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THE U.S. ADDRESSES ITS ROLE AS A TAX HAVEN

For many reasons, investors are choosing the United States. The nation is the world's largest economy, home to the most stable currency and financial system. Even in challenging political environments, the U.S. government is based on a system of checks-and-balances with a history of free elections and peaceful transfers of power. This is likely why, as of 2018, an estimated 20 percent of the world's offshore financial assets are kept in the United States.[5] Along with traditional investors, however, there are also those who bring their assets into the U.S. to avoid paying taxes in their home countries or to avoid making required financial disclosures to their local tax jurisdiction. In this regard, the U.S. lags behind its European peers in collecting and sharing information necessary to identify this type of tax evasion.

Since 2005, the European Union has had regulations on collecting information on those natural persons who control or own assets using legal entities which, when opaque, may be used as vehicles to engage in unlawful acts.[6] In

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[5] Tax Justice Network, *Financial Secrecy Index* (2018), *available at* https://www.financialsecrecyindex.com/; Tax Justice Network, *Narrative Report on USA* (2018), *available at* https://www.financialsecrecyindex.com/PDF/USA.pdf.

[6] *See* Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, 2005 O.J. L 309/15.

"Until recently, the United States has not collected... information on legal entities' beneficial owners, and it is generally prevented by existing laws from sharing such information with others. Consequently, the U.S. continues to attract those who seek a haven for their assets outside less stable, and occasionally less inquiring, home countries."

2015, the EU significantly strengthened those regulations through its Fourth Anti-Money Laundering Directive.[7] Under that Directive, member states agreed to track legal entities' beneficial owners — generally those who owned greater than 25-percent of an entity, or who exercised management or control over it — and to store that information in centralized databases.[8] These databases are accessible both to government authorities and to anyone, such as banks, law firms, and journalists, who can identify a "legitimate interest" in such information. Member states were given two years to implement this Directive with corresponding national legislation (though many missed this deadline).[9] Until recently, the United States has not collected such information on legal entities' beneficial owners, and it is generally prevented by existing laws from sharing such information with others.[10] Consequently, the U.S. continues to attract those who seek a haven for their assets outside less stable, and occasionally less inquiring, home countries.

Recently, the U.S. federal government has taken several steps to improve its disclosure and tax enforcement regime. Specifically, the United States has:

- Increased the use of Geographic Targeting Orders to gather information on the beneficial owner of a legal entity purchasing high-end real estate in certain areas;
- Added new customer due diligence rules that require financial instituti-ons to identify customers that own accounts through legal entities; and

[7] *See* Directive 2015/849 of the European Parliament and of the Councile of May 20, 2015, L 141/73.

[8] Laura Glynn, *UBO in Focus: FinCEN Final Rule vs 4th EU Money Laundering Directive*, Fenergo (Oct. 2016), *available at* https://www.fenergo.com/resources/blogs/ubo-in-focus-fincen-final-rule-vs-4th-eu-money-laundering-directive.html; Directive 2015/849/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, 2015 O.J. L 141/73.

[9] Trulioo, *4AMLD Review – Implementation and Recent News* (Oct. 26, 2017), *available at* https://www.trulioo.com/blog/4amld-review/.

[10] *See* 26 U.S.C. § 6103; *see also* Michael Volkov, *May 2018: D-Day for FinCEN Customer Due Diligence and EU's General Data Privacy Regulations*, Volkov Law (Dec. 13, 2017), *available at* https://blog.volkovlaw.com/2017/12/may-2018-d-day-fincen-customer-due-diligence-eus-general-data-privacy-regulations/.

"Recently, the U.S. federal government has taken several steps to improve its disclosure and tax enforcement regime... In addition, the U.S. Department of Justice is primed to focus investigations of alleged evaders of foreign tax laws who commit acts in the U.S... Together, these new measures are intended to better assist the United States in enforcing its own laws, and they may also make it easier for foreign tax jurisdictions to identify tax evaders that use the U.S. as a haven."

- Promulgated new disclosure requirements on certain foreign-owned U.S. companies.

