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Tax Regularizations in Latin America: What's a Financial Institution to Do?

The increasing number of tax regularization programs in Latin America—most recently in Argentina, Brazil, Colombia, and Peru—is of keen interest to the cross-border wealth management industry. These programs are the latest Latin models of the global transparency trend, and all four countries have announced their intention to participate in the OECD Automatic Exchange of Information program ("AEI") as soon as practicable. As a prelude to tax information exchange, all of these countries are offering their taxpayers the opportunity to regularize their assets before more punitive methods of enforcement occur in the post-AEI world.[1]

The attractiveness of the regularizations has long sparked debate, and now U.S. financial institutions are wrestling with a related stark question: What, if any, anti-money laundering reporting obligations arise when a financial institution learns that a customer participates in a regularization? This *Commentary* attempts to answer that question.

SAR Reporting of Foreign Tax Noncompliance

U.S. financial institutions are required under the Bank Secrecy Act ("BSA") to assist enforcement agencies in preventing and detecting money laundering by filing a Suspicious Activity Report ("SAR") with the Financial Crimes Enforcement Network ("FinCEN").[2] The BSA is explicit in its directive that SARs are meant to "have a high degree of usefulness in criminal, tax, or regulatory investigations"[3] in order to satisfy its purpose of "identify[ing] violations or potential violations of law to the appropriate law enforcement authorities for criminal investigation (e.s.)"[4] The efficacy of those goals may be diminished, however, by filing an SAR premised on acts outside the statutory scope of the BSA that may not be a criminal offense in the taxpayer's home country. This may be exacerbated by the fact that the act is evidencing an intent to obtain lawful forgiveness of any underlying home country sanction.

The application of the BSA to unspecified and extraterritorial conduct, specifically foreign tax noncompliance, is a topic of considerable debate. Regrettably, there is scant guidance from the regulatory authorities, and what exists muddles more than clarifies. The Federal Financial Institutions Examination Council ("FFIEC") Manual furthers this confusion by noting tax evasion as an example of an underlying crime yet failing to distinguish between foreign and domestic evasion.[5] It is indisputably clear, however, that the BSA does not list foreign tax evasion as a Specified Unlawful Activity ("SUA") that can form the basis for

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criminal money laundering.[6] This omission favors the notion that the legislature had no intention to broadly encompass foreign tax noncompliance as an SAR reportable activity. On the contrary, this inclusion would be inconsistent with the non-extraterritorial reach of the law. The United States Supreme Court precedent in *Morrison v. National Australia Bank* commands that "when a statute gives no clear indication of extraterritorial intent, it has none."[7] Accordingly, the contorting of the BSA to require reporting based solely on a suspicion of foreign tax crimes is unsupported by statute or case law.

SARs and U.S. Federal Criminal Activity are Interwoven

Under the BSA regulatory scheme, an SUA must serve as the predicate to criminal money laundering liability.[8] As a general rule, predicate offenses, the proceeds of which constitute the crux of criminal money laundering, are codified under 18 U.S.C. § 1956 in the form of an exhaustive list of criminal activities.[9] While domestic tax evasion is listed as an SUA—and constitutes an actionable predicate offense under U.S. law—foreign tax evasion is not.[10]

The reporting obligations under the BSA SAR program[11] are interwoven with the requirements of 18 U.S.C. § 1956. At law, an SAR reporting obligation is premised on (i) a known or suspected violation of federal law or (ii) transactions that involve criminal activity or an SUA.[12] Arguably, participation in a foreign tax regularization cannot fairly be viewed as either.

Foreign Tax Noncompliance is Not a Violation of Federal Law

The absence of criminal foreign tax noncompliance as an actionable SUA is undisputable.[13] The only debatable question is whether the BSA's generalized references to "crime" may broadly encompass foreign tax noncompliance as an SAR reportable activity. This argument is undermined by *Morrison* and its progeny, *United States v. Vilar*. *Morrison* set the modern-day standard for determining the extraterritorial effect of U.S. law and clarified that the presumptive intent of the legislature is to apply U.S. law only within the territorial jurisdiction of the United States.[14] *Vilar* later affirmed this directive and extended the *Morrison* presumption to criminal prosecutions.[15] Under *Morrison* and *Vilar*, foreign tax noncompliance is presumptively excluded from the BSA and the reach of its reporting requirements.[16]

Participation or Inquiry into Tax Regularization is Not an SAR Reporting Transaction

The BSA imposes SAR filing obligations on financial institutions whenever they detect or learn of suspicious *transactions* that might indicate money laundering or a violation of the BSA itself. Under the BSA and its related guidance, "transactions" are a deposit, withdrawal, transfer between accounts, exchange of currency, extension of credit, purchase or sale of securities, or any other payment, transfer, or delivery by, through, or to a bank.[17] The participation or inquiry into tax regularization programs is not a defined activity under the BSA or a transaction.

