Is the United States Still a Tax Haven? The Government Acts on Tax Compliance and Money Laundering Risks

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Peter D. Hardy, Scott Michel and Fred Murray highlight current developments stressing that the reporting requirements relating to foreign persons conducting financial transactions in the United States are becoming more robust.

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As the world now knows well, the Panamanian law firm Mossack Fonseca was the subject of a stunning breach of approximately 11.5 million financial and legal documents in April 2016. These leaked documents, the so-called "Panama Papers," have been publicized through an international consortium of journalists and allegedly reveal a global system of undisclosed offshore accounts, money laundering and other illegal activity. The effect of the Panama Papers has been explosive; the documents allegedly implicate world leaders, financiers, celebrities and other prominent individuals from across the world in the use of shell companies to conceal assets from their respective home country governments. The Office of the U.S. Attorney for the Southern District of New York has announced that it is launching an investigation into these matters, as have enforcement agencies in many other countries.

To date, reports swirling regarding the Panama Papers have suggested that relatively few U.S. taxpayers have employed the services, legitimate or otherwise, of Mossack Fonseca. However, reports also have suggested—ironically, given the mantle aggressively assumed by the U.S. government over the last decade of leading the global charge against international tax evasion[1]—that individuals from across the globe have perceived the United States as a potential tax haven and a secure place to hide assets. In particular, the States of Nevada, Wyoming and Delaware, which allow for the quick creation of limited liability companies (LLCs) without identifying the true beneficial owners, have been criticized.[2] Thus, the Panama Papers have stoked a growing national and global focus on the risks associated with money laundering, tax evasion, terrorist financing and other illicit activity arising from the creation and use of U.S. entities whose true owners are obscured through corporate forms, as well as the need to identify the individuals behind these entities.

Although stated efforts at regulatory efforts have been ongoing for several years, the Panama Papers scandal clearly has motivated the U.S. government to act recently to address the alleged attempts by non-U.S. persons to launder their proceeds of illegal activities through U.S. financial transactions. The government's current campaign focuses on identifying the true beneficial owners involved in financial transactions. This article does not attempt to lay out the full regulatory regime. Rather, we will highlight certain developments in order to stress the relevant point that the reporting requirements relating to foreign persons conducting financial transactions in the United States are becoming more robust. We will focus on recent efforts by the IRS and the Financial Crimes Enforcement Network (FinCEN), the agency charged with regulating the Bank Secrecy Act.[3] This trend of expanding duties reveals the current priorities of enforcement agencies and increases the potential risks—simply due to the expanding universe of required filings—for individuals making representations on behalf of possible bad actors from abroad who seek to conduct business or create entities within the United States. Both of these considerations feed into the main discussion of this article: the potential and sometimes surprisingly broad exposures faced by gatekeepers, such as attorneys, accountants and financial advisors, to money laundering charges for assisting in such financial transactions. In particular, we will discuss the potential money laundering exposures faced by attorneys who may knowingly assist clients in U.S. financial transactions which launder illegal proceeds earned abroad, including proceeds earned through the evasion of *foreign tax laws* or other crimes.

Expanding Reporting Obligations Regarding Beneficial Owners Under the Tax Code

The Treasury Department issued a Notice of Proposed Rulemaking (NPRM) on May 10, 2016, aimed at identifying the beneficial owners of foreign-owned single member LLCs. The NPR would impose additional reporting and recordkeeping requirements on these entities, by treating them as domestic corporations separate from their owners "for the limited purposes of the reporting and record maintenance requirements" imposed by the Internal Revenue Code ("the Code").[4] Similar to the other regulatory and enforcement steps outlined in this article, the proposed regulations are partially in response to the growing view of the United States as a tax haven for foreigners seeking to evade their foreign tax obligations or otherwise conceal their holdings. It also has been suggested that the 2011 peer review report on the U.S. by the Global Forum on Transparency and Exchange of Information for Tax Purposes, held by the Organization for Economic Cooperation and Development (OECD), was one factor behind the decision to proceed with the NPRM; the peer review report had indicated that the Financial Action Task Force rated the U.S. noncompliant regarding a recommendation involving beneficial ownership.[5]

The new regulations will be issued under Section 6038A of the Code, which currently requires certain foreign-owned U.S. corporations to file a Form 5472 disclosing the identity of their foreign owners and reporting certain related-party transactions. The current filing requirement generally applies where more than 25 percent of the voting power or value of all classes of stock are owned by a single foreign owner. The NPRM indicates that this filing requirement will be extended to foreign-owned, single-member LLCs, by treating LLCs as corporations solely for the purposes of Code Sec. 6038A.

