MONEY LAUNDERING

What Private Wealth Attorneys Need to Know About Money Laundering

Complex international estate plans can actually expose clients to violations of U.S. criminal laws and counsel to violations of U.S. criminal laws, codes of professional responsibility, and Circular 230.

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Estate planning attorneys are increasingly encountering situations in which clients have assets abroad and family abroad. Many attorneys may also represent foreign clients with either U.S. family or U.S. assets. Whichever the circumstance, U.S. counsel are often engaged to assist clients with international issues. The issues can be as simple as forming a foreign holding company for a nonresident alien through which to own U.S. real estate, or an international estate plan that can involve a complex series of international and domestic trusts, underlying investment companies, and both passive and nonpassive investment assets located in multiple jurisdictions. The very act of engaging in the planning and implementation of the international estate plan raises the possibility of counsel and the client being exposed to asset forfeiture.

It is all too possible to encounter a circumstance in which a client's plan may violate a local law, not to mention the circumstance where a client's subsequent actions, once the plan is in place, might lead to evasion of tax, whether U.S. or foreign. There is little guidance in the context of international estate planning as to what can happen when there are violations of foreign law or how easily a plan can violate U.S. wire fraud laws, money laundering laws, or mail fraud laws.

This article will begin with specific circumstances under which an estate plan can result in violations of money laundering laws and result in forfeiture of the assets involved. It will then discuss the specific forfeiture laws, both related to money laundering and income tax deficiencies, before concluding with an explanation as to how this can result in exposure of counsel with respect to malpractice and violations of Codes of Professional Responsibility and IRS Circular 230. Nevertheless, this article should not be relied on as a thorough analysis of these issues.

The basics

One of the first steps is determining what laws apply.

Money laundering statutes. Wire fraud simply requires the use of telecommunications facilities to effectuate a scheme to defraud. Similarly, mail fraud requires the use of the postal system to effectuate a scheme to defraud. [1]

Under the money laundering statutes, the IRS is authorized to assess a penalty in an amount equal to the greater of the proceeds realized from the fraudulent activity or $10,000. [2] All that is required to violate the money laundering statute is a financial transaction involving the *proceeds* of specified unlawful activity with the *intent* either to promote that activity or to violate 28 U.S.C. sections 7201 [3] or 7206. [4] The tax involved in the transaction and which is being avoided may be any type of tax, including, but not limited to, income tax, employment tax, estate tax, gift tax, and excise tax. [5]

In addition to monetary penalties, violations of the mail fraud, wire fraud, and money laundering statutes are punishable by civil and criminal forfeiture. 18 U.S.C. section 981(a)(1)(A) permits property involved in a transaction that violates 18 U.S.C. sections 1956, [6] 1957, [7] and 1960 [8] to be civilly forfeited. Seizures are made by warrant in the same manner as search warrants. [9] The burden of proof is by a preponderance of the evidence, and the

property may be seized under the authority of the Secretary of the Treasury when a tax crime is involved. [10]

If the offense charged is violation of the Money Laundering Control Act and the underlying specified unlawful activity is mail or wire fraud, courts may order criminal forfeiture of funds involved in the activity on conviction. [11] Because the Department of Justice Tax Division Policy requires U.S. Attorneys to obtain Tax Division approval before bringing any and all criminal charges against a taxpayer involving a violation of the Internal Revenue Code, such additional charges involving wire fraud, mail fraud, and money laundering would not normally be included, absent specific approval. [12] The consequence, however, to a hypothetical taxpayer is that he or she risks having the trust assets seized or forfeited if the additional charges are approved.

Internal revenue statutes. In addition to the government's ability to seize assets pursuant to a violation of the money laundering laws, the IRS already has such authority for seizure and forfeiture under Title 26. Code Section 7301 allows the IRS to seize property that was removed in fraud of the internal revenue laws. Section 7302 allows the IRS to seize property that was used in violation of the internal revenue laws. In fact, any property that is subject to forfeiture under any provision of Title 26 may be seized by the IRS. [13]

Why worry?