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1 GEOGRAPHIC TARGETING ORDERS IDENTIFY SUSPICIOUS INVESTMENTS IN THE U.S. REAL ESTATE MARKET

The United States is increasingly using Geographic Targeting Orders (GTOs) to identify the natural people behind holding companies used to pay for luxury residential real estate. These GTOs are issued by the Financial Crimes Enforcement Network (FinCEN) within the U.S. Treasury Department. FinCEN has the responsibility to safeguard "the financial system from illicit use and combat money laundering and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities." [11] To fulfill this obligation, FinCEN was given the authority to impose additional data collection and reporting requirements, through GTOs, on financial institutions and other trade or business activity for geographic areas.[12] By the terms of the authorizing statutes, GTOs can

[11] U.S. Dep't. of Treas., FinCEN, *What We Do: Mission*, https://www.fincen.gov/about_fincen/wwd/mission; *see also* Treasury Order 105-08, *Establishment of the Financial Crimes Enforcement Network*, (Apr. 25, 1990). Among other responsibilities, FinCEN is the agency that collects and analyzes the data from currency transaction reports (CTRs) filed at banks, reports collected from international travelers who carry cash in excess of $10,000 (CMIRs), suspicious activity reports (SARs) filed by financial institutions, and similar information reporting mechanisms.

[12] *See* 31 U.S.C. § 5326(a); 31 CFR § 1010.370; Treasury Order 180-01, *Federal Crimes Enforcement Network* (Sept. 26, 2002).

be effective for only up to 180 days at a time, but may be renewed without limitation.[13]

In 2016, FinCEN issued two GTOs requiring U.S. title insurance companies to identify the so-called "beneficial owners" of legal entities used in all-cash, luxury real estate transactions in Manhattan, a borough of New York City, and Miami-Dade County in the state of Florida.[14] Beneficial owners are defined as the natural people, whether foreign or domestic, who own a 25-percent or more interest in the legal entity used to purchase real estate. FinCEN directed these GTOs to title insurance companies (which guarantee that titles to property are in fact legitimate), rather than to banks or financial institutions, because these all-cash transactions generally do not require financing. FinCEN subsequently expanded the reporting requirement to include purchases made by check, money order, or wire transfer. For each covered purchase, a title insurance company must:

- Identify the purchasing entity's beneficial owners;
- Retain copies of each beneficial owner's identification documentation;
- For the purchasers that are limited liability companies, provide for each member of that company his or her name, address, and taxpayer identification; and
- Provide details about the transaction, including the property's address, purchase price, and date of closing.[15]

A violation of these GTOs could subject a covered title insurance company to civil penalties up to $100,000 or criminal penalties up to $500,000 and ten years in prison.[16]

The first two GTOs covered Manhattan in New York City and Miami-Dade County in Florida, and were in effect from March 2016 to August 2016. FinCEN Acting Director, Jamal El-Hindi, concluded that the GTOs were "producing valuable data that is assisting law enforcement and [are] serving to inform our future efforts to address money laundering in the real estate sector."[17] FinCEN issued several

[13] *Id.*

[14] *See* Press Release, U.S. Dep't of Treas., FinCEN, *FinCEN Takes Aim at Real Estate Secrecy in Manhattan and Miami* (Jan. 13, 2016), *available at* https://www.fincen.gov/news/news-releases/fincen-takes-aim-real-estate-secrecy-manhattan-and-miami.

[15] *See* FinCEN, *Geographic Targeting Order, available at* https://www.fincen.gov/sites/default/files/shared/Real_Estate_GTO-NYC.pdf.

[16] *Id.*

[17] Matthew D. Lee, *FinCEN Quietly Extends Real Estate Geographic Targeting Orders for Another Six Months*, Fox Rothschild (Apr. 25, 2018).

new GTOs from 2016 until the present. In early 2017, it issued GTOs covering Manhattan and Miami-Dade County again, and expanded coverage to the remaining boroughs of New York City, two counties neighboring Miami-Dade, as well as Los Angeles, the San Francisco region, and San Diego in California, and San Antonio in Texas.[18] The GTOs for these regions were extended in the fall of 2017 and again in the spring of 2018, and were expanded to include counties in Hawaii as well.[19]

Although these GTOs are, by statute, only authorized for 180 days, with the most recent GTOs scheduled to expire in September 2018, it seems likely that the U.S. government will continue to use this tool.