Under the proposed approach, each LLC would be required to (i) obtain entity identification numbers (EINs) from the IRS, which requires identification of a responsible party—*i.e.*, a natural person; (ii) annually file IRS Form 5472, an informational return identifying "reportable transactions" that the LLC engaged in with respect to any related parties, such as the entity's foreign owner; and (iii) maintain supporting books and records. These requirements would apply even if the LLC owns no U.S. assets and generates no U.S.-source income. Failing to file the Form 5472 can result in a $10,000 penalty, with additional incremental penalties of $10,000 if the failure continues for more than 90 days after the taxpayer is notified by the IRS. There is no cap on the total penalty, so a persistent refusal to comply with the proposed filing requirement could result in significant penalties.

In a letter to Congress, Treasury Secretary Jacob Lew explained that the proposed regulations are designed specifically "to close a current loophole in our system" that allows foreign persons to use U.S. LLCs in order to hide assets both in and out of the United States.[6] The NPRM itself further explains that the information obtained will be shared with other governments: "These regulations are intended to provide the IRS with improved access to information that it needs to satisfy its obligations under U.S. tax treaties, tax information exchange agreements and similar international agreements, as well as to strengthen the enforcement of U.S. tax laws."[7]

Expanding Reporting Obligations Regarding Beneficial Owners Under the Bank Secrecy Act: Customer Due Diligence Regulations

FinCEN is an agency of the Department of the Treasury, which focuses on fighting money laundering and other offenses through its implementation of the Bank Secrecy Act. Recently, FinCEN has turned to two areas that implicate in part the use of the U.S. financial system by foreign persons: the opening of financial accounts by entities and the purchasing of high-end real estate. Similar to the recently proposed regulations under the Code seeking to identify the natural persons behind wholly foreign owned LLCs, these recent steps by FinCEN also focus on identifying the actual individuals responsible for financial transactions, as part of the Treasury's ongoing efforts to prevent bad actors from using U.S. companies to commit money laundering, tax evasion and other illicit financial activities.

On May 11, 2016, FinCEN issued a final rule to strengthen the customer due diligence (CDD) efforts of "covered financial institutions." The CDD rule requires covered financial institutions, including banks, federally insured credit unions, broker-dealers, mutual funds, futures commission merchants and introducing brokers in commodities, to identify the natural persons that own and control legal entity customers—the entities' "beneficial owners."[8] The CDD rule has been almost four years in the making; the process has included an Advanced Notice of Proposed Rulemaking, issued in February 2012,[9] and a Notice of Proposed Rulemaking issued in August 2014.[10] The final release of this long-delayed rule appears to have been motivated in part by the recent disclosure of the Panama Papers.

The rule imposes several new obligations on covered financial institutions with respect to their "legal entity customers." "Legal entity customers" include corporations, LLCs, general partnerships and other entities created by filing a public document or formed under the laws of a foreign jurisdiction. Certain types of entities are excluded from the definition of "legal entity customer," including financial institutions, investment advisers and other entities registered with the Securities and Exchange Commission, insurance companies and foreign governmental entities that engage only in governmental, noncommercial activities.

For each such customer who opens an account, including an existing customer opening a new account, the covered financial institution must identify the customer's "beneficial owners." The CDD adopts a two-part definition of "beneficial owner," with an ownership prong and a control prong. Under this approach, each covered financial institution must identify: (i) each individual who owns 25 percent or more of the equity interests in the legal entity customer and (ii) at least one individual who exercises significant managerial control over the customer. The same individual(s) may be identified under both prongs. If no single individual owns 25 percent or more, the covered financial institution may identify a beneficial owner under only the control prong. The same approach is used for nonprofit entities, which do not have "owners."

The covered financial institution must verify the identity of each beneficial owner identified by the customer. Importantly, the covered financial institution is entitled to rely on the customer's certification regarding each individual's *status* as a beneficial owner. However, the covered financial institution must obtain personally identifying information about each beneficial owner. This information must be documented and maintained by the financial institution.

Obviously, the CDD rule applies to financial institutions, not individuals. However, the rule references a sample Certified Form, a copy of which is attached to the rule; the form is optional and the rule permits the covered financial institution to obtain and record the necessary information "by any other means that satisfy" its verification and identification obligations. Nonetheless, it is likely that most if not almost all financial institutions will use the proposed Certified Form, or a variant thereof, particularly because the rule allows a financial institution to rely upon the representations made in the form in the absence of information that such reliance would be unreasonable. On the proposed form, the signatory—designated as the person opening the account—purports to identify the beneficial owners of the entity opening the account. Thus, although the CDD rule directly imposes new obligations on financial institutions, it is the certification form which arguably represents the vehicle for the greatest legal risk—which is individual: if the person signing the form, or causing the form to be signed, knows or has reason to believe that the beneficial owners listed on the form are mere nominees intended to disguise the true beneficial owner, that person could be directly responsible for a fraud-related offense.