Estate planners might believe that wire and mail fraud are not issues with which they need to be concerned, but it is very easy to run afoul of the rules. Consider a grantor retained annuity trust (GRAT) or intentionally defective trust to which the client transfers a business interest. Once the trust is drafted and ownership of the business transferred into the trust, many practitioners are no longer involved with the business.

Similarly, assume that the client's estate plan contemplates use of an offshore grantor trust, to which substantial funds are transferred. It is rare that all discussions between counsel and their client will occur in the attorney's office. Thus, counsel will likely discuss the plan and provide instructions to effectuate the plan by telephone, e-mail, and U.S. mail. These combined actions, including the client's transfer of funds pursuant to counsel's instructions, can trigger a violation of U.S. money laundering laws and lead to asset forfeiture.

Assume further that, after the trust has been created and despite receiving tax compliance guidance, the end result is noncompliance by the client because the client fails to comply with tax and nontax laws and counsel fails to ensure ongoing full compliance. In addition, suppose the client's noncompliance is accompanied by affirmative acts of tax evasion. Because wire and mail fraud are "specified unlawful activities" [14] under the Money Laundering Control Act, [15] our hypothetical taxpayer has now provided a predicate for violation of the money laundering statutes.

Depending on the role of counsel in a client's noncompliance, the government may argue that counsel aided and abetted the client in evading U.S. tax. Of course, this would require counsel to take actionable steps—such as aiding and assisting in the submission of materially false information to the IRS [16] or assisting the client in removing or concealing assets with intent to defraud. [17] These are issues that would likely receive careful attention from the IRS under Sections 6694 [18] and 7212. [19] The counsel's role may also receive attention from the Office of Professional Responsibility in connection with Circular 230. [20] But even more serious, our hypothetical taxpayer risks having his or her trust assets seized or forfeited if the additional charges are approved.

There are recent examples of both civil and criminal forfeiture involved in tax offenses. For example, in *Greenstein* [21] the government sought criminal forfeiture in a tax shelter scheme by adding the charges of wire fraud and conspiracy to launder monetary instruments. *Greenstein* also involved additional offenses such as ill gotten professional fees not disclosed to the investor clients. Additionally, in the indictment in *Daugerdas,* [22] the government used a civil forfeiture in a tax shelter and Klein conspiracy prosecution under 18 U.S.C. section 371. [23]

Advisors should also be aware that while the government has lost, it may still seek to prosecute counsel who receive fees from a client if the funds being used to pay the fee came from illegal sources. [24]

U.S. money laundering law used to cover foreign law violations

Much has been written about *Pasquantino*, [25] in which the Supreme Court determined that a foreign government has a valuable property right in collecting taxes, and that right may be enforced in a U.S. court of law. The ruling has an enormous impact for those practitioners who counsel clients with international issues. Structuring a transaction that has the impact of reducing or deferring tax in a foreign jurisdiction could be viewed as interfering with a foreign government's right to collect tax.

The defendants in *Pasquantino* were New York residents who engaged in a liquor smuggling scheme whereby they

purchased liquor over the phone in Maryland, and then hired drivers to bring the liquor with them, undeclared, into Canada. This scheme evaded Canadian excise taxes, which, according to some estimates, were almost double the price paid in Maryland. The government prosecuted the taxpayers under a wire fraud statute based on communications made within the U.S. [26]

The wire fraud statute forbids schemes to obtain "money or property" by fraud. If no property or money is involved, the statute does not reach the conduct in question. The defendants in *Pasquantino* objected to being tried under the wire fraud statute on the grounds that uncollected Canadian taxes were not "property" for purposes of the wire fraud statute. The court disagreed, concluding that because the defendants would have paid taxes had they declared the liquor to border officials, their failure to pay taxes inflicted economic injury on Canada "no less than had they embezzled funds from the Canadian treasury." In concluding that Canada had a property right in its entitlement to collect tax, it stated:

> Petitioners used U.S. interstate wires to execute a scheme to defraud a foreign sovereign of tax revenue. Their offense was complete the moment they executed the scheme inside the United States; "[t]he wire fraud statute punishes the scheme, not its success." *United States v. Pierce,* 224 F3d 158 , 166 (CA2 2000*)* (internal quotation marks and brackets omitted); see *Durland,* 161 U.S., at 313 ("The significant fact is the intent and purpose"). This domestic element of petitioners' conduct is what the Government is punishing in this prosecution, no less than when it prosecutes a scheme to defraud a foreign individual or corporation, or a foreign government acting as a market participant.

Estate planning attorneys, especially when assisting clients with international issues, should be certain to engage foreign counsel when not intimately familiar with local law. While clients might object to the increased cost associated with engaging foreign counsel, significant benefits are associated with seeking counsel. There are the assurances that the client's plan will work as contemplated and that the client's plan will not violate foreign law (i.e., an avoidance of a *Pasquantino* type charge).

Professor Samuel A. Donaldson in an article for the ACTEC Journal [27] recognized that U.S. advisors are simply not capable of providing their clients who have international activities with competent service. He wrote: "[p]erhaps the best advice for planners representing U.S. citizens with investment or business activities abroad is to associate with competent counsel in the jurisdictions in which the client's activities occur. Few American tax professionals are competent to address the foreign income, estate, inheritance and gift tax consequences that can arise when the U.S. client implements an estate plan that shifts the manner in which business or investment assets are held."

Proposed legislation

Last year, legislation was introduced to make tax evasion a separate money laundering offense. [28] Tax evasion would have become a 20-year felony, and the law would clearly permit civil or criminal forfeiture. The American Bar Association Committee on Civil and Criminal Penalties provided substantive comments as to why such legislation would:

- Be duplicative of existing law.
- Discourage voluntary repatriation of funds.
- Make professional advisors subject to criminal prosecution.
- Severely curtail due process.
- Cause tax offenses to be prosecuted under the international money laundering statutes.
- Have a chilling effect on U.S. commerce and international tax enforcement cooperation. [29]

The substantive comments also took note of existing law under Sections 7301, 7302, and 7321. As enacted, the Fraud Enforcement and Recovery Act (S. 386) did not include the offending provision. [30]

The Fraud Enforcement and Recovery Act, as enacted, codified the definition of the term "proceeds" in the money laundering statute to make clear that the proceeds of specified unlawful activity includes the gross receipts of the illegal activity, not just the profits of the activity. Senators Patrick Leahy (D-VT) and Chuck Grassley (R-IA) introduced the original legislation, and one of the reasons they sought to codify the definition of "proceeds" in the legislation was that they felt the Supreme Court ruled contrary to congressional intent in *Santos.* [31] In that case, the Supreme Court ruled that the term "proceeds," as used in the money laundering statute, was ambiguous. Consequently, the Court defined the term as "net profits" rather than "gross receipts." The result was that the Court's decision limited the reach of the money laundering statute to profitable crimes.

Prior to *Santos*, the Eleventh Circuit in *Khanani* [32] held that the definition of "proceeds" is limited to "something which is obtained in exchange for the sale of something else," and thus does not include retained taxes. [33] The court stated that *proceeds* "does not contemplate profits or revenue indirectly derived from labor or from the failure to

remit taxes." The *Khanani* case centered on taxpayers convicted of hiring and paying illegal aliens with funds skimmed from their business. The skimmed funds were not reported to the IRS, and, as a result, the taxpayers failed to pay federal income tax and federal and state employment taxes.