2 U.S. STRENGTHENS CUSTOMER DUE DILIGENCE RULE REQUIRING FINANCIAL INSTITUTIONS TO KNOW BENEFICIAL OWNERS OF ENTITY OWNED ACCOUNTS

In 2016, FinCEN issued a rule imposing new customer due diligence (CDD) obligations that require certain U.S. financial institutions to identify the individual beneficial owners behind entities that own U.S. financial accounts.[20] When the rule was first issued in 2016, it provided a two-year implementation period.[21] The rule went into effect on May 11, 2018, and applies to accounts opened after that date unless, in the course of monitoring the account, the financial institution detects information that significantly changes the account's risk profile.[22] According to FinCEN, this rule was intended to clarify and strengthen existing anti-money laundering requirements for financial institutions and assist U.S. law enforcement in investigating financial crimes.

Customer due diligence involves four key elements: (1) customer identification and verification; (2) beneficial ownership identification and verification; (3) understanding the nature and purpose of customer relationships to develop a customer risk profile; and (4) conducting ongoing monitoring to identify and report suspicious transactions. "Covered" institutions for purposes of the CDD rule include federally regulated banks, federally insured credit unions, mutual funds, brokers or dealers in securities, futures commis-

[18] FinCEN, *Geographic Targeting Order* (Feb. 21, 2017), *available at* https://www.fincen.gov/sites/default/files/shared/Real%20Estate%20GTO%20February%20 2017%20-%20Generic.pdf.

[19] FinCEN, *Geographic Targeting Order* (Aug. 22, 2017), *available at* https://www.fincen.gov/sites/default/files/shared/Real%20Estate%20GTO%20Order%20-%20 8.22.17%20Final%20for%20execution%20-%20Generic.pdf.

[20] 81 Fed. Reg., 29397 (2016).

[21] *Id.*

[22] 81 Fed. Reg. 29,398.

sion merchants, and brokers of commodities.[23] The legal entity customers for which covered institutions must identify and collect beneficial ownership information include corporations, limited liability companies, and general partnerships, among other forms of entities.[24] Beneficial owners can be either those who own 25 percent or more of the equity interest in the legal entity customer, or those who have significant responsibility to direct the legal entity.[25] Both foreign and domestic beneficial owners are covered under the rule.

Under the rule, covered financial institutions must obtain, verify, and record the identities of the beneficial owners of their legal entity customers. To do this they must establish written procedures for verifying these customers. Such procedures must have "risk-based" practices for verifying the identity of each beneficial owner. And such procedures must generally enable the institution to identify the beneficial owners each time a new account is created.[26]

In response to industry inquiry, in April 2018, FinCEN released guidance in the form of Frequently Asked Questions about the new rule.[27] In the FAQs, FinCEN clarified that covered financial institutions can adopt more stringent written policies than those required by the rules.[28] For example, financial institutions can choose to collect beneficial ownership information down to a lesser 10-percent ownership threshold, rather than to the 25-percent standard. FinCEN also determined that companies listed on foreign exchanges are considered to be covered legal entities subject to the CDD rules.[29] In the context of multiple-tiered entities, FinCEN determined that covered financial institutions must identify the ultimate beneficial owners of legal entities that themselves own legal entity customers.[30] If a legal entity opens multiple accounts, FinCEN clarified that financial institutions must identify and verify the ownership information for each account, regardless of the number of accounts being opened.[31]

FinCEN also clarified the extent to which covered financial institutions can rely on information provided by

[23] 31 C.F.R. § 1010.605(e)(1).

[24] *Id.*

[25] *Id.*

[26] FinCEN, Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions (Apr. 3, 2018), *available at* https://www.fincen.gov/sites/default/files/2018-04/FinCEN_Guidance_CDD_FAQ_FINAL_508_2.pdf.

[27] *Id.*

[28] *Id.* at Question 1.

[29] *Id.* at Question 24.

[30] *Id.* at Question 3.