Expanding Reporting Obligations Regarding Beneficial Owners Under the Bank Secrecy Act: High-End Real Estate Transactions

In January 2016, FinCEN issued two geographic targeting orders (GTOs) aimed at combating money laundering in all-cash real estate transactions in Manhattan and Miami-Dade

County, Florida. In this context, "cash" means currency, as well as a cashier's check, bank draft, traveler's check or money order (*i.e.*, a check not drawn on a personal or business account). The GTOs, which took effect in March 2016, require title insurance companies to identify the natural persons behind entities using cash to purchase high-end real estate—properties with a sales price of more than $1 million in Miami-Dade County and more than $3 million in Manhattan.[11]

Once again, the focus is on identifying beneficial ownership. To comply with the orders, title insurance companies must: (i) complete a FinCEN Form 8300 that identifies the purchasing entity's beneficial owners, defined as each individual who owns 25 percent or more of the entity's equity; (ii) retain a copy of each beneficial owner's identification documentation (*e.g.*, passport, driver's license, *etc.*); (iii) if the purchaser is an LLC, provide each member's name, address and taxpayer identification number; and (iv) provide details about the transaction, including the property's address, purchase price and the transaction's closing date. Depending on the information generated by the GTOs, FinCEN may extend the GTOs beyond their current August 27, 2016, expiration and likely will expand its use of GTOs to other parts of the country.

In a speech in April 2016, former FinCEN Director Jennifer Shasky Calvery explained that the "real estate industry's vulnerability to money laundering has been a focus of the U.S. Congress and FinCEN for many years."[12] Most real estate transactions already are subject to anti-money laundering (AML) scrutiny through the AML programs and controls of banks and other mortgage lenders and originators. However, in the case of an all-cash purchase made "without a mortgage issued by a bank or mortgage broker," "none of the parties involved in the transaction are subject to AML program requirements." The GTOs are designed to help close this gap by allowing FinCEN to identify individuals attempting to launder criminal proceeds through cash real estate purchases. According to former Director Shasky Calvery, the beneficial ownership identification requirement is key to AML risk assessment and enforcement because the use of shell company purchasers "is often enough to dramatically increase the difficulty of tracking the true owner of a property in a transaction." Moreover, the purchasing of high-end real estate in the United States has been linked to individuals from abroad seeking to hide their assets.[13]

Money Laundering Exposures for Lawyers Engaged by Foreign Persons

Clearly, the U.S. government currently is focusing on the potential efforts of non-U.S. persons to conduct U.S. financial transactions in order to avoid taxes in their respective home countries or launder the proceeds of illegal activities. What are the resulting implications for professionals engaged to assist foreigners in arranging their business and tax affairs in the United States?

It is conceivable that attempts by individuals to evade the tax laws of foreign nations, coupled with subsequent efforts to conduct financial transactions in the United States with the proceeds of such foreign tax evasion, could constitute money laundering violations under U.S. law. Although real-world enforcement actions are rare, and the applicable law and policy is mixed, such investigations and possible prosecutions may become a more real-world scenario in light of the pressures created by the Panama Papers scandal. As we will discuss, such money laundering charges would rest on the use of proceeds earned through foreign tax offenses labeled by the U.S. government as mail or wire fraud crimes serving as the necessary predicate for the money laundering charges. If so, traditional concepts of criminal conspiracy and aiding and abetting—topics too broad for discussion within this article—could apply to the conduct of an attorney or other gatekeeper who is assisting in the financial transactions and who also knows that the underlying proceeds come from illegal activity. Typically, the key issue regarding the potential liability of third-party advisors for money laundering is knowledge that the proceeds involved in the transaction were earned through crime.

Money Laundering Basics

Very generally, the offense of money laundering under 18 USC §§1956 and 1957 involves a financial transaction conducted with the proceeds of a "specified unlawful activity," or SUA, while knowing that the proceeds were earned through illegal activity. The list of potential SUAs identified by Congress is specific but also extremely long (over 200 separate crimes)—but it does *not* include Title 26 criminal tax violations.[14] Thus, in the normal course, transactions involving proceeds earned through tax fraud cannot support money laundering charges.

Section 1956 generally requires the defendant to also act with one of four possible intents—an intent to conceal or disguise the nature, location, source, ownership or control of the SUA proceeds; to promote the underlying SUA; to avoid a transaction reporting requirement, such as a Suspicious Activity Report; or to commit the offense of tax evasion or filing a false tax return.[15] Section 1957—the so-called "spending" money laundering statute—merely requires a transaction involving over $10,000 and knowledge that the proceeds derived from criminal activity.

Typically, the key element in money laundering cases focused on a third-party professional—*i.e.*, the lawyer, accountant, banker, real estate agent, merchant or other professional who had no involvement in committing the underlying SUA but who later assisted the person who committed the underlying SUA with subsequent financial transactions involving the resultant proceeds—is knowledge: when the lawyer helped the business person set up a company to hold assets, did the lawyer know that those assets were derived from illegal activity?