The Third Circuit in *Yusuf* held that the government could use the mail fraud statute in support of an international money laundering charge. [34] The case dealt with a scheme to defraud the U.S. Virgin Islands out of a gross receipts tax. The tax at issue in this case was not an income tax, but a tax on a straight percentage of sales. In addition to holding that the retained taxes were the proceeds of mail fraud, the Third Circuit further held that the retained taxes amounted to "profits." Thus, *Yusuf* was consistent with *Santos*, and in conflict with *Khanani.* These cases, taken together, and the codification of "proceeds" represent the most current body of relevant law on the issues involved in this article.

Practitioners engaged in complex international estate planning should take no comfort in the failure of Congress to treat international tax evasion as a predicate offense for money laundering because there is already more than adequate authority on the part of the IRS and DOJ to act, should it so choose. Additionally, an aide to Senator Grassley told BNA on 5/18/2009 that the struck provision treating tax evasion as a separate money laundering offense represents a long-standing goal for the Senator. Grassley will “continue to push it in his larger money laundering reform package and at every available opportunity,” the aide said. Furthermore, informal discussions with high-ranking representatives of the IRS Office of Chief Counsel have indicated that the government believes such language will ultimately become law in one form or another.

IRS enforcement powers

Seizure and forfeiture can also arise in other contexts. For example, a taxpayer who mails a false state income tax return may be subject to a charge of mail fraud. [35] Additionally, as noted in a January 2009 *Journal of International Taxation* article, [36] the Department of Justice Tax Division amended Tax Division Directive 128 on 10/29/2004 so that domestic tax offenses may be charged as mail or wire fraud, which, as discussed above, are predicate offenses for a money laundering violation. Both state and federal tax offenses can arise as an adjunct to an international estate plan because of the attendant income and transfer taxes that may be due incident to the implementation or ongoing maintenance of the estate plan.

Tax Division Directive No. 128 permits the Department of Justice to bring such charges in tax-related schemes if:

(1) There is a large loss related to fraud or a substantial pattern of conduct.
(2) There is a significant benefit to bringing such charges in lieu of or in addition to tax charges.

The Directive does not apply in routine tax prosecutions, but it does apply in unusual circumstances. Fraud charges will be considered if there is significant benefit:

(1) At the charging stage to ensure that there is support for forfeiture of the proceeds of a scheme to defraud.
(2) At trial to ensure that all relevant evidence will be admitted.
(3) At sentencing to ensure full restitution.

Promoters of tax schemes are particularly targeted under this Directive. [37] This Directive is consistent with the Tax Division Policy that it will not authorize prosecution for money laundering "where the effect would merely be to convert routine tax prosecutions into money laundering prosecutions, as the statute was not intended to provide a substitute for traditional Title 18 and Title 26 charges related to tax evasion, filing of false returns or tax fraud conspiracy." [38]

While tax evasion is not tied to the money laundering statutes, there is no necessity for the government to resort to the money laundering statutes in order to seize assets. Practitioners should expect that in the current environment with a global focus on eliminating tax havens, the first crack in the Swiss banking system, and increased global focus on meeting the OECD standards of transparency, the government may resort to using such enforcement to drive home the point that noncompliance will simply no longer be tolerated.

While much of the discussion of Title 18 offenses has focused on the punitive aspects of the offense, there are interesting tax aspects as well. For example, in Ltr. Rul. 9207004, the IRS included in the decedent's estate the fair market value of bales of marijuana weighing 662.50 pounds, which had been confiscated under Florida's drug enforcement laws. The IRS similarly denied a deduction under Sections 2053 or 2054 for the confiscated property on the theory that doing so would "violate the sharply defined public policy against drug trafficking."

