

# GLOBAL PERSPECTIVES

TO LOCAL, INTERNATIONAL & LIFESTYLE REAL ESTATE



## CIPS

Certified International Property Specialist

### > GOVERNMENT AFFAIRS

## LEGAL AND POLICY DEVELOPMENTS

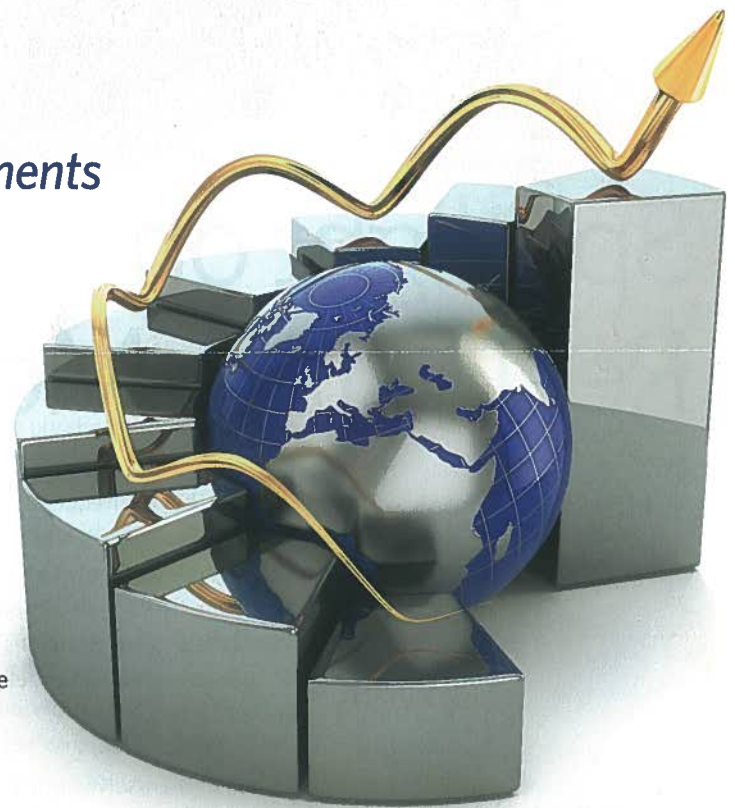
### *Impacting Global Real Estate Investments*

Among the many factors impacting demand for real estate, some of the more complex considerations relate to the laws and policies of various governments. From differences in tax treatments, to allowed investment strategies, or the ease of securing visas/residency status...all these factors and more can play a significant role in where and how global buyers, especially of luxury properties, choose to acquire real estate.

In today's market, one topic in particular is gaining special attention: the potential risk of **real estate money laundering**. This issue of *Global Perspectives* examines recent developments in the United Kingdom, Canada, and the United States, including new, increased scrutiny of luxury transactions in Manhattan and Miami. You'll also find guidance from the National Association of REALTORS® (NAR) on identifying and responding to suspicious activity.

Inside, you'll also learn about recent efforts to **reauthorize the U.S. EB-5 Regional Center Program**, central to efforts to stimulate the U.S. economy through job creation and capital investment by foreign investors, in exchange for immigrant visas for investors and their families.

Finally, you'll learn about **changes to the FIRPTA withholding rate**—a development that may impact U.S. transactions involving foreign property owners. Changes to the withholding rate, both the withholding amount and the transaction level at which it applies, are intended to accommodate other tax provisions that will have a very positive impact on foreign investment in U.S. commercial real estate. 🌐



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# Spotlight on Real Estate Money Laundering

**As efforts to combat terrorism have mounted—including blocking terrorists' ability to finance their activities via real estate money laundering—spillover effects are being felt throughout the luxury property market, long home to transactions cloaked in privacy.**

Wealthy buyers frequently use shell companies to take advantage of legal investment and tax strategies—or simply to maintain their privacy. However, these shell companies may be used in money laundering schemes that are designed to hide corruption and shelter criminal activity, including terrorism.

In and of themselves, shell companies are perfectly legitimate. They can be created in the names of accountants, lawyers or relatives, making it nearly impossible to establish money sources. Also, shell company ownership can be shifted at any time without updating property records. Further, since many high-end transactions are made in cash, ownership can't be traced through mortgage documents either.

Typically, the first and most important layer of control for anti-money laundering (AML) and anti-terrorism financing (ATF) rests with

banks and other financial institutions. However, depending on where you practice, real estate professionals may also be subject to compliance with AML and ATF regulations.

## How Significant is the Threat?

In some markets, like London, a major influx of global cash has fueled a high-end real estate boom. Unfortunately, strong international demand for luxury property—often with a commensurate spike in the prices of more moderate homes—can also invite scrutiny.

