Bruce
Zagaris

The US as the world's newest IFC and its impact on the Caribbean

During the last decade or so, the status of the U.S. as a superpower has enabled it to increasingly obtain market share from other countries by ignoring its failure to meet international standards while using its control of international organizations and groups, such as the OECD, the G7, the G20, FATF, and the Financial Stability Board, to sanction smaller jurisdictions with which it competes. In the last few years the the United States has consolidated its position as the world's newest international financial center (IFC).

Traditionally investors have come to the U.S. because the U.S. has been the world's largest economy. Its currency has been the most stable and has been clearly the reserve currency and the currency used for much of the world's trade. The U.S. political system has been considered strong and the U.S. has had peaceful transfers of power. Hence, in 2018, an estimated 20 percent of the world's offshore financial assets are in the U.S.[1]

This article discusses the politics of international regulatory initiatives followed by U.S. federal and state initiatives to attract foreign investment, including a section on regulatory arbitrage, in particular entity transparency, anonymous foreign investment in U.S. real estate, and automatic exchange of information. Finally, the article discusses the impact on small jurisdictions in the Caribbean. Some potential solutions are offered for rectifying the problem of the lack of a level playing field in international financial regulatory initiatives.

Federal and state incentives

Non-resident aliens have been traditionally exempt from tax on U.S. bank deposit interest. IRC §871 (h) and (i) exempts from U.S. tax the interest paid to NRAs by persons carrying on the banking business, savings institutions and insurance companies. CDs, open account time deposits, and multiple maturity time deposits are all exempt. A similar exemption applies with respect to estate taxes.

Many U.S. states offer single-member LLCs, whereby an individual can open an LLC to do foreign activities, generating non-sourced U.S. income and avoid U.S. and state taxation. By default, the IRS will treat a single-member limited liability company (SMLLC) as what it calls a disregarded entity. This means that the IRS will not look at an SMLLC as an entity separate from its single owner for the purpose of filing tax returns. Instead, just as it would do with a sole proprietorship, the IRS will disregard the SMLLC, and the owner will pay taxes for the business as part of his or her own personal tax returns. In 2016, the U.S. Treasury issued final regulations that require certain foreign-owned U.S. companies, known as limited liability companies, or LLCs, to disclose their owners to the IRS.

The list of U.S. states offering captive insurance include Alabama, Arizona, Arkansas, Colorado, Connecticut, Delaware, Florida, Hawaii, Illinois, Kentucky, Maine, Nevada, New Jersey, New York, North Carolina, Oklahoma, Oregon, Rhode Island, South Dakota, Tennessee, Utah, and Vermont. A captive insurance company is essentially a new subsidiary that is created by a parent company to underwrite the insurance needs of its operating subsidiaries. The basic idea of a captive is to bring in-house the purchasing of insurance that was previously done from unrelated commercial insurance companies, and retain the underwriting profits for the benefit of shareholders. For most tax purposes, there is little difference between an offshore captive (one formed outside the United States) or a domestic one, since the vast bulk of captives make the election under Tax Code § 953(d) to be treated as a domestic company. Thirty-seven states in the U.S. offer themselves as a captive domicile.

Under the EB-5 U.S. immigration program, for

> *In the last few years the U.S. has consolidated its position as the world's newest international financial center.*

an investment as low as $500,000, entrepreneurs (and their spouses and unmarried children under 21) are eligible to apply for a green card (permanent residence) if they: make the necessary investment in a commercial enterprise in the United States; and plan to create or preserve 10 permanent full-time jobs for qualified U.S. workers. The program has resulted in a series of fraudulent projects, investigations, and scams.

Regulatory arbitrage

In recent years, the U.S. unilaterally and through international organizations and groups has raised transparency and gatekeeper requirements without taking any significant measures itself. In 2006 and 2016, FATF found the U.S. non-compliant

with corporate transparency and gatekeeper requirements. In 2012, FATF raised standards further. Meanwhile, the G7 and G20 have similarly had initiatives against the abuse of entities.