We focus in the next section on how financial transactions in the United States could represent money laundering offenses because they involve the proceeds of foreign crime—specifically, the violation of foreign tax laws. This is a complex analysis. However, it is important to remember that other illegal conduct committed abroad may readily lend itself to supporting money laundering charges for subsequent transactions conducted in the United States. For example, if an individual acting abroad has committed a more straightforward violation of U.S. law—such as the Foreign Corrupt Practices Act[16] or a violation of a U.S. embargo, subject to prosecution under the International Economic Emergency Powers Act[17] or similar statutes—and then attempts to move the proceeds of such offenses from abroad and into the United States, the legal analysis under the money laundering statutes is generally much more straightforward: such proceeds clearly will represent SUA funds because the foreign conduct itself represents a violation of U.S. law. Under this scenario, the issues are limited to proof of sufficient mental state and, under Section 1957, also whether the financial transaction involved over $10,000. Likewise, Section 1956 defines SUA in part to specifically include a broad variety of foreign offenses, so long as the later financial transaction at issue was conducted in whole or in part in the United States.[18]

Moreover, Section 1956(f) explicitly extends jurisdiction over extraterritorial conduct when "the conduct is by a United States citizen or, in the case of a non-United States citizen, the conduct occurs in part in the United States," and the transaction has a value exceeding $10,000.[19] Thus, Section 1956(f) applies to *transactions* which occur in whole or in part in the United States; it does not require physical presence in the United States. Likewise, "conduct" occurring in the United States is not limited solely to physical activity; electronic conduct, such as a wire transfer into the United States from abroad, might satisfy Section 1956(f) and provide U.S. prosecutors with jurisdiction.

Finally, the international transfer of funds can itself represent money laundering. Section 1956 contains a separate prong that prohibits "international" money laundering that applies to transportations or transfers of funds in or out of the United States. This prong contains three alternative intent requirements: (i) an intent to promote an SUA; (ii) knowledge that the transaction is designed to conceal the proceeds of an SUA; or (iii) knowledge that the transaction is designed to avoid a transaction reporting requirement.[20] Although the statute is not a model of clarity, it arguably does not even require the funds involved in the transaction to be actual SUA funds.[21]

Money Laundering Charges Based on Foreign Tax Fraud, Labeled as Wire or Mail Fraud

Tax fraud, either foreign or domestic, could serve to form the predicate for related money laundering charges—albeit through a strained analytical route that often would violate the stated charging policy of the Department of Justice. As explained below, even foreign tax evasion schemes may suffice. Although such scenarios are unusual, they may become less esoteric if scandals such as the Panama Papers incentivize the DOJ to pursue the alleged U.S. facilitators of foreign tax schemes. Accordingly, attorneys who have concerns that a client may be attempting to elicit their assistance in a scheme aimed to thwart the tax laws of their home country, or to hide or simply deposit within the United States the proceeds of such foreign tax schemes, should consider the following issues under the money laundering statutes. Although the following discussion focuses on whether such proceeds can rightfully be considered to represent "SUA proceeds" supporting a potential money laundering charge, the other key issue involving any money laundering investigation into a U.S. gatekeeper will likely be knowledge, as noted.

Our starting point is the Supreme Court case of *Pasquantino*, which is the theoretical wellspring of turning foreign tax fraud into U.S. money laundering charges. In *Pasquantino*, the Court held that a scheme to smuggle liquor from the United States into Canada to avoid Canadian taxes constituted a wire fraud scheme because Canada's right to the uncollected taxes constituted property within the meaning of the wire fraud statute. In sum, the Court explained that "[w]e granted certiorari to resolve a conflict in the Courts of Appeals over whether a scheme to defraud a foreign government of tax revenue violates the wire fraud statute … .We agree with the Court of Appeals that it does and therefore affirm the judgment below."[22]

To fully appreciate the full potential implications of the *Pasquantino* opinion, one must appreciate the breadth of the federal mail and wire fraud statutes. The mail fraud[23] and wire fraud[24] statutes are staples of federal white-collar crime prosecutions. Federal prosecutors employ them in a vast array of fraud and public corruption cases, and they represent the "go-to" statutes for Assistant U.S. Attorneys. Because the statutes involve "schemes to defraud," indictments involving mail and wire fraud can be elaborate and expansive, including a variety of conduct over time by a single individual. Thus, charges can resemble "one-person conspiracies." The mailing or wiring itself does not have to be false or fraudulent, so long as it occurs "in furtherance" of the scheme. Further, the mailing or wiring does not have to be an essential part of the fraudulent scheme, so long as it is "incident to an essential part of the scheme."[25]

Given the versatility of the mail and wire fraud statutes, their familiarity to all federal prosecutors, and their high statutory maximums, they would be powerful weapons for charging tax fraud schemes, which invariably involve a mailing or a wiring. Indeed, the mailed or wired tax document itself would not even have to be false or fraudulent. Moreover, the mail and wire fraud statutes have a distinct advantage which the criminal tax statutes lack: aside from charging flexibility, higher statutory maximum penalties and generally higher advisory sentencing ranges under the Federal Sentencing Guidelines, mail fraud and wire fraud can constitute an SUA for purposes of the money laundering and Racketeer Influenced and Corrupt Organizations Act (RICO) statutes and thus can support charges under those statutes as the underlying criminal activity.[26] As already noted, *Title 26 criminal tax statutes cannot*. In theory, the mail and wire fraud statutes could displace almost entirely the use of criminal tax statutes to combat tax fraud.

