

NEWS ANALYSIS

The United States as Tax Haven, Part 2

by Lee A. Sheppard

Miami's best hotels must be at the beach, right? Er, um, no. They're next to the banks and the lawyers' offices, in the downtown area on Brickell Avenue. The best restaurants are also there. It's one-stop shopping for wealthy Latin Americans visiting their money.

Miami is the financial capital of Latin America. And both sides like it that way. Latin American elites have their money stashed safely away from hyperinflation and untrustworthy governments, the city flourishes, and the dominance of El Norte is assured by dollar deposits. U.S. diplomacy is so much easier when the wealth of the people sitting across the table is in U.S. banks!

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So what's the problem? This cozy arrangement is out of step with the worldwide push for transparency. The United States is being called the world's biggest tax haven. Europeans — who recognize a hypocrite when they see one — are questioning the U.S. failure to sign on to the common reporting standard (CRS).

Ain't gonna change, because neither side of the equation wants it to change. Yes, it's mildly embarrassing for the United States. But the Europeans — whose lifestyle is propped up in various ways by the United States for geopolitical reasons — are on a bender about tax collection because they chose to have an unsustainable single currency. The question is how much influence their views have on the rest of the world.

Robert Stack, former Treasury deputy assistant secretary (international tax affairs),

speaking as a private citizen, had an interesting take on the U.S. posture in his luncheon speech in Miami at the recent 10th annual U.S.-Latin America Tax Planning Strategies conference sponsored by the American Bar Association, International Bar Association, International Fiscal Association, and Tax Executives Institute. He encouraged Latin American countries to participate in G-20 and OECD meetings lest an undesirable level of public transparency be imposed on them.

By whom? Few Latin American countries are OECD members, although Mexico and Chile enthusiastically implement OECD programs. Brazil is about to join — which says less about the merits of OECD membership than it does about the country's international credibility in the wake of the Operation Carwash corruption scandals. Stack acknowledged that the OECD is Eurocentric and is sometimes used by its mostly European membership to get results they cannot obtain from the EU.

Right now, the Europeans are using the G-20 to foster their transparency goals. The European Parliament's Economic and Monetary Affairs and Legal Affairs committees are threatening to require some corporate country-by-country reporting information to be publicly disclosed. Potential CbC disclosure gives Stack and the corporate crowd the vapors. Public disclosure of beneficial ownership registries is also being discussed. (Prior coverage: *Tax Notes Int'l*, June 12, 2017, p. 947.) Stack denounced blacklists — of which both European and Latin American countries are fond.

How does this relate to elite Latinos wanting to preserve the anonymity of their dollar bank accounts? Stack argued that Latin American countries should participate in the OECD and the G-20 — of which Argentina is the next president — to neutralize European public transparency efforts. "The world wouldn't have CRS if not for FATCA," he said, making a point acknowledged by Europeans. Both of those programs are for intergovernmental transparency. His audience might have been forgiven for



Brickell Avenue in Miami — one-stop shopping for wealthy Latin Americans visiting their money.

thinking that no one in the Americas wants the status quo of nontransparency to change.

Shame doesn't make governments change their tax systems. Congress can't be shamed, nor can any other government defending its tax sovereignty — which is the last remaining scrap of sovereignty for many governments. The threat of being booted from the international bank clearing system — SWIFT — does get their attention. Recent experience in Panama and Mexico shows that bank regulation is not only the bottom line for tax evasion and money laundering accusations, but also a potentially productive route for countries seeking information.

Panama

“The Panama Papers were just a flashpoint in an ongoing process,” said Leonard Schneidman of Andersen Tax. “It's not a secret what's going on here.” He noted that there are business reasons to use Panama, but some at the Justice Department regard them as excuses. Panama uses the U.S. dollar as its currency. It has a stable legal system and low inflation. It has geographical accessibility, stable government, good communications, banks, support services, and competent courts.

