Targeting U.S. Luxury Real Estate – Forced Disclosure of Wealth

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Steven Toscher, Esquire
Hochman, Salkin, Rettig, Toscher and Perez, P.C.
Beverly Hills, California 90212
310-281-3200
toscher@taxlitigator.com
www.taxlitigator.com

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Geographic Targeting Orders

- The U.S. Financial Crimes Enforcement Network (FinCEN) announced on August 22, 2017 the issuance of revised Geographic Targeting Orders (GTOs) that require **U.S**. **title insurance companies** to identify the natural persons behind shell companies used to make "all-cash" purchases of high-end residential real estate in seven metropolitan areas for the period September 22, 2017 to March 20, 2018.

- Following the recent enactment of the **Countering America's Adversaries through Sanctions Act (Pub. L. 115-44)** (signed by President Trump on August 2, 2017), FinCEN revised the GTOs to capture a broader range of transactions and include transactions involving **wire transfers or other "fund transfers"** and expanded the GTOs to include transactions conducted in the City and County of Honolulu, Hawaii.

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Using High End U.S Real Estate to Launder Money

- FinCEN is concerned about shell companies being used to buy luxury real estate in "all-cash" transactions. In addition, feedback from law enforcement indicates that the reporting has advanced criminal investigations. FinCEN believes the expanded GTOs will further help law enforcement and inform FinCEN's future efforts to assess and combat the money laundering risks associated with luxury residential real estate purchases.

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Filing of Form 8300

- U.S. title insurance companies report to FinCEN by filing a FinCEN Form 8300 within 30 days of the closing of the **Covered Transaction**. Each FinCEN Form 8300 filed pursuant to this GTO must be: (i) completed in accordance with the terms of this GTO and the FinCEN Form 8300 instructions (when such terms conflict, the terms of the GTO apply); and (ii) e-filed through the Bank Secrecy Act E-filing system. Further, they must: (1) retain all records relating to compliance with the GTO for a period of five years from the last day that the GTO is effective (including any renewals of the GTO); (2) store such records in a manner accessible within a reasonable period of time; and (3) make such records available to FinCEN or any other appropriate law enforcement or regulatory agency, upon request.

FinCEN Advisory

- FinCEN published an Advisory to provide financial institutions and the real estate industry with information on the money laundering risks associated with real estate transactions, including those involving luxury property purchased through shell companies, particularly when conducted without traditional financing. The Advisory provides information on how to detect and report these transactions to FinCENs.

- In January 2016, FinCEN issued GTOs to require U.S. title insurance companies to report beneficial ownership information on legal entities, including shell companies, used to purchase certain luxury residential real estate in Manhattan and Miami—specifically, luxury residential property purchased by a **shell company without a bank loan** and made at least in part using a cashier's check or similar instrument. In July 2016 and February 2017, FinCEN reissued the original GTOs and extended coverage to all boroughs of New York City, two additional counties in the Miami metropolitan area, five counties in California (including Los Angeles, San Francisco, and San Diego), and the Texas county that includes San Antonio. On August 22, 2017, FinCEN extended the GTO to Honolulu, Hawaii.

Covered Transaction

- The GTOs identify a **Covered Transaction** as a transaction in which: (a) a Legal Entity (corporation, limited liability company, partnership or other similar business entity, whether formed under the laws of a state or of the United States or a foreign jurisdiction); (b) purchases residential real property; (c) **without a bank loan** or other similar form of external financing; and such purchase is made, at least in part, using currency or a cashier's check, a certified check, a traveler's check, a personal check, a business check, or a money order in any form, **or a funds transfer**; (d) the total purchase price is (i) $2,000,000 or more in the California counties of San Diego, Los Angeles, San Francisco, San Mateo, or Santa Clara; (ii) $3,000,000 or more in the City and County of Honolulu in Hawaii; (iii) $3,000,000 or more in the Borough of Manhattan in New York City, New York; (iv) $1,500,000 or more in the Borough of Brooklyn, Queens, Bronx, or Staten Island in New York City, New York; (v) $1,000,000 or more in the Florida counties of Miami-Dade, Broward, or Palm Beach; and (vi) $500,000 or more in the Texas county of Bexar.

Covered Business

- The GTOs require a **Covered Business** to collect and report certain identifying information about the Beneficial Owner(s) of the Purchaser in a Covered Transaction. For purposes of the GTOs, a "Beneficial Owner" means each individual who, directly or indirectly, owns 25% or more of the equity interests of the Purchaser. The GTOs provide that the Covered Business must obtain and record a copy of the Beneficial Owner's driver's license, passport, or other similar identifying documentation. The Covered Business may reasonably rely on the information provided to it by third parties involved in the Covered Transaction, including the Purchaser or its representatives, in determining whether the individual identified as a Beneficial Owner is in fact a Beneficial Owner.