[31] *Id.* at Question 10.

their legal entity customers to identify and verify their ultimate beneficial owners.[32] FinCEN confirmed that financial institutions generally could identify their customers' beneficial owners by relying on information given by their legal entity customers' representatives, provided that the institution had no substantial reason to question the reliability of that information.[33] FinCEN further confirmed that financial institutions could verify the identity of a beneficial owner by obtaining from the legal entity a copy of a valid identity document.[34]

According to the U.S. government, the impact of the CDD rule is significant. It estimated that the rule itself will affect approximately 21,500 institutions in the United States.[35] The U.S. Treasury also estimates that the rule could curb an estimated $1.8 billion in illicit proceeds generated in the United States by financial crimes.[36]

Striking a balance, FinCEN also recently issued highly anticipated guidance in response to an inquiry by the Florida International Bankers Association (FIBA) that limits disclosure obligations in certain circumstances.[37] In February 2018, FinCEN determined that U.S. financial institutions need not file Suspicious Activity Reports (SARs) when foreign customers enter into tax amnesty or regularization programs in their home countries, voluntarily disclosing past financial noncompliance to taxing authorities.[38] Regulations promulgated under the Bank Secrecy Act require a financial institution to file a SAR when it detects a suspicious transaction conducted by, at, or through a U.S. financial institution.[39] In connection with recently implemented tax regularization or voluntary disclosure programs in Latin America, U.S. financial institutions are often requested to provide documentation verifying the value of a customer's U.S. holdings. FIBA asserted that both as a matter of law and best practices, a financial insti-

[32] *Id.* at Questions 4-6.

[33] *Id.*

[34] *Id.*

[35] Customer Due Diligence Requirements for Financial Institutions, 79 Fed. Reg. 45169 (Aug. 2014) (to be codified at 31 C.F.R. § 1010.230).

[36] *Id.*

[37] FinCEN, *Request for Guidance on SAR Filing Obligations with regard to Customer Participation in a Tax Regularization Program* (Feb. 21. 2018).

[38] For purposes of SAR reporting, a transaction is suspicious if it:

1 involves funds derived from illegal activity or if it is conducted to hide or disguise funds or assets derived from illegal activity as part of a plan to violate or evade Federal law or regulation or to avoid any Federal transaction reporting requirement;

2 is designed to evade any requirements of the BSA or any BSA implementing regulations; or

3 has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the financial institution knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.
31 CFR § 1010.320.

[39] 31 C.F.R. §§ 1010.320, 1020.320.

tution in this situation does not have an obligation to file a SAR, but instead should subsequently undertake a review of its customer's accounts.[40]

FinCEN agreed that a customer's inquiry to the financial institution or participation in a voluntary disclosure does not constitute a suspicious transaction or activity for purposes of the SAR regulations.[41] FinCEN did, however, advise that the financial institution "may choose to undertake a subsequent review" of its customer's accounts.[42]

Prosecution for money laundering can include not only the person responsible for the underlying crime that generated the illicit funds, but also any person or business that knowingly assists or attempts to assist in the effort.[43] The United States has brought prosecutions based on "willful blindness" as well as actual knowledge.[44] Thus, while FinCEN determined that financial institutions can rely on representations made by its customers regarding the owner or controller of accounts, institutions cannot turn a blind eye to suspicious activity. The best defense is a comprehensive Anti-Money Laundering and Bank Secrecy Act compliance program.

3 SINGLE MEMBER LIMITED LIABILITY COMPANIES ARE NOW REQUIRED TO DISCLOSE THEIR FOREIGN OWNERS

In 2016, the U.S. Treasury Department issued final regulations that require certain foreign-owned U.S. companies, known as limited liability companies, or LLCs, to disclose their owners to the Internal Revenue Service.[45] When an LLC has just one owner, known as a "member," it is considered to be a disregarded entity for U.S. tax purposes, and the income it generates is reported on the income tax returns of the individual LLC owner.[46] Prior to the promulgation of the new regulations, single-member LLCs generally did not file tax returns, nor did they file the Internal Revenue Service's Form SS-4 for the issuance of an Employee Identification Number. The Treasury Department's regulations changed all that.

[40] FIBA, Letter to Andrea Sharrin, Associate Director, Regulatory Policy and Programs Division, FinCEN, U.S. Department of Treasury (Dec. 19, 2016).

[41] FinCEN Guidance, *supra* note 35.