On July 16, 2018, the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes issued a second-round evaluation of the U.S., updating the first-round evaluation from 2011, and downgrading U.S. ratings in four areas, including beneficial ownership, the availability of banking information, and exchange of information on request.

The U.S. has not yet reciprocated on the exchange of information under the FATCA IGAs although the U.S. promised in 2011-13 to do so. In the FATCA IGAs the U.S. agrees to develop a multilateral regime on exchange of information. While many countries became early adherents to the OECD's Common Reporting Standard (CRS) on March 19, 2014, the U.S. has taken the position that it did not have authority to sign. Four years later there is no sign the U.S. is interested in joining the CRS.[2]

Fueled apparently by the potential to anonymously invest, significant foreign investment is made each year in U.S. real estate, especially luxury homes. U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) has issued Geographic Targeting orders (GTO) that temporarily require certain U.S. title insurance companies to identify the natural persons behind companies used to pay "all cash" for high-end residential real estate in the certain jurisdictions, such as Borough of Manhattan in New York City, New York, and Miami-Dade County, Florida, Los Angeles, the San Francisco region, and San Diego in California, and San Antonio, Texas. FinCEN has required the information reporting on all-cash purchases Under the EB-5 U.S. immigration program, for an investment as low as $500,000.00, entrepreneurs (and their spouses and unmarried children under 21) are eligible to apply for a green card – i.e., those without bank financing – that may be conducted by individuals trying to hide their assets and identity by purchasing residential properties through limited liability companies or other opaque structures. FinCEN is requiring certain title insurance companies to identify and report the true owner. The GTOs are only authorized for 180 days. It seems likely the U.S. government will continue to use this tool. Other countries, such as the U.K., have a law requiring beneficial ownership information of foreign investment in real estate.

Impact on small jurisdictions in the Caribbean

The fact that U.S. and states continue to develop various incentives to attract international financial services in the way of tax incentives, regulatory arbitrage, and customized products while simultaneously failing to adhere to international regulatory standards means that small jurisdictions have trouble competing. For instance, small jurisdictions in the Caribbean have pressure to have public registers and the ever changing "fair tax" requirements of the EU Tax Haven Initiative. They are regularly evaluated by FATF, the OECD, and the Financial Services Forum with the risk of being black listed if they do not meet the standards. Even though the U.S. does not remedy the above-mentioned non-compliant ratings, international organizations do not dare put the U.S. on a blacklist. The U.S. is the largest financial contributor to both the OECD and FATF.

Unless the international organizations and informal implement the regimes with a level playing field they profess to have, small jurisdictions will continue to lose business to the U.S. Two initiatives that may help redress the disproportionate balance of power is to have FATF and OECD evaluate not just the U.S., but selected states that have strong international financial sectors, such as Delaware, Montana, South Dakota, and Wyoming. After all, states have their own blacklists. When foreign governments have complained about the state black lists, the U.S. Treasury has said it does not have authority to interfere. Alternatively, neutral bodies, such as the Society of Trust and Estate Practitioners, should do their own evaluations of the states, so that governments worldwide will be able to evaluate whether there is a level playing field in the international initiatives and use such information against states that do not comply.

ENDNOTES

[1] Tax Justice Network, Financial Secrecy Index (2018), available at https://www.financalsecrecyindex.com/Tax Justice Network, Narrative Report on USA (2018), available at https://www.finacialsecrecyindex.com/PDF/USA.pdf.

[2] For additional discussion of these regulatory arbitrage issues with the U.S., see Bruce Zagaris, International Tax Enforcement Cooperation in the Trump Administration, TAX NOTES INT'L 1013 (Sept. 3, 2018).

Bruce Zagaris
Partner
Berliner Corcoran & Rowe L.L.P., 1101 Seventeenth St., N.W. Washington, D.C. 20036
T: +1 (202) 293 2371 E: bzagaris@bcr-dc.com