Why did Panama cave so easily? Because it was afraid of being kicked out of the clearing system. Panamanian lawyer Estif Aparicio of Fabrega & Fabrega defended Panama's record. Before 2013, when Panama was placed on a Financial Action Task Force (FATF) gray list for money laundering, it had never signed any tax

information sharing agreement, having no need for information itself.

But as a dollarized, connected financial center, Panama needed to stay in the good graces of FATF and the clearing system. The United States has dominated the Panamanian economy since the opening of the canal over a century ago. A member of the WTO and beneficiary of the Caribbean Basin initiative, Panama operates one of the world's largest free-trade zones — which facilitated money laundering in the past.

The biggest threat to the Panamanian banking sector was the possibility that banks would be excluded from the clearing system because U.S. banks and others would refuse to permit correspondent accounts. Without correspondent accounts, Panama could not clear dollar transactions, all of which are cleared by a handful of money center banks in New York. That's what it was really about: bank clearing.

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Panama's recently elected government did what it had to do. It adopted anti-money-laundering laws, eliminated bearer shares, enhanced know-your-customer rules, and expanded suspicious activity reporting. It got off the FATF gray list, and it is now mostly FATF compliant, Aparicio noted. Tax evasion is not a predicate offense to money laundering under Panamanian law, but the law will be changed to include it in the future.

Panama was also on an OECD gray list. So it signed 30 tax information exchange agreements, including one with the United States. It adopted CRS. It signed the Convention on Mutual Administrative Assistance in Tax Matters (MAATM) for bilateral exchanges. (Prior coverage: *Tax Notes Int'l*, Mar. 27, 2017, p. 1151.) Panama flunked its first peer reviews in the OECD's Global Forum but later passed phase 1. The Panama Papers caused it to fail phase 2, because it lacked beneficial ownership information. Panama expects to pass phase 2 later

this month. It was hosting a Global Forum meeting as Aparicio spoke.

“But they keep raising the bar,” Aparicio sighed. Panama hopes to stay off the G-20 list of noncooperative countries expected in September. (Prior coverage: *Tax Notes Int'l*, Sept. 19, 2016, p. 1021.) After all, most of the companies Mossack Fonseca formed were not Panamanian, but organized in the British Virgin Islands, Aparicio noted. Mossack was an incorporation facilitator with 40 offices in 24 countries and a Panamanian law firm at its center.

Mexico

An early adapter of CRS, Mexico delivers more information to the United States than it gets in return. The two countries have established automatic exchange of certain types of information, with the first delivery to start in September. Years ago, at an earlier episode of the same conference, a Mexican tax official expressed dissatisfaction with the results his government was getting under the more than 40 TIEAs it has signed. (Prior coverage: *Tax Notes Int'l*, June 27, 2011, p. 1004.)

“We tried to be the poster boy for the OECD,” Layda Carcamo Sabido of Calvo Nicolau y Marquez Cristerna-DFK said.

Mexico is pursuing nearly 300 Mexican account holders revealed in the Panama Papers. To that end, the Mexican Tax Administration Service (SAT) asked the National Commission of Banking and Securities (CNBV) to require 70 Mexican bank branches of foreign banks, including U.S. and U.K. banks, to provide information on Panama Papers transactions with tax havens, including the United States. (Prior coverage: *Tax Notes Int'l*, May 23, 2016, p. 749.)

The request for information emanated from the 2013 *pago anónimo* (anonymous return) program aimed at noncompliant individuals with undeclared offshore income. Taxpayers were permitted to calculate their own taxes owed on their foreign accounts, self-assess, and pay anonymously by direct debit from their Mexican bank accounts. There was no formal compliance required, like filing returns for controlled foreign corporations or disclosing foreign-source income on regular returns. (Prior analysis: *Tax Notes Int'l*, Mar. 11, 2013, p. 924.)