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FinCEN Findings

- Within the scope of real estate transactions covered by the GTOs, FinCEN data indicates that about **30 percent** of reported transactions involve a beneficial owner or purchaser representative that was also the subject of a **previously filed suspicious activity report**. A covered financial institution is required to file a SAR if it knows, suspects, or has reason to suspect a transaction conducted or attempted by, at, or through the financial institution involves funds derived from illegal activity, attempts to disguise funds derived from illegal activity, is designed to evade regulations promulgated under the BSA, lacks a business or apparent lawful purpose, or involves the use of the financial institution to facilitate criminal activity.

FinCEN Findings

According to FinCEN, beneficial owners or purchaser representatives in a significant portion of transactions reported under the GTO had been previously connected to a wide array of suspicious activities, including:

• A beneficial owner suspected of being connected to over $140 million in suspicious financial activity since 2009 and who sought to disguise true ownership of related accounts.

• Two beneficial owners (husband and wife) involved in a $6 million purchase of two condominiums were named in nine SARs filed from 2013 – 2016 in connection with allegations of corruption and bribery associated with South American government contracts.

• A beneficial owner suspected of being connected to a network of individuals and shell companies that received over $6 million in wire transfers with no clear business purpose from entities in South America. Much of these funds were used for payments to various real estate related businesses.

FinCEN Findings

Eleven SARs filed from 2008 through 2015 named either the buyer (an LLC), beneficial owner, or purchaser's representative involved in a GTO-reported $4 million purchase of a residential unit. Law enforcement records indicate that both the purchaser's representative and his business associate were associated with a foreign criminal organization involved in narcotics smuggling, money laundering, health care fraud, and the illegal export of automobiles.

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New Rules for Foreign Owned Disregarded Entities

Background

- U.S. Limited Liability Companies (LLC) can be formed in many states and ownership is not a matter of public record.
- An LLC can be established by an "incorporator," who can be a lawyer, accountant, paralegal, or other person who has no interest in the company and no obligation to disclose the owners.
- For U.S. tax purposes, U.S. LLCs are deemed to be partnerships if they have two or more members and are deemed to be "disregarded entities" if they have only one member.

Foreign Owned Disregarded Entities

- A nonresident alien can form an LLC and if it invests solely in assets that do not have income that is "effectively connected" with a U.S. trade or business or U.S. source income, it is not required to file a U.S. income tax return, nor is it required to obtain an employer identification number (EIN).
- Under current U.S. law, there was a limited ability to obtain information about the ownership of these entities, their assets and activities.
- **The new rules are intended to provide the IRS with improved access to information to satisfy its obligations under tax treaties and tax information exchange agreements, as well as to strengthen the enforcement of U.S. tax laws.**

New Regulations

New Regulations

- Regulations were proposed in 2016 and are now final to amend Treasury Regulations Section 301.7701-2(c) to treat a domestic disregarded entity wholly owned by a foreign person as a domestic corporation separate from its owner for the limited purpose of the reporting and record maintenance requirements under IRC Section 6038A, including the requirement of obtaining an Employer Identification Number.
- This change will not affect the treatment of single member LLCs as disregarded entities for substantive tax purposes.
- The new reporting rules are effective for tax years beginning on or after **January 1, 2017**.

New Regulations

- An entity obtains an EIN by filing a form SS-4 (Application for Employer Identification Number), which requires the identification of the responsible party. The SS-4 instructions define a responsible party for an entity as “the individual who has a level of control over, or entitlement to, the funds or assets in that entity that, as a practical matter, enables the individual, directly or indirectly, to control manage, or direct the entity and the disposition of its funds and assets.”

New Regulations

- Reporting requirements under Section 6038A include any sale, assignment, lease, license, loan, advance, or other transfer of any interest in or a right to use any property or money, the performance of any services for the benefit of, or on behalf of another taxpayer, and amounts paid or received in connection with the formation, dissolution, acquisition, and disposition of the entity, including contributions to and distributions from the entity.

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New Regulations

- The penalty for failing to file a Form 5472 for each reportable transaction is $10,000 and the failure to maintain records is a violation under Section 6038(a) and is subject to a similar $10,000 penalty.

- Criminal penalties apply for the willful failure to submit information or for filing false or fraudulent information.

Final Beneficial Ownership Regulations and Proposed Legislation

Background

- Unlike many other countries, the U.S. has not required the collection of beneficial ownership information.
- Recent finalization of regulatory amendments to the Bank Secrecy Act ("BSA") make explicit Customer Due Diligence Rules (CDD), including identifying beneficial owners for covered financial institutions.

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New Beneficial Ownership Regulations

New Regulations

- The New Regulations requires covered financial institutions to identify and verify the identity of natural persons who are the beneficial owners of a legal entity customer, subject to certain exemptions.
- These requirements apply to all new accounts going forward from the date of implementation of the Regulations; they do not apply to existing accounts unless a legal entity customer opens a new account with the financial institution.
- The New Regulations define the term "beneficial owner" using a two-pronged test of ownership and control.