The case focused on a Tennessee decedent who died when his plane crashed in Florida on a smuggling trip. On the plane, the police found bales weighing 459.50 pounds. Soon after, they arrested two men in a truck with 204.90

pounds of marijuana. The pilot had arranged for the men to meet him on the highway and unload the marijuana. All of the marijuana was found to be includable in the pilot's estate in accordance with Section 2033, as the laws of both Florida and Tennessee held an individual's possession of personal property is prime facie evidence of the individual's ownership of the personal property. A series of cases have similarly denied an income tax deduction for taxpayers who had drugs confiscated. [39]

The public policy reasons for denying a deduction related to losses forfeited in the narcotics context applies equally to losses forfeited under the Racketeer Influenced and Corrupt Organization Act (RICO). In *Ianniello* [40] the taxpayers were convicted of mail fraud, tax evasion, and violations of RICO. As a result, the taxpayers were sentenced to prison, fined, and each required to forfeit $666,667 in restaurant profits that had been illegally skimmed. The IRS then assessed each taxpayer a fraud penalty for failure to include the skimmed profits in taxable income. The taxpayers questioned:

> (1) Whether the skimmed receipts were income because they were forfeited to the government.
> (2) If the receipts were classified as income, whether the taxpayers were entitled to loss deductions under Section 165(a) in the tax year in which the receipts were forfeited.

The court dismissed the argument that the receipts were not income. "A taxpayer obtains possession, custody and control of proceeds he acquires unlawfully, despite a statutory forfeiture provision that vests legal title to the proceeds in the United States, on the date he acquires such proceeds." [41] Because Section 61 provides that gross income means all income from whatever source derived, the Supreme Court held that gross income includes all "accessions to wealth, clearly realized and over which the taxpayers have complete dominion." [42] The taxpayers were similarly denied a loss deduction. One could certainly argue that assets forfeited incident to the commission of predicate offenses and money laundering leave the taxpayer with the obvious dilemma that the taxes remain due and owing, despite the forfeiture.

Conclusion

The planning and implementation of a complex international estate plan can actually expose the client to violations of U.S. criminal laws, with attendant forfeiture of the assets, and counsel to violations of both U.S. criminal laws, codes of professional responsibility, and Circular 230. The law is evolving, and the ultimate outcome of the process suggests that counsel be proactive, rather than on the defensive.

We do not suggest that seizure and forfeiture are issues in the vast majority of international estate plans, but the issues appear to be now joined and may well deserve further consideration in the planning process. Practitioners may wish to consider these issues, if for no other reason than to reduce their exposure to claims of aiding or abetting, claims of Circular 230 violations, or even claims for malpractice when a client's assets are seized or forfeited. The degree of disclosure that counsel should make to clients regarding the attendant risks of forfeiture are far from clear. Nevertheless, as this body of law is surely to evolve, there likely will need to be discussion of the issues and guidance as to how to mitigate the exposure. This is, at least for the present time, counsel's obligation to act within the applicable codes of professional responsibility.

1 18 U.S.C. section 1341.

2 The authority is actually granted to the United States by statute, and not the IRS. It is enforced either by a civil penalty or a civil lawsuit. 18 U.S.C. section 1956(b).

3 Section 7201 criminalizes willful attempts to evade tax.

4 Section 7206 criminalizes false and fraudulent statements made to the IRS.

5 U.S. Department of Justice Criminal Tax Manual, Chapter 25, 25.03[2](a).

6 18 U.S.C. section 1956 outlaws the knowing and intentional transportation or transfer of monetary funds derived

from specified criminal offenses. There must be an element of promotion, concealment, or evasion for section 1956 to be violated.
7

18 U.S.C. section 1957 penalizes spending transactions when the funds are contaminated by a criminal enterprise.
8

18 U.S.C. section 1960 penalizes the unlicensed money transmitting business.
9

18 U.S.C. section 981(b)(2).
10

18 U.S.C. section 981(b)(1).
11

18 U.S.C. section 982(a)(1)(A).
12

U.S. Department of Justice Criminal Tax Manual, Chapter 25, 25.01.
13

Section 7321.
14

Specified unlawful activities (commonly referred to as SUAs) are the predicate offenses under the money laundering statues and come in three varieties: state crimes, foreign crimes, and federal crimes. CRS Report for Congress. Money Laundering: An Abridged Overview of 18 U.S.C. 1956 and Related Federal Criminal Law, Charles Doyle, Senior Specialist, American Law Division (7/18/2008). SUAs are listed in 18 U.S.C. section 1956(c)(7).
15

