The Panama Papers and the U.S. Response: New Risks for Financial Institutions, Clients and Advisors

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The massive Panama Papers leak from the law firm Mossack Fonseca has exposed a variety of suspicious and possibly illegal activity and drawn the attention of tax enforcement authorities and investigators worldwide. On May 9, 2016, the International Consortium of Investigative Journalists (ICIJ), released a searchable database with almost a quarter-million names of individuals and entities named in the underlying documents. There are thousands of U.S.-related "hits" in the data. While many of those listed may have engaged in perfectly lawful and properly reported offshore activities, the disclosures will inevitably lead to new criminal investigations and civil and regulatory proceedings around the world.

Of interest in the database is the fact that many well-respected professional firms are named because of their role in providing what were likely lawful services to their clients. The disclosures come at a time, however, when the United States is also coming under increasing scrutiny for what are perceived as more permissive rules as to shell companies and their financial accounts. The concept of the "U.S. as a Tax Haven" has gained increasing currency globally.

Indeed, just days ago, both the Treasury Department and the Financial Criminal Enforcement Network (FinCEN) announced initiatives to require enhanced disclosure of beneficial owners who stand behind onshore shell companies. Treasury will soon require companies owned by a single non-U.S. person and treated as a disregarded entity for tax purposes to apply for a tax identification number and in some circumstances file annual returns with the IRS. FinCEN has strengthened the requirements for financial institutions opening accounts for such companies, and similar entities with undisclosed beneficial owners. FinCEN is also targeting high-end, all-cash real estate purchases in New York and Miami for further scrutiny.

Recent legal developments have crystallized concerns among financial institutions and professional services firms that non-U.S. persons, and their families and business interests, may create risks with regard to the potential facilitation of U.S. or foreign tax evasion. More serious is that in some circumstances, engaging in transactions with funds that are the product of foreign tax evasion may constitute money laundering under U.S. law. To be sure, the U.S. has been aggressive now for eight years in pursuing Americans who have concealed offshore accounts, often held through foreign entities formed in financial secrecy jurisdictions. This remains a top U.S. enforcement priority. Now, there is a growing concern that American law enforcement may turn its attention to U.S. banks, advisors and others who may have facilitated similar conduct in another country.

The confluence of the Panama Papers release and the enhanced attention given to possible American enablers of U.S. and foreign tax evasion suggest that professional firms should examine their current client base and intake and client management practices. Banks and other financial services firms, which have increasingly asked for evidence of U.S. tax compliance, are likely now to include a foreign tax component in their due diligence.

A confidential internal review of particular files may be appropriate, and implementation of stricter compliance programs with regard to client intake and management would better position affected firms to avoid missteps in the first instance and to more credibly address any future inquiry.

Caplin & Drysdale's unique combination of its criminal tax and white collar defense practices, and its decades of experience in advising financial institutions and professional services firms on ethical and due diligence issues, is well suited to advising clients who face these increasingly important issues. Please contact one of our members with any questions.

Mark E. Matthews
mmatthews@capdale.com
202.862.5082

Scott D. Michel
smichel@capdale.com
202.862.5030

Cono R. Namorato
cnamorato@capdale.com
202.862.5090

Caplin & Drysdale
ATTORNEYS

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For more information, please visit us at www.caplindrysdale.com.

Washington, DC Office:
One Thomas Circle, NW
Suite 1100
Washington, DC 20005
202.862.5000

New York, NY Office:
600 Lexington Avenue
21st Floor
New York, NY, 10022
212.379.6000

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