[42] *Id.*

[43] 18 U.S.C. §§ 1956, 1957.

[44] *United States v. Quinones*, 635 F.3d 590, 594 (2d Cir. 2011). *See also United States v. Vinson*, 852 F.3d 333, 357 (4th Cir. 2017); *United States v. Haire*, 806 F.3d 991, 998 (8th Cir. 2015); *United States v. Adorno-Molina*, 774 F.3d 116, 124-25 (1st Cir. 2014); *United States v. Alaniz*, 726 F.3d 586, 611-13 (5th Cir. 2013); *United States v. Antzoulatos*, 962 F.2d 720, 725 (7th Cir. 1992).

[45] T.D. 9796 (Dec. 13, 2016).

[46] Treas. Reg. § 301.7701-2(c)(2)(i).

040 Under the new regulations, when an LLC is owned by a single individual who is not a U.S. person, that entity must:

- Obtain an employer identification number from the IRS by filling out the Form SS-4 with the responsible party's social security number, taxpayer number, or employer identification number;
- Annually file Form 5472, which identifies, among other things, the foreign shareholders that own 25-percent or more of the legal entity;
- Identify certain transactions between the LLC and related parties and the LLC's foreign owner, including payments from the LLC to its owner, capital contributions, or use of LLC's property by the owner; and
- Maintain records sufficient to establish the accuracy of the filing of Form 5472.[47]

Failure to file a Form 5472 or to maintain the supporting records as required could result in civil or even criminal penalties.[48]

These regulations were hailed as "critical to preventing criminals from using the global financial system to launder proceeds from corruption or other illegal activities, finance criminal activity or even terrorism, evade international sanctions regimes, or evade taxes."[49] They represent another step in the U.S. Government's efforts to enhance its abilities, through disclosure and transparency, to investigate and prosecute the use of US financial systems and investments to commit transnational crime, money laundering, and foreign tax evasion.

4 POTENTIAL OF U.S. PROSECUTIONS FOR EVADERS OF FOREIGN TAX LAWS

In addition to these tools, and potentially more disclosure requirements to come, federal prosecutors are using an older tool: the ability to charge foreign tax evasion as a U.S. crime under the reasoning of *Pasquantino v. United States.*[50] Through *Pasquantino*, the government may reach for money laundering and other criminal charges that will give rise to forfeiture actions.

[47] Treas. Reg. §1.6038A-2(e)(3) & (e)(4).

[48] 26 U.S.C. § 6038A(d).

[49] Fact Sheet, The White House, Office of the Press Secretary, *Obama Administration Announces Steps to Strengthen Financial Transparency, and Combat Money Laundering, Corruption, and Tax Evasion*, (May 5, 2016), available at https://www.whitehouse.gov/the-press-office/2016/05/05/fact-sheet-obama-administration-announces-steps-strengthen-financial.

[50] 544 U.S. 349 (2005).

In *Pasquantino*, the defendants were convicted of wire fraud for carrying out a scheme to evade Canadian excise taxes. At trial, the court found that the defendants, while in New York, used a telephone to order discount liquor from a store in Maryland on numerous occasions.[51] They would then employ several individuals to conceal the liquor in their cars and drive it over the Canadian border, thus avoiding paying the required excise taxes to the Canadian tax authority.[52]

On appeal to the U.S. Supreme Court, the initial question was "whether a plot to defraud a foreign government of tax revenue violates the federal wire fraud statute."[53] Section 1343 of Title 18 of the U.S. Code prohibits the use of interstate wires to effect "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises."[54] The Court held that Canada's right to excise taxes constituted a "property" interest that can serve as the object of a fraud within the meaning of the wire fraud statute.[55] The defendant's plot was found to be a "scheme or artifice to defraud" Canada of tax revenue, as the evidence showed that the defendants regularly concealed, and failed to declare to Canadian officials, imported liquor.[56]

The defendants argued that the prosecution contravened the common law revenue rule[57] because it required the Court to recognize and assist in the collection of taxes arising out of the revenue laws of Canada.[58] Additionally, the defendants argued that enforcement of the wire fraud statute in connection with foreign tax matters intruded on the executive branch's domain of establishing international tax policy. In particular, the defendants cited to multiple provisions of the U.S.-Canada Income Tax Treaty (the "Treaty"), including one provision in the Protocol Amending the Treaty that provides that the United States and Canada agree "to

[51] *See id.* at 352 (citing *United States v. Pasquantino*, 336 F.3d 321, 325 (4th Cir. 2003)).

