed two additional 20 year felonies for wire fraud and mail fraud may be the subject of US Dept. of Justice Criminal Prosecution.

US taxpayers with offshore shell companies (with nominee officers, directors and/or shareholders) have two separate problems:

1) Criminal tax evasion if they fail to report the income from the accounts, or disclose the account holdings under the FBAR rules for accounts over \$10k (FinCen form 114) or the FATCA rules (Form 8938) for specified foreign financial assets over \$50k (these two forms are independent filings and may both be due for foreign financial assets over \$50,000).

The penalties include criminal tax evasion (5 year felony), obstruction of tax collection ( 3 year felony), conspiracy to commit tax evasion, if done in tandem with others (5 year felony), and failures to file Form 8938 and FinCen Form 114 (the criminal penalties for the failure to file Form 8938 are subject to IRS/US DOJ review, the FBAR filing penalty is up to 10 years in jail for each year the FBAR is not filed).

2) IRS Civil tax audit: the failures to file Form 8938 and/or FBARS may suspend the IRS civil statute of limitations for audits. In addition, under

audit the taxpayer may be liable for tax, interest and penalties including: Civil Tax Fraud Penalty: 75% of tax due), FBAR penalty (up to 50% of the highest value of the offshore account per year, with each year not filed being subject to an additional 50% penalty so after 3 years the FBAR penalty is 150% of the account balance, see 2014 tax case Florida taxpayer, Carl Zwerner), and other civil penalties.

## **US Taxpayers**

For those US taxpayers (over 2000) listed in the Panama Papers they have now been publicly identified and are subject to IRS civil tax audits, referrals to the Criminal Investigation Division (IRS) for investigation, and if warranted a referral by the IRS/CID to the US Department of Justice for criminal prosecution for tax crimes.

## **Offshore Tax Evasion: IRS Tax Audit**

For those US taxpayers committing offshore tax evasion i.e. not reporting foreign income, not disclosing offshore accounts, they face a myriad of IRS tax audit issues: Civil and Criminal Penalties, and a myriad of Statute of Limitations.

The IRS Civil and Criminal Penalty Issues include the following:

### **Civil Penalty Issues**

1. Civil Tax Fraud (75% of tax due) (no statute of limitations).
2. Underpayment of Tax (25% of tax due).

3. For voluntary disclosures, under the IRS Offshore Voluntary Disclosure Program (2012), the values of foreign accounts and other foreign assets are aggregated for each year and the penalty is calculated during the period covered by the voluntary disclosure.

Under the 2012/IRS Voluntary Disclosure there may be total penalties of up to 90% of unpaid income tax. There is additional Title 26 misc. tax of 27.5% based on the highest total balance (held in the foreign bank accounts/ or value of foreign assets. As of 7/1/14 the penalty is increased to 50% for assets held at listed foreign banks.

The up to 90% penalty for unpaid income tax includes the following penalties:

- a. Failure to File a Tax Return (IRC Sec. 6651(a)(1), up to 25% tax due.
- b. Failure to Pay Tax (IRC Sec. 6651(a)(2), up to 25% tax due.
- c. Accuracy Related Penalty (IRC Sec. 6662), a 40% penalty for tax underpayment attributable to undisclosed foreign financial asset understatement.

### **Criminal Penalty Issues**

U.S. taxpayers with undisclosed offshore bank accounts and unreported income face criminal charges for:

1. Tax Evasion (IRC 7201), five years in jail, \$25,000 fine;

2. Filing False Tax Return (IRC Sec. 7206(1)), three years in jail, \$250,000 fine;

3. Failure to File Tax Return (IRC Sec. 7203), one year in jail, \$100,000 fine;

4. Willful failure to file FBAR or Filing False FBAR (31 USC Sec. 5322), ten years in jail, fines up to \$500,000 with related civil penalty the greater of \$100,000 or 50% of the total balance of the foreign account per violation (IRC Sec. 5321(a)(5)).

In addition there are specialized tax, and other issues for offshore tax evasion:

1. The failure to file the Report of Foreign Bank and Financial Account ("FBAR", Fincen form 114, formerly TDF-90-22.1) can result in penalties that exceed the account balance e.g. the 50% yearly penalty imposed on the undisclosed account balance is imposed every year so if the FBAR report is not filed for 4 years the penalty is 200% of the account balance. So, if there was \$5M on account, after 4 years of no FBAR filings the penalty would be \$10M (which does not include the income tax on the unreported account earnings, additional penalties, see above, and interest);

2. An FBAR filing has a 6-year statute of limitations for imposition of the civil and related criminal penalty. These statutes do not begin to run until the FBAR is filed (this filing discloses all foreign bank and financial accounts over \$10k).

In addition until the FBAR is filed, and the foreign bank accounts are disclosed, the Statute of Limitations on the related tax year Form 1040 filing does not commence.