To avoid that very consequence, the DOJ Tax Division has enacted policies to curb the use of the mail and wire fraud statutes in tax cases. However, these policies were relaxed in the mid-2000s. For years, the DOJ had a very restrictive policy regarding the use of the mail and wire fraud statutes. Tax Division Directive No. 99, issued in 1993, stated in pertinent part:

> [T]he authorization of the Tax Division is required before charging mail, wire or bank fraud, either independently or as predicate acts to a RICO charge or as the specified unlawful activity element of a money laundering charge, when the mailing, wiring, or representation charged is used to promote or facilitate any criminal violation arising under the internal revenue laws. In the exercise of its prosecutorial discretion, the Tax Division will grant such authorization only in exceptional circumstances. As a general rule, the use of such charges will not be approved (1) when the only mailing charged is a tax return or other internal revenue form or document, or a tax refund check; (2) when the only wire transmission is a transmission of tax return information to the IRS or the transmission of a refund to a bank account by electronic funds transfer; or (3) when the mailing, wiring, or representation charged is only incidental to a violation arising under the internal revenue laws (for example, although the mailing of a set of instructions to a cohort in a tax shelter scheme might support a mail fraud charge, such a mailing would be considered incidental to the primary purpose of the scheme which is to defraud the United States by abetting the filing of false income tax returns).
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> Normally, violations arising under the internal revenue laws should be charged as tax crimes and the specific criminal law provisions of the Internal Revenue Code should form the focus of prosecutions when essentially tax law violations are involved, even though other crimes may have been committed ... .
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> A mail, wire, or bank fraud charge arising out of a scheme to defraud the Government through the use of the revenue laws might be appropriate in addition to, but never in lieu of, other charges based on violations of the internal revenue laws, however, where the Government has also lost money in a non-revenue raising capacity or individuals or other entities have been the financial victims of the crime. The bringing of such charges will seldom, if ever, be justified by the mere desire to see a more severe term of imprisonment or fine imposed. Rather, they must serve some federal interest not adequately served by the bringing of traditional tax charges ... .
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> A similar policy will be followed with respect to RICO or money laundering charges predicated on mail, wire, or bank fraud violations which involve essentially only a federal tax fraud scheme. Tax offenses are not predicate acts for RICO or specified unlawful activities for money laundering offenses—a deliberate Congressional decision—and converting a tax offense into a RICO or money laundering case through the charging of mail, wire or bank fraud based on a violation of the internal revenue laws as the underlying illegal act could be viewed as circumventing Congressional intent unless circumstances justifying the use of a mail, wire or bank fraud charge are present.[27]

However, the DOJ issued a new policy in October 2004. Tax Division Directive No. 128, which superseded Directive No. 99, still requires Tax Division approval for mail or wire fraud charges in tax cases and still limits the uses of the relevant statutes. Nonetheless, it does away with many of the specific limitations articulated in Directive No. 99 and essentially reduces the policy to an expression of self-imposed restraint that will yield in particular circumstances. Tax schemes in which the government is the sole victim are now fair game for consideration of mail and wire fraud charges, so long as there is "a large fraud loss" or "a substantial pattern of conduct" and mail or wire fraud charges would produce "a significant benefit." As for bootstrapping money laundering or RICO charges onto tax schemes through the mail or wire fraud statutes, Tax Division Directive No. 128 states that this practice will not be authorized in "routine" tax cases, but that it will be authorized in "unusual circumstances," based in part on considerations of "tactical advantages." Tax Division Directive No. 128 states in part as follows:

> Tax Division approval is required for any criminal charge if the conduct at issue arises under the internal revenue laws, regardless of the criminal statute(s) used to charge the defendant. Tax Division authorization is required before charging mail fraud, wire fraud or bank fraud alone or as the predicate to a RICO or money laundering charge for any conduct arising under the internal revenue laws, including any charge based on the submission of a document or information to the IRS. Tax Division approval also is required for any charge based on a state tax violation if the case involves parallel federal tax violations.
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> The Tax Division may approve mail fraud, wire fraud or bank fraud charges in tax-related cases involving schemes to defraud the government or other persons if there was a large fraud loss or a substantial pattern of conduct and there is a significant benefit to bringing the charges instead of or in addition to Title 26 violations. *See generally* United States Attorneys' Manual (U.S.A.M.) §9-43.100. Absent unusual circumstances, however, the Tax Division will not approve mail or wire fraud charges in cases involving only one person's tax liability, or when all submissions to the IRS were truthful.
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> Fraud charges should be considered if there is a significant benefit at the charging stage (*e.g.*, supporting forfeiture of the proceeds of a fraud scheme; allowing the government to describe the entire scheme in the indictment); at trial (*e.g.*, ensuring that the court will admit all relevant evidence of the scheme; permitting flexibility in choosing witnesses); or at sentencing (*e.g.*, ensuring that the court can order full restitution). *See id*. §9-27.320(B)(3) ("If the evidence is available, it is proper to consider the tactical advantages of bringing certain charges.").
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> For example, mail fraud (18 U.S.C. §1341) or wire fraud (18 U.S.C. §1343) charges may be appropriate if the target filed multiple fraudulent returns seeking tax refunds using fictitious names, or using the names of real taxpayers without their knowledge. Fraud charges also may be considered if the target promoted a fraudulent tax scheme.
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> … .
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> *Racketeering and Money Laundering Charges Based on Tax Offenses*
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> The Tax Division will not authorize the use of mail, wire or bank fraud charges to convert routine tax prosecutions into RICO or money laundering cases. The Tax Division will authorize prosecution of tax-related RICO and money laundering offenses, however, when unusual circumstances warrant it.
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> … .
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> A United States Attorney who wishes to bring a money laundering charge (18 U.S.C. §1956) based on conduct arising under the internal revenue laws must obtain the authorization of the Tax Division and, if necessary, the Criminal Division's Asset Forfeiture and Money Laundering Section. U.S.A.M. §9-105.300.[28]

This general policy of restraint was confirmed by the DOJ Tax Division in early 2014 in a Tax Division Directive on the forfeiture policy in tax-related investigations and prosecutions; this Directive clearly states in part that Title 18 offenses such as mail and wire fraud should not be used to convert a traditional legal-source income tax case into a Title 18 fraud case.[29]

A case from the Third Circuit exemplifies how Directive No. 128 is merely a policy of restraint and does not represent a categorical prohibition against the bootstrapping of tax crimes, foreign or domestic, into money laundering charges. In *Yusuf,* the defendants retained tax monies by filing Virgin Islands gross receipts tax returns (which apply a four-percent tax rate) through the mail. The Third Circuit held that "unpaid taxes, which are unlawfully disguised and retained by means of the filing of false tax returns, constitute 'proceeds' of mail fraud for purposes of supporting a charge of federal money laundering." Thus, the *Yusuf* court reversed the district court's pretrial vacation of the international money laundering counts in the indictment, stating that "simply because funds are originally procured through lawful activity does not mean that one cannot thereafter convert those same funds into the 'proceeds' of an unlawful activity." The Third Circuit relied in part on *Pasquantino.* The *Yusuf* court also stated that "[t]he use of the mail to file fraudulent tax returns and fail to pay all taxes owed was not only incident to an essential part of the scheme, but also was clearly an essential part of the scheme because such mailings were the defendants' way of concealing the scheme itself by making the fraudulently reported gross receipts seem legitimate."[30] Accordingly, the Third Circuit set forth a road map for prosecutors to charge money laundering based on underlying mail or wire fraud violations, which in turn rest on alleged violations of foreign tax laws.

However, In *Khanani*, business owners were charged with employing illegal aliens and evading the employment taxes for those aliens. Further, the defendants were charged with mail and wire fraud based upon their mailing and e-mailing of fraudulent state and federal tax forms, and with conspiracy to commit money laundering based on financial transactions involving the alleged proceeds of the claimed tax and cost savings derived from hiring illegal aliens. It was not contested that the transmission of tax returns could support the mail and wire fraud charges. However, the district court vacated the money laundering conspiracy conviction, finding that the element of "proceeds" for money laundering cannot include "profits or revenue indirectly derived from labor or from the failure to remit taxes." The Eleventh Circuit upheld this ruling, finding that "proceeds" must represent something obtained through a sale of something else, rather than merely tax and labor savings.[31]

Nonetheless, both the *Yusuf* and *Khanani* opinions either embraced or at least did not question the proposition that a tax crime can be charged as a mail or wire fraud violation. Further, at least two district courts have embraced *Yusuf*. In an unpublished case, the Central District of Illinois accepted the Third Circuit's position in *Yusuf*: while upholding the defendant's money laundering convictions, which rested on wire fraud transactions that sought to disguise and retain funds in order to hide income from the IRS, the district court stated that the conviction was valid under *Yusuf* and quoted the holding in *Yusuf* "that 'unpaid taxes, which are unlawfully disguised and retained by means of the filing of false tax returns through the U.S. mail, constitute 'proceeds' of mail fraud for purposes of supporting a charge of federal money laundering.'"[32] Likewise, the Eastern District of New York held that, under *Yusuf*, sales of an industrial chemical on which no excise taxes had been paid involved the "proceeds" of a SUA because unpaid taxes disguised and retained through mail fraud can represent SUA proceeds.[33]

Conclusion

With increasing media attention and more aggressive global enforcement against assets and accounts that have gone undeclared to tax authorities, the U.S. ironically became a place where some individuals, and their advisors, have attempted to take advantage of lax rules concerning the identification of beneficial owners. In the past few months, the IRS and FinCEN have taken steps to counter this trend, and practitioners should be aware of, and alert to, such changes. Moreover, the movement of funds into the U.S. always carries a risk that if the money is derived from unlawful activity, including even foreign tax evasion, there are circumstances where the Justice Department might consider mail or wire fraud charges, or even money laundering charges. Practitioners, financial institutions and others should consider their own due diligence in such matters and monitor continuing regulatory and enforcement developments.