The Obligation to Assess All Available Customer Information

The current Argentine and Brazilian legislation require active participation of custodial institutions in providing participants with documentary support for the valuation of assets to be regularized (i.e., documents certifying individualized assets owned by the customer, including a bank account statement for local and foreign held accounts). This requirement itself may place U.S. financial institutions on inquiry notice as to a customer's potential noncompliance with home country regulations. Particularly, it may raise concern as to whether noncompliance with local laws was the triggering reason for the customer's pursuit of regularization. When coupled with the uncertainty of the published guidance, this awareness creates heightened concern among U.S. financial institutions regarding SAR reporting obligations.

Countering that uncertainty, perhaps the most instructive guidance is that found in the FFIEC Examination Manual. The FFIEC Manual notes the nonreportable nature, per se, of similar nontransactional and status-based information (i.e., the receipt of law enforcement or grand jury inquiries). Tellingly, rather than viewing the new information as a non-event, the FFIEC instructs financial institutions to review the

transactional history of a customer's account through the prism of the newly gained knowledge.[18] This directive to apply *all available customer information*—including tax status and participation in tax regularizations—to the financial institutions' assessment is well-reasoned and well-supported.

The Legitimate Ends of SAR Reporting are Diminished by Foreign Tax Noncompliance Reporting

At the core of the reporting conundrum is the premise that participation in a regularization is an indicia of criminal local tax noncompliance. Yet, there are no reliable grounds to equate with any degree of certainty that participation standing alone is in fact indicative of criminal conduct. From a customer's perspective, there may be myriad reasons to participate in a regularization program regardless of underlying criminality.

The complexity of modern-day structures measured against lesser-developed tax codes, the attractiveness of regularization regimes coupled with the developing trend of information exchange, and local escape clauses for normalization when payment is voluntarily made all create various incentives for participation beyond relief from any potential criminal proceedings. Customers may choose to adhere to regularizations simply as an insurance policy in the face of doubt.

FinCEN has long made clear its reluctance to encourage defensive or precautionary SAR filings as failing to further legitimate law enforcement ends, needlessly increasing compliance costs and burdens and skewing statistical data. Given the ambiguities existing in the application of local taxes to offshore accounts, the directive to report participation in a foreign tax regularization regime as unusual or suspicious activity to U.S. authorities remains distant from FinCEN's guidance.

Moreover, U.S. financial institutions already participate in an elaborate regulatory scheme and make requisite filings with the IRS under the Foreign Account Tax Compliance Act ("FATCA"). To the extent the compilation of U.S. account information of international clients is a legitimate end of financial institution reporting, FATCA and its Intergovernmental Agreements network seem to be a more precise and developed mechanism to exchange relevant tax information with foreign signatory jurisdictions.

FinCEN's mission is 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." If U.S. financial institutions were to submit an SAR suspicious activity report for each customer participating in an international amnesty, the result could be the filing of thousands of redundant SARs, all relating to potential non-U.S. legal violations. Consequently, this could overburden the legitimate expenditure of law enforcement resources, all without advancing a sound U.S. law enforcement mission. Much like the Supreme Court in *Pasquantino* wondered as to the use of the federal government's resources to prosecute a U.S. citizen for smuggling liquor into Canada, one might wonder why authorities would expend federal resources to investigate financial institutions for failure to report customers who have identified themselves before the competent authorities of their home countries.[19]

Application of SAR Obligations to Tax Regularizations in Latin America

The unique attributes of current and recent tax regularization regimes programs in Latin America provide further support for nonreporting. In Argentina, participation in the regularization program does not trigger local suspicious activity reporting obligations, while in Brazil, participation is limited to funds of licit origin. Notably, tax evasion is not categorized as a crime in Colombia, and recent amendments to Peru's Decree No. 1264/2015 have clarified the suspension of money laundering prosecutions when the origin of the undeclared funds is derived from fiscal noncompliance.