When their names cropped up in the Panama Papers, some Mexican taxpayers claimed they had paid fully under *pago anónimo*. Failure to file returns could be subject to criminal prosecution under normal rules. Obviously the banks had the *pago anónimo* participants' identifying data. So the SAT wanted to know whether the taxpayers found in the Panama Papers data had paid their full tax liabilities.

As of September 2016, 64 banks had furnished information to the SAT and six gave information to the CNBV in the Panama Papers inquiry. The government followed up with MAATM requests to 22 signatory governments. The effort brought in a trifling \$23 million in tax remittances as of March 2017, mostly from polite entreaties to affected taxpayers to come in and pay up.

You read that right — \$23 million in a country of 150 million people. The numbers look small because Panama Papers taxpayers are eligible for Mexico's current, very generous, amnesty announced in January 2017. Even taxpayers under audit are eligible. The six-month program offers an 8 percent tax rate but requires repatriation of assets, which must remain in Mexico at least two years, invested in Mexican securities, equities, or other qualifying Mexican investments. (Prior analysis: *Tax Notes Int'l*, Apr. 10, 2017, p. 167.)

This program has two deadlines — July 19 for repatriation and August 3 for tax payment. Many taxpayers are expected to show up at the deadline. But with the Mexican election in 2018 and NAFTA renegotiation, some nervous taxpayers are filing amended returns without repatriating. That is, they don't want to invest their assets in Mexico and are willing to forgo the 8 percent offer to avoid the risk of detection under information exchange.

Roughly 72 percent of the Panama Papers recovery came from what the SAT calls “invitation letters” in which it invites the relevant taxpayer to comply with his tax obligations. An invitation is not a formal audit. But it scares individual taxpayers — that's the idea. It is a practical, low-cost mechanism to collect taxes without the costs of a formal audit, one practitioner noted. The remaining 28 percent collected came from formal audits.

Carcamo Sabido stated that apart from the Panama Papers effort, the SAT has asked for all

transfers made during the past five years by Mexican residents to more than 100 tax havens, including Delaware, Nevada, Switzerland, and Luxembourg. The SAT through the CNBV has requested from Mexican banks information on transfers made between 2011 and 2015 from Mexico to over 100 jurisdictions (this includes Delaware and Nevada).

This would be a way for the SAT to have access to information even before the exchange of information agreements with other countries, like CRS, become effective, Carcamo Sabido explained. Provided it worked — which it hasn't, by and large. The response from the requested countries has been that the request is a fishing expedition.

The SAT hasn't confirmed the existence of these efforts to Tax Analysts, but practitioners are dealing with affected taxpayers. Bank regulatory power and a tax amnesty in effect during the years at issue provided the legal justification for these requests. Mexico does not have bank secrecy.

Uruguay

Uruguay, like Miami, has scenic beaches and is a tax haven for South Americans, particularly Argentines. But it is under pressure. Uruguay signed the MAATM and adopted CRS. (Prior coverage: *Tax Notes Int'l*, Sept. 26, 2016, p. 1140.)

It also created a rather long blacklist of 73 countries that includes obvious candidates such as the British Virgin Islands plus numerous tiny countries no one even knew existed. The purpose is to require withholding on transfers of blacklisted shell companies having 50 percent of their assets composed of Uruguayan shares. Withholding rates have been increased and will be imposed on deemed gain of 30 percent of sales proceeds.

The United States is not on the blacklist, even though technically it should be because it has no TIEA with Uruguay. So a Delaware limited liability company holding Uruguayan shares could be used to avoid withholding on a transfer, according to Javier Otegui of Guyer & Regules. MAATM signatories will eventually come off the blacklist, which is political and temporary, although revenue authorities treat it as final, Otegui commented.

Luiz Felipe Centeno Ferraz of Mattos Filho interjected that Brazil's blacklist, which also excludes the United States, is administratively treated as final. Spain will establish a list of noncooperative jurisdictions, according to Javier Vinuesa of Gomez-Acebo & Pombo Abogados SLP. The Europeans are beavering away at an EU blacklist intended to replace national blacklists. It is unlikely to include the United States, Vinuesa predicted, even though the country has an outsized banking sector, stable laws, and a low level of disclosure, but it has a corporate income tax. (Prior coverage: *Tax Notes Int'l*, Feb. 27, 2017, p. 789.)