ENDNOTES

1 The Department of Justice and IRS have waged for years an aggressive enforcement campaign against undisclosed foreign accounts held by U.S. taxpayers and the foreign banks and advisors allegedly involved in such activity. However. the United States has been criticized for pressuring other countries to implement the Foreign Account Tax Compliance Act, or FATCA, which requires foreign financial institutions to report to the IRS accounts with direct or indirect U.S. beneficial ownership, while failing to enact legislation that would require American banks to collect and disclose reciprocal information to foreign countries and refusing to sign on to the more wide-reaching Common Standard on Reporting and Due Diligence for Financial Account Information proposed in 2014 by the Organization for Economic Cooperation and Development, or OECD.

2 *E.g.* Hamish Boland-Rudder, *US States Under Pressure As World Pushes For Financial Transparency*, International Consortium of Investigative Journalists (May 13, 2016), available online at *https://panamapapers.icij.org/20160513-us-states-london-summit.html* (last visited June 18, 2016); *see also* Samuel Rubenfeld, *Murky U.S. Incorporation Comes Under Scrutiny*, Wall Street Journal (May 2, 2016), available online at *http://blogs.wsj.com/riskandcompliance/2016/05/02/murky-u-s-incorporation-comes-under-scrutiny/* (last visited June 18, 2016).

3 The Bank Secrecy Act, or BSA, is found at 31 USC §5311 through §5322.

4 *See* IRS, Notice of Proposed Rulemaking, *Treatment of Certain Domestic Entities Disregarded as Separate From Their Owners as Corporations for Purposes of Section 6038A* (May 10, 2016), available online at *www.federalregister.gov/articles/2016/05/10/2016-10852/treatment-of-certain-domestic-entities-disregarded-as-separate-from-their-owners-as-corporations-for* (last viewed June 18, 2016).

[5] Kevin A. Bell, Peer Pressure Seen Prompting U.S. Action On Proposal for Disclosure of LLC Owner, 24 Bloomberg Tax Management Transfer Pricing Report 23 (Bloomberg BNA April 14, 2016).

[6] Letter from Jacob J. Lew, Secretary of the Treasury, to the Hon. Paul D. Ryan, Speaker of the U.S. House of Representatives (May 5, 2016), available online at *www.treasury.gov/press-center/press-releases/Documents/Lew%20to%20Ryan%20on%20CDD.PDF* (last viewed June 18, 2016).

[7] These proposed regulations of course will compliment an existing system of tax reporting regarding income and assets associated with foreign persons. For example, foreign gifts or inheritances above certain threshold monetary amounts must be reported on an IRS Form 3520. *See generally* IRS, *Gifts from Foreign Person*, available online at *www.irs.gov/businesses/gifts-from-foreign-person* (last visited June 18, 2016). Further, many U.S financial institutions must report to the IRS the interest payments that they make to nonresident alien persons. 26 C.F.R. §§ 1.6049-4(b)(5); 1.6049-5(b)(12), (f); 1.6049-6(e)(4), (e)(5); 1.6049-8(a); 31.3406(g)-1. Again, regardless of the full complexities of the entire reporting regime, the newly proposed regulations underscore the current priorities of enforcement agencies and increase the opportunity for potential misstatements to be made on behalf of bad actors from abroad.

[8] FinCEN, *Customer Due Diligence Requirements for Financial Institutions* (May 11, 2016), available online at *www.federalregister.gov/articles/2016/05/11/2016-10567/customer-due-diligence-requirements-for-financial-institutions* (last visited June 18, 2016). Covered institutions have until May 11, 2018 to comply with the rule.

[9] FinCEN, *Customer Due Diligence Requirements for Financial Institutions*, 77 FR 13046 (Mar. 5, 2012), available online at *www.gpo.gov/fdsys/pkg/FR-2012-03-05/pdf/2012-5187.pdf* (last visited June 18, 2016).

[10] FinCEN, *Customer Due Diligence Requirements for Financial Institutions*, 79 FR 45151 (Aug. 4, 2014), available online at *www.fincen.gov/statutes_regs/files/CDD-NPRM-Final.pdf* (last visited June 18, 2016).