Argentina. After years of failed amnesties and a "white list" approach to offshore taxation, Argentina promulgated Law No. 27,260 ("Law 27,260"), permitting those who voluntarily declare unreported assets by March 31, 2017, to regularize their tax status and extinguish tax related civil and criminal penalties. Eligibility for the program is limited to assets not maintained in the Financial Action Task Force high-risk jurisdictions or Non-Cooperating Countries and Territories.

In response to local banking inquiries, Argentine authorities have addressed the coverage of SAR reporting obligations of

local financial institutions with respect to local participants. The Argentine Financial Information Unit ("UIF") recently published guidelines providing that the UIF will not require local SAR filings related to participation in a voluntary declaration under Law 27,260.[20]

In furtherance of these directives, Mariano Federici, the head of the UIF, has publicly stated that local SARs should not be filed in cases where the only offense is nondisclosure. During a recent speech in Cambridge, Federici clarified that the UIF will not investigate SARs reporting tax evasion from those who enlist in the program because he considers past tax evasion "understandable" in Argentina. With the absence of prosecutorial interest in the home country, the statutorily required usefulness of an SAR is substantially eroded.

Brazil. Brazil has enacted the Special Tax Regime and Foreign Currency Market Regulation ("RERCT"), Law No. 13,254/2016, establishing a voluntary disclosure program aimed at encouraging complete disclosure of assets held offshore. The RERCT has two significant features: (i) tax regularization for those who disclose unreported funds of licit origin; and (ii) criminal regularization providing an exemption for crimes incurred by failing to declare offshore assets to the Brazilian Central Bank.

Criminal proceeds are statutorily excluded from participation as the RERCT limits its reach to funds of licit origin (*origem lícita*). As such, RERCT participants must affirmatively declare the licit origin of the funds regularized and may be held to a standard of documentary proof of licit origin by the Brazilian *Receita Federal*.[21] Worth noting is that, under Brazilian law, documentary tax fraud is needed to incur criminal liability, and a taxpayer's mere failure or omission to pay taxes is not deemed criminal.[22] This distinction between tax evasion by mere omission and tax fraud further weakens the equating of participation in the RERCT with an underlying local crime and further weakens the effectiveness of an SAR filed solely under those premises.

Colombia. Colombia's tax regularization, enacted in December 2014, amends the Colombian Tax Statute and creates a new normalization tax imposed from 2015 through 2017.[23] A tax and not an amnesty, the reform consists of an additional complementary tax to the equity tax, available to those willing to voluntarily report omitted assets.

Participation in this regularization relieves the taxpayer of the high penalty of the omitted assets tax and includes foreign exchange regularization.[24] Importantly, Colombia does not criminalize tax evasion; rather, it solely classifies it as an administrative offense.[25] While a current legislative initiative seeks to criminalize tax evasion, its reach is not retroactive. Accordingly, the lack of home country criminal liability argues forcefully that no underlying crime exists to be reported as unusual or suspicious.

Peru. On December 9, 2016, the recently elected government enacted Legislative Decree No. 1264/2015 to incentivize local taxpayers to declare assets held abroad in exchange for regularizing their tax status.[26] As an attempt to reactivate the economy and promote formalization among individuals and small companies, this new regulation offers attractive tax benefits to those who come forward within the statutory term and an even higher incentive for those willing to transfer funds held abroad back to Peru.[27] This temporary regime will be available only until December 29, 2017.[28]

As part of the regularization, all the applicable interests and fines will be deemed waived upon filing the required documents and paying the corresponding due taxes. Notably, the application of this new program is designed to benefit taxpayers who have not engaged in any criminal activity nor have breached any local or international regulations regarding money laundering. Under recent amendments, the Public Ministry must forego any prosecutions for money laundering stemming solely from past omissions or evasion.[29]

Conclusion

This *Commentary* has attempted to accurately describe the legal strictures of SAR reporting and the BSA.[30] Under those guideposts, the requirement to file SARs for participation in a regularization program is unclear, if not altogether absent from a legal perspective, and fails to advance the policy goals of the BSA. Far from advocating inaction, the burden on any institution requires a fresh review of customers' activity in light of the new awareness.