[52] *Id.*

[53] *Pasquantino*, 544 U.S. at 352.

[54] 18 U.S.C. § 1343.

[55] *See Pasquantino*, 544 U.S. at 355–56.

[56] *Id.* at 358.

[57] Historically the common law principle known as the "revenue rule" prevented U.S. courts from recognizing or enforcing foreign tax laws. The revenue rule is traditionally traced to Lord Mansfield's holding in *Holman v. Johnson* that "no country ever takes notice of the revenue laws of another." (1775) 98 Eng. Rep. 1120, 1121 (K.B.). The modern-day revenue rule is more narrow, preventing "courts of one sovereign [from] enforc[ing] final tax judgments or unadjudicated tax claims of other sovereigns." *Att'y Gen. of Can. v. R.J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d 103, 110 (2d Cir. 2001) (observing that the revenue rule originated in English courts in the eighteenth century and that the "rule has entered United States common law [and] international law").

[58] *See* Brief for the Petitioners at 16, *Pasquantino v. United States*, 544 U.S. 349 (2005) (No. 03-725).

ensure comparable levels of assistance to each of the Contracting States."[59] According to the defendants, this provision demonstrates that the United States and Canada have "expressed a policy preference for reciprocity in the level of each other's tax judgments and claims."[60]

The U.S. Supreme Court rejected these arguments and held that the common law revenue rule prohibited the U.S. government from enforcing foreign penal law, but not from enforcing domestic criminal law.[61] In this case, the Court ruled the "offense was complete the moment they executed their scheme intending to defraud Canada of tax revenue inside the United States... Therefore only domestic conduct is at issue here."[62] The dissent, on the other hand, was convinced that because the wire fraud statute required prosecutors to provide evidence that defendants deprived the victim of money or property, an unadjudicated Canadian tax claim does not sufficiently satisfy this requirement, and the Treaty provisions and revenue rule safeguards prevent a U.S. court from adjudicating the claim on Canada's behalf.[63]

The use of a telephone, the Internet, or mail in the United States in pursuit of a scheme to evade foreign taxes by means of filing a false tax return might be seen by prosecutors as a means to charge wire or mail fraud. Under the reasoning of *Pasquantino*, it is also possible that a federal prosecutor may assert that active concealment of income or assets in the United States to avoid foreign tax-through, for example, formation of a holding company to conceal the foreign person's identity – may be sufficient to constitute fraud.

In *United States v. Yusuf*, the Third Circuit, a federal appellate-level court, relied on the Supreme Court's holding in *Pasquantino* to affirm a conviction under the federal money laundering statute.[64] To establish the criminal offense of money laundering, the government must prove that the defendant engaged in a financial transaction using proceeds of a "specified unlawful activity" while knowing that the proceeds

[59] Protocol Amending the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, U.S.-Can., 2030 U.N.T.S. 237, art. 15 (Mar. 17, 1995).

[60] Brief for the Petitioners, *supra* note 47 at 48.

[61] *See Pasquantino*, 544 U.S. at 364.

[62] *Pasquantino*, 544 at U.S. at 371.

[63] *See Pasquantino*, 544 U.S. at 380-81 (Ginsburg, J., dissenting) (finding that "there is scant room for doubt about Congress' general perspective: Congress has actively indicated, through both domestic legislation and treaties, that it intends 'strictly [to] limit the parameters of any assistance given' to foreign nations").