[11] FinCEN, *FinCEN Takes Aim at Real Estate Secrecy in Manhattan and Miami* (Jan. 13, 2016), available online at *www.fincen.gov/news_room/nr/html/20160113.html* (last visited June 18, 2016).

[12] FinCEN, *Comments of Jennifer Shasky Calvery at the ACAMs AML and Financial Crimes Conference*, (Apr. 12, 2016), available online at *www.fincen.gov/news_room/nr/html/20160412.html* (last visited June 18, 2016).

[13] Louise Story, *U.S. Will Track Secret Buyers of Luxury Real Estate*, N.Y. Times (Jan. 13, 2016), available online at *www.nytimes.com/2016/01/14/us/us-will-track-secret-buyers-of-luxury-real-estate.html?_r=0* (last visited June 18, 2016) (stating that the "new government efforts were inspired in part by … the rising use of shell companies as foreign buyers increasingly sought safe havens for their money in the United States[,]" and that "[f]uture investigations … will focus increasingly on professionals who assist in money laundering, including real estate agents, lawyers, bankers and L.L.C. formation agents.").

[14] 18 USC § 1956(c)(7).

[15] The prong involving an intent to commit the crimes of tax evasion or false tax return of course still must involve proceeds earned through the commission of an earlier SUA—and, as noted, the above tax crimes are not included in the statutory list of offenses qualifying as SUAs.

[16] 15 USC §§ 78dd-1, *et seq.*

[17] 50 USC §§ 1701-1707.

[18] 18 USC §1957(c)(7)(B) provides that the following foreign offenses represent SUAs:

(i) the manufacture, importation, sale, or distribution of a controlled substance … ;

(ii) murder, kidnapping, robbery, extortion, destruction of property by means of explosive or fire, or a crime of violence … ;

(iii) fraud, or any scheme or attempt to defraud, by or against a foreign bank … ;

(iv) bribery of a public official, or the misappropriation, theft, or embezzlement of public funds by or for the benefit of a public official;

(v) [certain specified] smuggling or export control violations … ;

(vi) an offense with respect to which the United States would be obligated by a multilateral treaty, either to extradite the alleged offender or to submit the case for prosecution, if the offender were found within the territory of the United States; or

(vii) trafficking in persons, selling or buying of children, sexual exploitation of children, or transporting, recruiting or harboring a person, including a child, for commercial sex acts[.]

[19] 18 USC §1956(f).

[20] 18 USC §1957(a)(2).

[21] Hardy, Criminal Tax, Money Laundering and Bank Secrecy Act Litigation Ch. 3.III.C (BNA Bloomberg 2010).

[22] *Pasquantino,* SCt, 544 US 349 (2005).

[23] 18 USC §1341.

[24] 18 USC §1343.

[25] *Schmuck*, SCt, 489 US 705, 715 (1989).

[26] *See* 18 USC §§1956(c)(7)(A) & 1961 (1)(B).

[27] U.S. Dep't of Justice, Tax Division Directive No. 99, Clarification of Tax Division Policy Concerning The Charging of Tax Crimes as Mail Fraud, Wire Fraud, Or Bank Fraud (18 USC §§1341, 1343, 1344) or as Predicates to a Rico Charge or as the Specified Unlawful Activity Element of a Money Laundering Offense (Mar. 30, 1993) (footnote omitted), available online at *www.justice.gov/tax/criminal-tax-manual-300-policy-directives-and-memoranda#99* (last visited June 20, 2016).

[28] U.S. Dep't of Justice, Tax Division Directive No. 128 (Supersedes Directive No. 99), Charging Mail Fraud, Wire Fraud or Bank Fraud Alone or as Predicate Offenses in Cases Involving Tax Administration (Oct. 29, 2004), available online at *www.justice.gov/usam/tax-resource-manual-14-tax-division-directive-no-128* (last visited June 20, 2016).

[29] U.S. Dep't of Justice, Tax Division Directive No. 145, Restraint, Seizure and Forfeiture Policy In Criminal Tax and Tax-Related Investigations and Prosecutions, at fn. 4, available online at *www.justice.gov/sites/default/files/usam/legacy/2014/10/17/tax00039.pdf* (last visited June 21, 2016).

[30] *Yusuf,* CA-3, 536 F3d 178, 186–190 (2008). *See also Paramo*, CA-3, 998 F2d 1212, 1218 (1993) (depositing fraudulently-obtained IRS tax refund checks through mail fraud constituted "promotion" of a SUA in violation of 18 USC §1956(a)(1)(A)(i)).

[31] *Khanani*, CA-11, 502 F3d 1281, 1295–1297 (2007).

[32] *Patridge*, No. 09-CV-2149, 2010 U.S. Dist. LEXIS 77161, at *10–*12 (C.D. Ill. July 30, 2010) (unpublished) (citing *Yusuf*, 536 F3d at 189).

[33] *Shellef,* DC-NY, 732 FSupp2d 42, 75, n.48 and n. 49 (2010).