Under CRS as implemented in Uruguay, nonresidents will be prospectively required to report accounts of any size; residents have a \$50,000 threshold. Ultimate beneficial owners of 15 percent of an entity — lower than the FATF standard of 25 percent — must be disclosed and registered with the central bank. Only vastly larger nonresident accounts — \$1 million individual and \$250,000 entity — would be subject to information exchange. Otegui explained that nonetheless, the prospect of account disclosure caused Argentine investors to flee Uruguay for the United States.

Amnesties

Amnesties are popular in Latin America. "It doesn't matter what the law says. At the end of the day, you will have an amnesty and you will be able to regularize this income at an attractive rate," said Roberto Alvarez Lopez, director of taxes at Grupo Posadas, a hotel chain, and president of Pool Fiscal, a tax executives organization.

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Most of the countries whose practitioners participated in the Miami conference currently maintain an amnesty. Some programs are so generous they are properly dubbed amnesties even though they call for some payment of taxes. Argentina and Brazil have had very successful

amnesties. (Prior coverage: *Tax Notes Int'l*, Apr. 10, 2017, p. 113; and *Tax Notes Int'l*, May 15, 2017, p. 560.)

Things are not going so well in the mother country. Spain's Constitutional Court just declared its 2012 amnesty program illegal because the government established it by decree. (Prior coverage: *Tax Notes Int'l*, Jun. 19, 2017, p. 1065.) Decrees cannot be used to change constitutional rights. But the court did not reach the tax fairness merits, according to Vinuesa.

Spanish taxpayers who have closing agreements should not be affected. For taxpayers who dissolved their offshore entities, there could be a capital gain liability (liquidations are not tax free in Europe). Spain's Agencia Tributaria is expected to spell out who is affected, Vinuesa noted. Spain has been criminalizing some tax matters because anti-money-laundering law allows authorities to get more information, according to Pere Pons of Uria Menendez.

Mexico has had seven amnesties, including the current one, according to Carcamo Sabido. The current amnesty has been a success outside of the Panama Papers inquiries. Taxpayers have repatriated more than \$1 billion and remitted taxes of roughly 5 percent of that sum through June 14. This is regarded as an improvement over the 2016 amnesty, which had only 55 taxpayers participating because its meager benefits were outweighed by the public disclosure of users.

Electronic Compliance

At the same time, Latin American countries have embraced taxpayer data collection. Mexico, Brazil, Chile, and Argentina have the capability and use it, often aggressively.

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In these countries, electronic invoicing and tax mailboxes that interface with government systems are mandatory. Tax authorities can look into business taxpayers' books and records for real time auditing and pre-assessment. Invoicing, tax return filing, tax reporting, and financial

accounting are completely electronic in Brazil. For comparison, the United States merely requires electronic filing, and the taxpayer's books are its own business.

In several Latin American countries, the tax authority has a business's books and records in its database and examines them in real time. So when a company deducts a payment to a particular payee, the tax authority can cross-check whether the latter included it in income, according to Alvarez Lopez. He complained that the new data regime forces business taxpayers to invest heavily in mirror information technology systems to comply with administrative data demands.

Commercial compliance software is available in Brazil and Chile. Nonetheless, Brazilian tax managers gripe that keeping up with electronic obligations, required declarations, and tax legislation is costly and burdensome. Electronic transmission is fast, but tax audits are still slow. And electronic systems might also enable Latin American countries to maintain multiple levels of taxes that would otherwise be too complex to sustain. For readers who fantasize about access to Uruguayan beaches or Chilean skiing, there is a labor shortage of tax compliance and systems professionals.