[64] 536 F.3d 178 (3d Cir. 2008).

were earned through an unlawful activity.[65] The term "specified unlawful activity" includes wire fraud and mail fraud.[66] Conspicuously absent from the long list of offenses that may constitute "specified unlawful activity" under the money-laundering statutes are violations of the U.S. tax laws under Title 26, the Internal Revenue Code. In addition to the above elements, the government must also prove that the defendant acted with one of four intentional proscribed purposes: (1) to conceal or disguise the nature, location, source, ownership, or control of the proceeds of the specified unlawful activity; (2) to promote the specified unlawful activity; (3) to further the crimes of tax evasion, or subscribing to and filing materially false federal tax returns; or (4) to avoid state or federal currency transaction reporting requirements, such as a Suspicious Activity Report.[67]

In *Yusuf*, the defendants engaged in a scheme to defraud the U.S. Virgin Islands out of a gross receipts tax.[68] The defendants in *Yusuf* were required to comply with statutorily mandated monthly reporting of gross receipts and payment of a four-percent tax on those receipts to the Virgin Islands.[69] The defendants, however, engaged in a scheme to avoid reporting approximately $60 million in gross receipts on the monthly tax returns.[70] The scheme included purchasing cashier's and traveler's checks and money orders made payable to third parties to disguise the proceeds as legitimate financial instruments.[71] The grand jury returned a 78-count indictment, charging various counts relating to mail fraud, tax evasion, and international money laundering.[72]

The trial court dismissed the money-laundering counts, finding that the tax savings cannot be considered "proceeds" of mail fraud because such amounts "were merely *retained*, rather than *obtained*, money resulting from defendants' noncompliance with the Virgin Islands' gross receipts reporting statute."[73] The issue on appeal to the Third Circuit was whether unpaid taxes owed to the Virgin Islands that were "retained by means of the filing of false tax returns through the U.S. mail are 'proceeds' of mail fraud for purposes of sufficiently stating an offense for money laundering."[74]

[65] 18 U.S.C. § 1956.

[66] *Id.* at § 1956(c)(7).

[67] *Id.* at § 1956(a).

[68] *See Yusuf*, 536 F.3d at 181 (citing 33 V.I. Code.§ 43).

[69] *See Yusuf*, 536 F.3d at 181–82.

[70] *Id.*

[71] *Id.*

[72] *Id.* at 182.

[73] *Id.* at 184 (emphasis in original).

[74] *Id.* at 184 – 85.

The Third Circuit reversed the trial court's pretrial decision to vacate the international money-laundering indictment. The court relied on the Supreme Court's reasoning in *Pasquantino*, finding that for purposes of the mail fraud statute "the defendants' scheme was that of concealing certain gross receipts from the Virgin Islands government through the mailing of fraudulent tax returns in order to defraud, cheat, and deprive the government of the 4-percent gross receipts taxes it was owed, thus enabling the defendants to unlawfully retain such government property and profit from their scheme."[75] Therefore, the court concluded that the "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."[76]

More recently, in *U.S. v. Real Property Located at 9144 Burnett Rd.*, a federal district court upheld civil forfeiture where the government seized real property acquired out of the proceeds of money laundering from a criminal defendant who allegedly established an organized crime ring to evade taxes in Romania. [77] The court held that organizing such a crime ring was unlawful activity sufficient to justify civil forfeiture. And in 2017, the Department of Justice successfully investigated a Mexican businessman who ultimately pled guilty to wire fraud for a scheme to unlawfully obtain over $20 million in tax refunds from the Mexican government.[78]

Under *Pasquantino* and its progeny, prosecutors arguably have a basis for charging money laundering predicated on underlying mail or wire fraud violations that in turn rests on evading taxes owed to a foreign jurisdiction.

5 THE U.S. GOVERNMENT SHOULD SAFEGUARD AGAINST POTENTIALLY OVER-EXTENSIVE ENFORCEMENT.

In some ways, the potential use of the mail, wire, and money-laundering statutes to prosecute acts of foreign tax evasion is consistent with other law enforcement efforts in the United States. For example, courts have long sup-

[75] *Id.* at 189 (citing *Pasquantino*, 544 U.S. at 355–56).

[76] *Yusuf*, 356 F.3d at 189.

[77] 104 F. Supp. 3d 1187 (W.D. Wash. 2015).