**Case in point:** In March, 2015, Transparency International UK issued a report titled, "Corruption on Your Doorstep: How Corrupt Capital is Used to Buy Property in the UK." Among the report's findings: 36,342 London properties totaling 2.25 sq. miles are held by offshore haven companies.





While offshore ownership doesn't automatically imply corrupt activity, the report also stated that since 2004, over £180 million of UK property had been brought under criminal investigation as the suspected proceeds of corruption. Transparency International UK promotes ten recommendations to "end this crisis," starting with full disclosure of offshore ownership.

Since publication of the report, UK Prime Minister David Cameron weighed in on the side of transparency, saying "The UK must not become a safe haven for corrupt money from around the world." He advocated for the creation of a central register of land owned by overseas companies, although it could be months before any measures actually take shape.

To be sure, there have been several high-profile cases of dirty money flowing through London's luxury market and concerns are growing. But there are also concerns that crackdowns could prompt negative, unintended consequences, potentially triggering a market collapse.

Transparency aside, UK politicians have stepped up efforts to eliminate certain tax privileges enjoyed by "non-dom" owners of residential property, including the use of offshore companies to avoid inheritance taxes. It may be reasonable to assume that slowing overheated property markets and creating new revenue sources are stronger drivers behind the latest measures.

### U.S. Developments

Following London, New York City is generally regarded as a top international destination for luxury real estate purchases, potentially involving money laundering schemes.

Throughout 2015, *The New York Times* published a series of articles under the banner "Towers of Secrecy" which examined the people behind shell companies purchasing high-end Manhattan condos. *The Times* found that almost half of the most expensive residential properties in the U.S. (over \$5 million) are now

purchased anonymously through shell companies—a fact that may or may not relate to illicit activity.

Among the individuals and transactions featured in *The Times*, perhaps the most noteworthy is Jho Low, a Malaysian financier with close ties to the family of Malaysia's prime minister, Najib Razak. Low spent over \$140 million on five luxury properties in New York and Los Angeles and Razak now faces a corruption inquiry by the U.S. Department of Justice.

On the flip side, many captains of industry and notable celebrities have also been owners of Manhattan's luxury high-rise condos. At Time Warner Center alone, there are at least 17 owners that can be found on *Forbes* magazine's annual list of the world's richest people. Celebrity owners have included singer-songwriter Jimmy Buffet and Patriots quarterback Tom Brady.

The developers of Time Warner Center actively promoted ownership beyond the U.S., with 26 percent of original sales made to international buyers. Among recent purchases, that figure has grown to 50 percent. The current ownership of 64 percent of the building is now in the hands of shell corporations. (See sidebar.)

Taking a broader perspective, NAR's *2015 Profile of International Home Buying Activity* reports that roughly \$104 billion in U.S. real estate transactions between April 2014 and March 2015 involved international buyers. Half those sales occurred in four states—Florida, California, Texas, and Arizona. New Jersey, New York, Illinois, and Washington all tied for fifth place. On average, international buyers paid nearly \$500,000 for their homes.

### FinCEN Steps In

In January, 2016, the U.S. Financial Crime Enforcement Network (or FinCEN, part of the U.S. Treasury Department), announced temporary requirements for certain title insurance companies participating in high-end all-cash shell company real estate transactions

### Shell Corporation Ownership of Manhattan's Luxury Condos by Building (percentage)



Source: *The New York Times*, Feb. 2015

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in Miami-Dade County (properties over \$1 million) and the Borough of Manhattan (over \$3 million).

The pilot data collection and reporting program, running from March 1 to August 27, 2016, requires designated title insurance companies (but not all title insurance companies) to determine and confirm the identities of natural persons with 25 percent of more ownership in a legal entity (such as an LLC, corporation, or partnership) and to report those names and proof of identity to FinCEN.

The information collected may be used in conjunction with efforts by other law enforcement agencies, but no public disclosure is intended.

FinCEN's announcement was made as an international Financial Action Task Force (FATF) team arrived in the U.S. to assess the United States' anti-money laundering regulations. (The FATF was created by the G-7 nations in 1989.)

NAR met with the FATF team and spoke to NAR's voluntary guidelines developed in collaboration with FinCEN, as an effective means for its one million plus members to be aware of and partner with relevant government agencies when suspicious financial transactions take place.

"In the U.S., real estate transactions typically involve the use of regulated



**The Times found that almost half of the most expensive residential properties in the U.S. (over \$5 million) are now purchased anonymously through shell companies—a fact that may or may not relate to illicit activity.**



financial institutions, for example through the use of a wire transfer or external financing, and such entities already have obligations under the BSA (Bank Secrecy Act)," explains Bill Gilmartin, NAR Senior Policy Advisor. "Real estate professionals rarely have access to the type of information necessary to detect money laundering activity." Still, NAR supports AML and ATF efforts and is working to heighten NAR members' awareness and knowledge of its voluntary anti-money laundering guidelines. (See page 5.)