Snow Washing

"The U.S. refusal to participate in CRS is key" to the United States being dubbed a tax haven, according to Schneidman. The Foreign Account Tax Compliance Act merely requires foreign financial institutions to report U.S. account holders—it does not require reporting in the other direction. "FATCA is just for our benefit," said Schneidman. (Alan Appel and Schneidman, "Hiding the Ball — Transparency, Tax Law and the U.S. as the World's Favorite Tax Haven," 75 *NYU Institute on Federal Taxation* (2017) (forthcoming).)

U.S. cooperation with noncriminal information exchange is limited to a regulation requiring collection of information on interest payments on individually held bank accounts (T.D. 9584; reg. sections 1.6049-4(b)(5) and 1.6049-8). The regulation is a symbolic show of U.S. good faith that the government will abide by information reporting obligations in treaties, TIEAs, and FATCA intergovernmental

agreements. Even that was controversial (*Florida Bankers Association v. United States*, 799 F.3d 1065 (D.C. Cir. 2015)).

Currently, no information is reported about securities accounts, any accounts owned by entities, or ownership of those entities. Brazil has come close to blacklisting Nevada and Delaware for the anonymity of their LLCs. A regularly introduced bill, H.R. 3331, S. 1465, the Incorporation Transparency and Law Enforcement Assistance Act, has gone nowhere.

Moreover, Treasury's Financial Crimes Enforcement Network (FinCEN) final bank customer due diligence regulations have a lot of gaps, such as deeming trustees to be beneficial owners. The rules also conflate company managers with beneficial owners, when the former could lack control. The requirements need to be fleshed out, Schneidman noted. Moreover, the regulations are prospective, so older deals escape scrutiny. (Prior analysis: *Tax Notes*, Dec. 21, 2015, p. 1433.)

CRS requires automatic exchange of information of some beneficial owners of financial accounts. Although 96 countries have signed on, CRS requires a bilateral agreement with every country with which a government proposes to exchange information, so merely enacting enabling legislation doesn't do the job. Some of the world's worst tax havens are listed as participating because they passed CRS legislation. Switzerland won't accept a CRS request without the assurance that the account holder will have a voluntary disclosure program available at the other end, Schneidman noted.

CRS instructions look very much like the FATCA regulations, and CRS treats most entities as financial institutions. But no individual owner's taxpayer identification number or place of birth need be disclosed if the country is not in the habit of issuing or collecting them. CRS will depend on self-certification.

Because the United States does not participate in CRS and FinCEN rules treat a trustee as account owner, some advisers argue that a trust with a U.S. resident trustee can be used to skirt all reporting and disclosure requirements. Such a trust would have to minimize contact with CRS countries, because CRS requires disclosure of controlling persons, and hold only U.S. assets.

CRS requires designation of a controlling person, which must be an individual. For a trust, the controlling person is the settlor, trust protector, or beneficiary exercising effective control over the trust.

Mossack Fonseca marketed Canadian shell companies to South Americans. Mexicans in particular are using Canadian partnerships owned by trusts with U.S. trustees to invest into the United States — a tactic called snow washing.

Under some circumstances, a trust can be a foreign person for U.S. tax purposes even if it has a U.S. trustee, such as by giving a foreign person the right to terminate the trust or replace the trustee (reg. section 301.7701-7). Only U.S. tax resident trusts are required to file Form 8938, the tax analogue of a foreign bank account report. The disparate treatment relies on CRS treating a trust as resident where its trustee is located and the United States treating it as foreign (Peter A. Cotorceanu, "Hiding in Plain Sight," 21(19) *Trusts and Trustees* 1050-1063 (Dec. 2015)).

Often the arrangement involved is a U.S.-formed trust with a foreign protector (treated as a foreign non-grantor trust) that is a limited partner of a Canadian limited partnership, according to Roy Berg of Moodys Gartner Tax Law LLP. Mexican law treats partnerships as entities because the Canada-Mexico treaty overrides the Canadian domestic rule, Berg explained. SAT has ruled that Canadian partnerships are treated as entities. The Canada-United States treaty does not override domestic treatment.

