

FATCA Violation Underlies Latest US Tax and Securities Fraud Charges

Indictment demonstrates the strength of US law enforcement efforts to combat offshore fraud and is the first to charge a FATCA violation.

On September 9, 2014, in *US v. Robert Bandfield, et al.*, federal prosecutors in the Eastern District of New York announced the indictment of a US citizen and others, including offshore corporate service providers (CSPs) and investment managers, for conspiring with numerous US citizens to violate securities and tax laws, including evading reporting obligations under the recently implemented Foreign Account Tax Compliance Act (FATCA).¹ According to US prosecutors, the defendants engaged in a US\$500 million offshore securities fraud, tax avoidance and money laundering scheme. The indictment describes a sophisticated multi-agency undercover operation and clearly demonstrates the United States' commitment to use a wide variety of law enforcement tools to combat offshore tax evasion and financial fraud. Notably, this week's indictment is the first time a FATCA violation has been charged as an "overt act" in furtherance of a tax conspiracy and securities fraud and strikes a cautionary note for financial institutions and financial service providers that may be used as instrumentalities of crime.

Background

FATCA, enacted in 2010 and implemented on July 1, 2014, is a complex regulatory scheme that requires foreign financial institutions (FFIs) worldwide, including CSPs and investment managers, to perform in-depth due diligence and to collect information to identify any ultimate US beneficial owners of financial assets abroad, and, through intergovernmental agreements, to automatically disclose account information annually to the US Internal Revenue Service. Non-compliance can subject the FFI to 30 percent withholding on all US-source payments. As a part of the alleged conspiracy charged in the *Bandfield* indictment, foreign nominees completed false IRS withholding exemption forms (W-8BEN) for purposes of disguising the US beneficial owner and to circumvent FATCA reporting obligations.

The indictment alleges that the defendants, operating in Belize and Panama, engaged in a conspiracy to: (1) defraud investors in US publicly traded companies by manipulating the price of microcap or "penny" stocks, (2) help their clients avoid US taxation, including by completing false Forms W-8BEN, and (3) launder the proceeds of the fraudulent securities transactions. The defendants are alleged to have run US\$500 million through numerous bank accounts on behalf of over 100 US clients. US prosecutors announced that one of the defendants was arrested in Miami, and the US will be seeking extradition of the other defendants from Belize. Prosecutors are also seeking to recover the proceeds of the defendants' activities through criminal forfeiture proceedings.

Multi-Agency US Undercover Operation Reveals Sweeping Scheme

As detailed in the indictment, beginning in late 2012, an undercover US law enforcement officer posed as a promoter of fraudulent stock schemes who wished to avoid SEC and IRS scrutiny. He approached Belize and Panama-based investment managers who agreed to open brokerage accounts in the name of offshore shell companies to conceal the agent's beneficial ownership. The broker-dealers introduced the agent to a corporate service provider (founded and operated by the US defendant Bandfield) to set up the shell companies, and local Belize employees of the CSP agreed to serve as nominee owners of the companies, executing Forms W-8BEN falsely attesting to their beneficial ownership of the foreign companies. The indictment states that the corporate service providers boasted on secret recordings made by the agent that they had incorporated more than 5,000 shell companies, and they claimed the offshore structure was specifically designed to avoid FATCA reporting. According to the indictment, the CSPs told the undercover agent that they could arrange for the issuance of prepaid credit cards that could be used to secretly transfer the proceeds of the stock fraud back to the United States; other clients were offered unidentifiable debit cards for the same purpose. The indictment further alleges that similar arrangements with other US clients were uncovered through judicially authorized wiretaps and search warrants earlier this year.

President Obama's Financial Fraud Enforcement Task Force conducted the investigation. The task force — a coalition of federal agencies, US Attorneys' offices and local partners — was established in 2009 to aggressively combat financial crimes. Pointedly noting FATCA's new role, IRS-Criminal Investigation Acting Special Agent-in-Charge Shantelle Kitchen commented:

“The investigation of offshore tax evasion and money laundering are top priorities for IRS-Criminal Investigation, and we are committed to using all of our enforcement tools to stop this abuse. The enactment of FATCA is yet another example of how it is becoming more and more risky for US taxpayers to hide their money globally. Moreover, this partnership of IRS-CI, the FBI, HSI [Homeland Security Investigations], and the U.S. Attorney's Office demonstrates the government's resolve to combat international crime.”

Indictment Sends Signal on FATCA Compliance, Aggressive Enforcement

The scheme detailed in the *Bandfield* indictment follows a well worn path of prior similar offshore financial frauds, but the prosecutors' focus on the defendants' alleged attempt to avoid FATCA compliance, coming only two months after the complex statute's implementation and a full six months before the initial FATCA reporting deadline, sends a strong message to the global financial community. Over 100 countries have signed or consented to sign FATCA compliance agreements, and this indictment shows that attempts to circumvent the law's due diligence and reporting requirements will not be taken lightly, no matter where they occur. FATCA violations may now be used as indicia of fraud, and clearly the US will use its asset forfeiture and extradition powers when appropriate. Moreover, the bulk of the global financial community trying to comply with its regulatory obligations must nonetheless remain alert to attempts to use financial institutions in furtherance of fraudulent schemes.

The indictment confirms the coordinated and aggressive tactics US law enforcement is now employing to investigate and prosecute offshore financial fraud. This follows on the heels of recent high-profile US indictments and major international banks' guilty pleas for tax and trade sanctions offenses. *Bandfield* is also the second federal indictment in 2014 resulting from a sophisticated undercover “sting” operation. The first, *US v. Joshua Vandyk, et al.*, brought in the Eastern District of Virginia, involving allegations of a remarkably similar tax fraud and money laundering scheme, resulted in guilty pleas by US and Canadian investment firm executives operating in the Cayman Islands, as well as that of a Canadian lawyer based in Turks and Caicos. In recent years, the US has prosecuted more than 100 depositors, bankers and

other facilitators of offshore tax fraud. Along with active whistleblower and voluntary disclosure initiatives, the US Department of Justice's (DOJ's) innovative Swiss Bank disclosure program is providing leads about the locations of hundreds of billions of dollars in previously hidden US customer funds that have been transferred out of Switzerland since 2009. See our earlier client alert [US Allows Swiss Banks With Undisclosed Accounts To Wipe the Slate Clean](#).

Conclusion: Be Prepared

We expect these initiatives to lead to increased US treaty requests, inquiries, investigations and enforcement actions around the globe. Banks and financial service providers need to be aware of the impact of enhanced US regulatory obligations and implement appropriate compliance measures. These institutions must also remain sensitive to risks presented by unscrupulous customers. Finally, they must be ready to manage appropriately information-gathering and investigatory inquiries originating with US authorities, as we discussed in [Beyond Switzerland: Preparing for the Fallout from FATCA and Other Global Transparency Initiatives](#).

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

[Miriam L. Fisher](#)
miriam.fisher@lw.com
+1.202.637.2178
Washington, D.C

[Brian C. McManus](#)
brian.mcmanus@lw.com
+1.202.637.2173
Washington, D.C.

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Endnotes

¹ The US Securities and Exchange Commission (SEC) has filed a parallel civil complaint against several of the indicted defendants, charging them with violating securities reporting rules.