[78] Department of Justice, Mexican Businessman Pleads Guilty to Orchestrating $20 Million Tax Fraud Against the Government of Mexico (September 19, 2017), *available at* https://www.justice.gov/usao-sdny/pr/mexican-businessman-pleads-guilty-orchestrating-20-million-tax-fraud-against-government.

ported the use of these statutes to prosecute the fraudulent evasion of state taxes.[79]

It is well established, however, that the government cannot use the more general mail or wire fraud statutes as a substitute for prosecuting conduct that also violates the domestic criminal tax provisions in the Internal Revenue Code. As the Supreme Court recently reaffirmed, the criminal tax statutes incorporate the element of "willfulness," which is defined as "voluntary, intentional violation of a known legal duty."[80] The mail and wire fraud statutes do not contain this heightened scienter requirement. It is a bedrock principle of criminal tax enforcement in the United States that the more general statutes (such as mail or wire fraud) cannot be used to subvert this statutory requirement.[81]

It is a long-standing policy of the Tax Division of the Department of Justice that it "will not authorize the use of mail, wire, or fraud charges to convert routine tax prosecutions into RICO or money laundering cases."[82] Federal tax crimes have long been viewed as a bad fit for a money-laundering prosecution. There is too great a risk that, if a defendant under-reports taxable income, the government could seek to freeze and forfeit legally earned income and ordinary bank accounts. If the underlying unreported income is the result of other criminal activity, then other provisions of the money-laundering statute may apply. However, if the income is from legal sources, then all that arises is a tax debt to the U.S. government, which can be redressed civilly through the Internal Revenue Code. Additionally, the federal tax statutes also address inchoate offenses of attempted evasion, willfully non-filed returns, and materially false statements that may not necessarily give rise to a tax liability.[83]

[79] *See, e.g., United States v. Porcelli*, 404 F.3d 157 (2d Cir. 2005). More recently, a prominent Manhattan energy investor was indicted in a tax fraud scheme that involved the evasion of over $45 million of state income and sales tax. *See United States v. Zukerman*, 1:16-cr-00194 (May 25, 2016).

[80] *See Marinello v. United States*, 138 S. Ct. 1101, 1107 (2018) (citing *United States v. Pomponio*, 429 U.S. 10, 12 (1976); *see also Cheek v. United States*, 498 U.S. 192 (1991) ("Willfulness, as construed by our prior decisions in criminal tax cases, requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty.")); 26 U.S.C. §§ 7201, 7203, 7206 (all requiring "willfulness" as an element of the crime).

[81] *See United States v. Henderson*, 386 F. Supp. 1048 (S.D.N.Y. 1974).

[82] Tax Division Directive No. 128, *Charging Mail Fraud, Wire Fraud or Bank Fraud Alone or as Predicate Offenses in Cases Involving Tax Administration.*

[83] *See, e.g.*, 26 U.S.C. §§ 7201 ("Any person who willfully attempts in any manner to evade... tax... shall... be guilty of a felony..."), 7203 ("Any person required under this title... to make a return... who willfully fails to... make such return... shall... be guilty of a misdemeanor..."), 7206 ("criminalizing various conduct, including willfully making a materially false statement under penalties of perjury and assisting or aiding the preparation of a return, affidavit, claim or other document that is fraudulent or is false as to any material matter").

"The laws of other countries are not always fair on their face, and they may not be fairly and equally applied. While the United States may want to avoid serving as a global haven for foreign tax evasion and the concealment of criminal proceeds, it should also seek to avoid acting as the enforcer for foreign laws that are used more for persecution than prosecution. The same reasons foreign investors are legitimately drawn to the United States — our currency and financial systems are sound, and our democratic government offers stability and due process — are the exact reasons that the U.S. government should tread carefully when asked to vindicate foreign crimes."

There are sound reasons for the heightened scienter requirement for tax crimes, which may easily result from a lack of knowledge or a misunderstanding of the complexities of the Internal Revenue Code. There are similarly sound reasons to tread carefully when considering using U.S. enforcement tools to move against those from other countries who use U.S. banks and other investment structures. The laws of other countries are not always fair on their face, and they may not be fairly and equally applied. While the United States may want to avoid serving as a global haven for foreign tax evasion and the concealment of criminal proceeds, it should also seek to avoid acting as the enforcer for foreign laws that are used more for persecution than prosecution. The same reasons foreign investors are legitimately drawn to the United States — our currency and financial systems are sound, and our democratic government offers stability and due process — are the exact reasons that the U.S. government should tread carefully when asked to vindicate foreign crimes.