The limited partnership's asset is typically a U.S. single-member LLC. The disregarded entity reporting rules override infamous state laws shielding beneficial ownership, Schneidman noted. Those rules require a disregarded entity wholly owned by a foreign person to get an employer identification number, file a Form 5472, and keep records (reg. sections 1.6038A-2 and 301.7701-2(c)(2)(vi)). Contributions to and distributions from the disregarded entity, as well as any other related-party transaction described in reg. section 1.482-1(i)(7), must be reported on Form 5472 (reg. section 1.6038A-2(b)(3)(xi)).

Why Canada? Despite its high rates, membership in the Joint International Tax Shelter and Collaboration network, and CRS adoption, Canada is a stable, common-law jurisdiction,

which investors like. Canadian law requires suspicious activity reporting of large transfers. Current Canadian law does not require disclosure of information about Canadian partnerships with neither resident owners nor Canadian-source income. There are strict privacy laws. Importantly, Canada's IGA interpretation makes it an attractive entrepot to U.S. investment.

Canada's IGA interpretation makes it an attractive entrepot to U.S. investment.

Canada does not treat private trusts or private holding companies as financial institutions for purposes of its U.S. IGA. Section 263 of the Income Tax Act defines listed financial institution to exclude them. Instead, private trusts and holding companies are treated as nonfinancial foreign entities (NFFEs). If none of the controlling persons of a passive NFFE are a U.S. citizen or resident, it will not be a U.S. reportable account, but payments to the holder must be reported. (Prior analysis: *Tax Notes Int'l*, Oct. 13, 2014, p. 151.)

Canada has been accused of playing fast and loose with the purposes of the IGA. (Prior coverage: *Tax Notes*, Mar. 17, 2014, p. 1178.) Canadian efforts seem to be primarily directed toward tax avoidance by Canadian residents. (Prior analysis: *Tax Notes Int'l*, Feb. 6, 2017, p. 507.) (Berg and Paul Barba, "FATCA in Canada: The Restriction on the Class of Entities Subject to FATCA," 62(3) *Canadian Tax Journal* 577 (2014).)

"If you plan properly, you can move your assets to the United States, and your home country will never know about it, CRS or not," said Schneidman, whose firm eschews such planning. ■

ECONOMIC ANALYSIS

Why the CBO Became So Pessimistic About Growth

by Martin A. Sullivan

Climate is what you expect. Weather is what you get.
— attributed to Mark Twain

Tax reform's progress — if you want to call it that — consists of endless, mostly behind-the-scenes meetings in which lawmakers, staff, and lobbyists learn about problems faster than they can find solutions. Under these Sisyphean conditions, despite the fact that U.S. government finances are one recession away from an unprecedented free-fall, the temptation grows daily to dismiss the eminently reasonable constraint of revenue neutrality — even though it has already been relaxed to allow dynamic scoring and downsized baselines.

The word is out: Republican contributors and voters will revolt if significant tax legislation is not enacted before the November 2018 election. All this means more loose talk about tax cuts. "We're going to pass the largest tax cut since the days of Ronald Reagan," Vice President Mike Pence said on June 20.

The U.S. economy has grown in excess of 3 percent over the last six decades. Why is the CBO now predicting average growth over the next 10 years of only 1.8 percent?

The dilemma for Republicans is that over the years they have complained as loudly for the need for deficit reduction as they have for the need for a tax overhaul. To stiffen the spine of would-be deficit hawks reluctant to reduce revenue, it will be necessary to raise a smokescreen around the deficit. There will have to be a lot of smoke because the deficit will total \$560 billion in 2017 and, according to the Congressional Budget Office, will reach \$1 trillion in 2023.

This can be done in two ways. First, as has been vigorously argued by the Trump administration, implementation of new policies related to regulation, infrastructure, trade, immigration, and tax can boost growth and