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Beneficial Ownership Regulations

- Under the **<u>ownership prong</u>**, a beneficial owner is "[e]ach individual, if any, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, <u>owns 25 percent or more of the</u> equity interests of a legal entity customer." Financial institutions are not required to identify more than four beneficial owners. If no individual owns 25% or more of a legal entity, the financial institution is not required to identify any beneficial owner under this prong.
- Under the **<u>control prong</u>**, a beneficial owner is defined as "[a] single individual with significant responsibility to control, manage, or direct a legal entity customer[.]" The single individual with control could be an <u>executive officer or senior manager</u>, including one of the positions enumerated in the definition, such as the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer, a Managing Member, a General Partner etc.

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Proposed Legislation

Proposed Legislation

- Last year the U.S. Treasury Department submitted to Congress legislation that would amend the BSA to require the reporting of beneficial ownership information for United States entities.
- Legislation requiring the disclosure of beneficial ownership information has been introduced in the past, but never enacted, and has been opposed by states, because of the costs involved and because a number of these states generate significant revenue from incorporation fees.

Proposed Legislation

- Treasury's proposed legislation would amend the BSA to include a section allowing the Secretary to require the maintenance of records and filing of reports with the Treasury Department relating to the beneficial owners of entities formed in the United States at the time of the company's creation.
- The proposed legislation addresses widespread criticism of the ability for shell companies to incorporate under U.S. state law and hide assets.

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Proposed Legislation

- The proposed legislation requires any entity formed in the U.S. to maintain records and file reports on the beneficial owners of the U.S. entities.
  - Reports or records shall include names, addresses, unique identifying numbers, such as social security, tax identification, passport, and driver's license numbers, and such other information, including information on the identity of any entity and individual who formed the United States entity as well as the identity of the individual who is submitting the report, as the Secretary may prescribe by regulation.

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Proposed Legislation

- Any person who fails to comply with any requirement of this section or any regulation prescribed under this section shall be liable to the United States for a civil penalty of $5,000 for each such violation. Each day a violation continues shall constitute a separate violation for purposes of this paragraph.
- The United States entity and any beneficial owner whose identity the United States entity was required to disclose in the report or record may be liable for the penalty.

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The Ability to Hide Wealth in US Has Been Greatly Diminished

- The expanded GTOs, new IRS Regulations and the beneficial ownership rules all work together to try to identify hidden wealth.
- The GTOs focus on a specific abuse area—all cash purchases of luxury real estate; new IRS regulations for the first time gives the IRS information on disregarded foreign owned entities; and the new beneficial ownership rules focus on financial institutions knowing who their legal entity customers are, regardless of where those entities are formed, as part of due diligence at the time of account opening. However, the information provided may not be reliable, and may be impossible to verify given the lack of requirements for states to maintain reliable, verified, and up-to-date entity formation information.
- The proposed legislation focuses on ensuring that legal entities formed in the United States are more transparent to law enforcement regardless of where they conduct their financial activity.

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The Ability to Hide Wealth in US Has Been Greatly Diminished

- The new rules plug long standing loopholes in U.S. reporting requirements for the reporting of the real or beneficial owners, including tax reporting and reporting under the Bank Secrecy Act.
- The proposed legislation on beneficial ownership – given its history – may not become reality, but the GTOs, the new tax reporting regulations and new BSA regulations for financial institutions will require more robust reporting of the beneficial owners of U.S. entities.
- Persons who fail to comply with these new requirements are subject to substantial civil penalties under the IRC and BSA for failure to comply, including criminal sanctions for intentional failures.

Biographical Information

Steven Toscher is a tax attorney and principal of the law firm of Hochman, Salkin, Rettig, Toscher & Perez, P.C., Beverly Hills, California where he specializes in civil and criminal tax litigation. He is also an Adjunct Professor at the University of Southern California, School of Accounting, where he teaches Federal Tax Procedure.
Mr. Toscher is a Certified Tax Specialist in Taxation, the State Bar of California Board of Legal Specialization, a Fellow of the American College of Tax Counsel and has received an "AV" rating from Martindale Hubble. He is a past Chair of the Taxation Section of the Los Angeles County Bar Association and served as the tax editor on the Editorial Board of the Los Angles Lawyer.

Prior to entering private practice, Mr. Toscher served as a Trial Attorney with the Tax Division of the United States Department of Justice, where he received its Outstanding Attorney Award. He is a *summa cum laude* graduate of the University of San Diego School of Law and a former Internal Revenue Agent. Mr. Toscher is a frequent lecturer and author on tax controversy topics, including FBAR and other international enforcement matters. In addition to his many periodical publications, he is a co-author of Tax Management's "*Tax Crimes*" Portfolio.

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