18 U.S.C. sections 1956 and 1957.
16

Section 7206(2).
17

Section 7206(4).
18

Section 6694 imposes penalties on tax preparers.
19

Section 7212 imposes criminal penalties for interfering with the administration of the internal revenue laws.
20

Circular 230 sets forth the rules to practice before the U.S. Treasury Department and is governed by regulations that appear in Title 31, Part 10, of the Code of Federal Regulations. Part 10 contains rules governing the recognition of attorneys, certified public accountants, enrolled agents, and other persons representing taxpayers before the IRS. An attorney who is not permitted to practice before the IRS is not permitted to represent a taxpayer.
21

Superseding Indictment No. CR08-0296RSM, Western District of Washington at Seattle; United States Attorney's Office, Western District of Washington, News Release, 6/4/2009.
22

Indictment No. S1 09 Cr. 581, Southern District, New York; United States Attorney Southern District of New York, Press Release, 6/9/2009.
23

18 U.S.C. section 371 is the general conspiracy statute. It makes it a crime for two or more persons to conspire to

commit an offense against the U.S. by violating a specific statute or statutes, as well as two or more persons to agree to defraud the U.S. A Klein conspiracy is a prosecution where the government must prove that there was an agreement by two or more persons to impede the IRS and each participant knowingly, willfully, and intentionally participated in the conspiracy.

[24]

United States of America v. Velez, Kuehne, and Ochoa, D.C. Docket No. 05-20770-CR-MGC, (CA-11, 10/26/2009).

[25]

96 AFTR2d 2005-5392 (2005).

[26]

18 U.S.C. section 1343. The statute provides: "[w]hoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both. If the violation affects a financial institution, such person shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both."

[27]

Donaldson, "A Hitchhiker's Guide to International Estate Planning: Estate Planning for United States Citizens with Assets Abroad and for Nonresidents with United States Assets," ACTEC J., Vol. 33, No. 4 (Spring 2008).

[28]

2009 TNT 80-4 (4/28/2009).

[29]

52 DTR G-7.

[30]

94 DTR G-2.

[31]

553 US 507, 170 L Ed 2d 912 (2008).

[32]

502 F3d 1281 1296-97 (CA-11, 2007).

[33]

U.S. Department of Justice Criminal Tax Manual, Chapter 25, 25.03[1].

[34]

536 F3d 178 (CA-3, 2008).

[35]

Helmsley, 68 AFTR 2d 91-5272, 941 F2d 71, 91-2 USTC ¶50455 (CA-2, 1991), *cert. den.* 502 U.S. 1091 (1992).

[36]

Comisky and Lee, "Increased Scrutiny of Offshore Activity: Raising the Stakes for U.S. Citizens with Bank Accounts Abroad," 20 J. Int'l Tax'n 38 (January 2009).

[37]

See USAM 6-4.210.

[38]

U.S. Department of Justice Criminal Tax Manual, Chapter 25, 25.01.

[39]

See, Wood, 63 AFTR 2d 89-709, 863 F2d 417, 89-1 USTC ¶9143 (CA-5, 1989); Gambina, 91 TC 826 (1988); Holt, 69 TC 75 (1977); Bailey, TC Memo 1989-674, PH TCM ¶89674, 58 CCH TCM 1030 , *aff'd* 929 F.2d 700 (CA-6, 1991).

[40]

98 TC 165 (1992).

[41]

Wood, *supra* note 39.

[42]

James, 7 AFTR 2d 1361, 366 US 213, 6 L Ed 2d 246, 61-1 USTC ¶9449, 1961-2 CB 9 (1961) (quoting Glenshaw Glass Co., 47 AFTR 162, 348 US 426, 99 L Ed 483, 55-1 USTC ¶9308, 1955-1 CB 207 (1955)).