3. Effective Tax Year 2011, Form 8938 is required to be attached to Taxpayer's Form 1040 to disclose the aggregate value of all foreign assets over \$50k, which includes: Financial Accounts at foreign institutions, foreign stock, security, financial instrument or contract of interest in a foreign entity). Filing an FBAR does not eliminate the need to file Form 8938 to report foreign financial assets.

For example, a US beneficiary of a foreign trust who is not within the scope of the FBAR reporting requirements because his interest in the trust is less than 50%, may still be required to disclose the interest with his tax return if the \$50k threshold is met. As with the FBAR filing, failure to file the Form 8938 suspends the statute of limitations for the related tax year Form 1040, which does not commence until the Form 8938 (and any other information returns due are filed).

### **Statute of Limitations for IRS Audits**

Civil and criminal tax proceedings have different statutes of limitation.

Civil Tax Fraud – For civil tax fraud (i.e. unreported income/undisclosed foreign bank accounts), there is no statute of limitations. The tax can be assessed at any time.

Criminal Tax Evasion – For criminal tax evasion (i.e. unreported income) the criminal statute of limitations is only on the prosecution of the crime of tax evasion, (not the assessment of the tax owed).

Offenses arising under the Internal Revenue laws generally have a 3-year period of limitation for prosecution (IRC Sec. 6531).

When the prosecution is for the offense of willfully attempting in any manner to evade or defeat any tax, the statute of limitations is 6-years (i.e. unreported Income).

IRC Sec. 6531(1): for offenses involving the defrauding or attempting to defraud the United States (whether by conspiracy or not, and in any manner);

IRC Sec. 6531(2): for the offense of willfully attempting in any manner to evade or defeat any tax;

IRC Sec. 6531(3): for the offense of willfully aiding or assisting in the preparation of a false or fraudulent tax return.

IRC Sec. 6531(4): for the offense of willfully failing to pay any tax or make any tax return.

IRC Sec. 6531(5): for offenses relating to false statements and fraudulent documents under IRC Sec. 7206(1) and Sec. 7207.

IRC Sec. 6531(8): for offenses arising under 18 U.S.C. 371, where the object of the conspiracy is to attempt in any manner to evade or defeat any tax.

Under IRC Sec. 6531, the 6-year statute of limitations shall be tolled, while the U.S. taxpayer who committed the offenses is outside the United States.

Generally, the IRS has 3 years from the date of the tax filing (Form 1040) to commence an audit. However, the 3 years are extended to 6 years if the Taxpayer:

1. Omitted more than 25% of gross income;
2. Omitted more than \$5000 of foreign income;
3. Failed to file the FBAR and disclose the foreign account (which is required under

Form 1040/Schedule B, Part III, question (7)(a), and if not disclosed is both perjury and a felony for filing a false tax return with up to 3 years in jail), which 6-year statute does not commence until the FBAR is filed (due June 30 each year, for the prior year, no extensions, in 2014 required to be filed electronically i.e. no paper filing, no "lost in the mail excuses".)

As stated above, for the reasons specified the Statute of Limitations for the IRS to audit the Form 1040 may be extended from 3-6 years. Even if there is no understatement of income, if there is a failure to file information returns for offshore holdings/entities then the Form 1040 Statute of

Limitations is suspended until the complete Form 1040 is filed with all information filings due.

The following information filings are due annually for offshore holdings/entities:

1. FBAR for accounts over \$10k (due 6/30)

2. Form 8938 ("FATCA Filing" since 2011) for Foreign Financial Assets over \$50k (due 4/15, unless extension (with Form 1040)).

Under Form 8938 (Statement of Specified Foreign Financial Assets): a 3-year statute of limitations for failure to report a specified foreign financial asset or failure to file Form 8938;

A 6-year statute of limitations for U.S. taxpayer's failure to include in gross income an amount relating to specified foreign financial assets and the amount omitted is more than \$5,000.

3. Form 3520-A to report annual foreign trust income; (with Form 1040)

4. Form 3520 to report transfers to the trust and distributions to trust beneficiaries; (with Form 1040)

5. Form 5471 for any US person who controls a foreign corporation. Control is defined as ownership of more than 50% of the outstanding stock or voting power for at least 30 consecutive days during that tax year. Control also includes: five or fewer US Persons who collectively own more than a 50% interest and individually own more than a 10% interest in the corporation.

A US person who becomes an Officer or Director of of a foreign corporation and owns at least 10% of the corporation stock by vote or value, must also file Form 5471 (with Form 1040).

6. Form 8865 Foreign Partnerships (same rules as Form 5471 re: control, filing dates);

7. Form 8858 for US persons who are owners of foreign disregarded entities (with Form 1040).

US Taxpayers with foreign income, entities should carefully review their annual tax filings due.