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Endnotes

1 Argentines have declared P$21.9 billion in previously undeclared assets, including P$7.2 billion in cash deposits, MercoPress. Brazilians have regularized R$169.9 billion, and R$46.8 billion was raised in tax revenues. Colombia has collected P$123.7 billion, but it is estimated to receive an additional P$70.9 billion undeclared by Colombian taxpayers, Portafolio. Peru has only recently implemented a tax regularization program, so there is no data yet available to assess the effectiveness of the measure.

2 *See* 12 C.F.R. § 208.62 , 12 C.F.R. § 21.11, 12 C.F.R. § 353.1.

3 31 U.S.C. § 5311.

4 FFIEC, Bank Secrecy Act/Anti-Money Laundering Examination Manual (2014), 65.

5 *Id.* at 68.

6 *See* 18 U.S.C. § 1956(c)7.

7 *Morrison v. National Australia Bank*, 561 U.S. 255 (2010).

8 18 U.S.C. § 1956 requires the knowing involvement "in a financial transaction which represents the proceeds of some form of unlawful activity (…) with the intent to promote the carrying on of specified unlawful activity."

9 *See* 18 U.S.C. § 1956(c)(7).

10 The Financial Action Task Force in its 40+9 Recommendations (2012) has proposed that serious tax crimes be adopted as a predicate act in all member nations. While many jurisdictions have amended their anti-money laundering laws to include those offenses as predicate, the United States, to date, has not done so.

11 *See* 12 C.F.R. § 21.11 applicable to nationally chartered banks. Other financial institutions share nearly identical requirements.

12 *See* 18 U.S.C. § 1956(c).

13 *See* 18 U.S.C. § 1956(c)(7).

14 *Morrison*, at 255.

15 *United States v. Vilar*, 729 U.S. 62, 74 (2d Cir. 2013).

16 While 18 U.S.C. § 1956 expressly captures certain extraterritorial conduct, it does so only in highly limited circumstances. That expressed and limited inclusion of crimes other than foreign tax crimes gives further weight to the Morrison presumption against an overly broad catch-all predicate.

17 *See* 18 U.S.C. § 1956(c)(3). See also, FFIEC, Bank Secrecy Act/Anti-Money Laundering Examination Manual (2014) at 60.

18 As indicated in the FFIEC Manual, the mere receipt of any law enforcement inquiry does not, per se, require an SAR filing by the bank. However, a law enforcement inquiry may be relevant to the bank's overall risk assessment of its customers and accounts (e.g., upon receiving a grand jury subpoena, the bank should review the account activity for the relevant customer in accordance with its BSA compliance program). FFIEC, Bank Secrecy Act/Anti-Money Laundering Examination Manual (2014) at 63.

19 *Pasquantino v. United States*, 544 U.S. 349, 356 (2005).

20 Resolution No. 895/2016, Art. 25, July 27 2016 (Arg.).

21 Art. 3, Lei No. 13.254 de Janeiro de 2016, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 1.14.2016 (Braz.).

22 Art. 1, Lei No. 4.729 de Julho de 1965, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 7.14.1965 (Braz.).

23 L. 1739/2014, Diciembre 23, 2014, DIARIO OFICIAL [D.O.] (Colom.).

24 In 2015, the Constitutional Court held that Colombia's normalization tax complies with the country's Constitution, thus creating incentives for the disclosure of assets, as opposed to tax amnesties. Decision C-551/2015 Constitutional Court of Colombia.

25 *See* C.P.C. art. 402.

26 Decreto Legislativo No. 1264, December 9, 2016 (Peru).

27 Instead of paying up to a 30 percent tax rate, taxpayers will have to pay only a 10 percent rate over undeclared assets held abroad. Alternatively, should taxpayers decide to return such funds to Peru, a 7 percent rate will apply. *Id.* at Art. 7.

28 *Id.* at Art. 10.

29 *See* El Peruano, Normas Legales, 31 de Diciembre de 2016, p. 611578, 611579.

30 Other salutary considerations such as reputational risk and *Pasquantino*-based aiding and abetting mail and/or wire fraud are beyond the scope of this *Commentary*.

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