## Canada's Experience

In Canada, the Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA) places significant reporting obligations upon approximately 31,000 regulated entities, including credit unions, financial institutions, insurance companies, money services businesses (foreign exchange, money remittance, etc.), securities dealers, real estate firms, precious metals/stones dealers, casino operators, and others.

Recent reports commissioned by the Financial Transactions and Reports Analysis Centre of Canada (commonly called FINTRAC) have placed new scrutiny on real estate professionals, saying "the purchase of Canadian real estate assets with offshore money and/or by offshore persons was noted as a significant risk factor."

Canadian real estate brokers, sales representatives and real estate agents must report suspicious transactions and transactions involving the receipt of \$10,000 or more in cash. Between January 2012 and June 2015, FINTRAC received just eight such reports—which some interpret as gross under-reporting, while others see as evidence of little wrongdoing.

In any case, and particularly in reaction to stronger efforts to combat terrorist financing, FINTRAC has taken steps to increase its compliance examinations within the real estate sector.

## Agent's Obligations

Regulation of the real estate industry, with regard to anti-money laundering, varies considerably by country, with Canada imposing some of the strictest compliance orders. In the U.S., agents are not legally obligated to report suspicious activities, whereas U.K. estate agents are required by law to file Suspicious Activity Reports (SAR) with the country's National Crime Agency.

As global real estate professionals dealing in cross-border transactions and/or luxury properties, it's essential for CIPS designees, in particular, to stay informed about anti-money laundering developments, not just in your home country, but also wherever your business may take you. 🌐

To download the American Land Title Association's "Fact Sheet for Financial Crimes Enforcement Network Geographic Targeting Orders for Manhattan, N.Y., and Miami-Dade County, Fla." go to: [alta.org/fincen/fact\\_sheet\\_for\\_financial\\_crimes\\_enforcement\\_network\\_geographic\\_targeting\\_orders.pdf](http://alta.org/fincen/fact_sheet_for_financial_crimes_enforcement_network_geographic_targeting_orders.pdf)





# KNOW YOUR BUSINESS

Real estate professionals should be aware of “red flags” that may indicate illegal financing activities. The presence of one, or even multiple factors, does not necessarily mean the purchaser or seller is engaging in money laundering activities.

Risk factors fall into broad categories:



## Geographic Risk

- Is the customer and/or the source of funds located in a jurisdiction with weak anti-money laundering regimes, supports or funds terrorism, or has a high degree of political corruption?



## Customer Risk

- Is there a large unexplained geographic distance between the location of the property and the buyer?
- Is there unusual involvement by third parties?
- Will residential title be held by a corporation that obscures the owner's identity, without a legitimate business explanation?
- Does the purchase involve high-ranking foreign political officials or their family?



## Transaction Risk

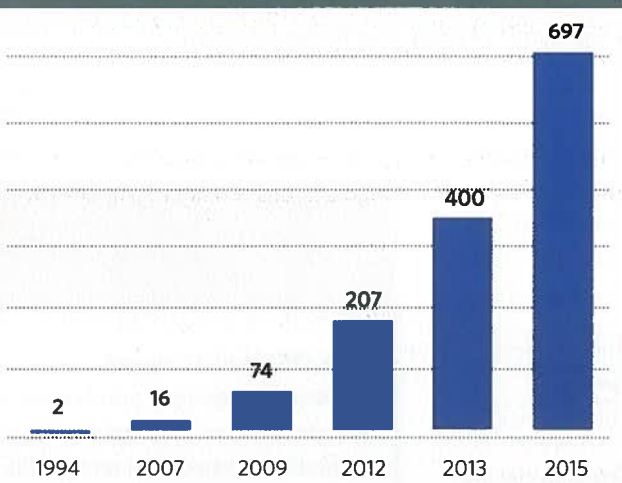
- Is the owner selling for significantly less than the purchase price, or seems disinterested in obtaining a better price?
- Is the buyer bringing actual cash to closing?
- Is the purchase without a mortgage and inconsistent with the buyer's occupation or income?
- Is the buyer interested in immediate resale, especially at a substantially higher or lower price, without reasonable explanation?
- Is the buyer purchasing property without viewing it, or with no interest in its characteristics?
- Are there any other activities that appear suspicious and do not make professional or commercial sense?

**Your obligation to report suspicious activity** depends on your jurisdiction. U.S. real estate professionals should refer to NAR's voluntary guidelines concerning anti-money laundering (available here: [narfocus.com/billdatabase/clientfiles/172/4/1695.pdf](http://narfocus.com/billdatabase/clientfiles/172/4/1695.pdf)). Before proceeding, it's also advisable to consult with your managing broker and attorney.

**UPDATE:**

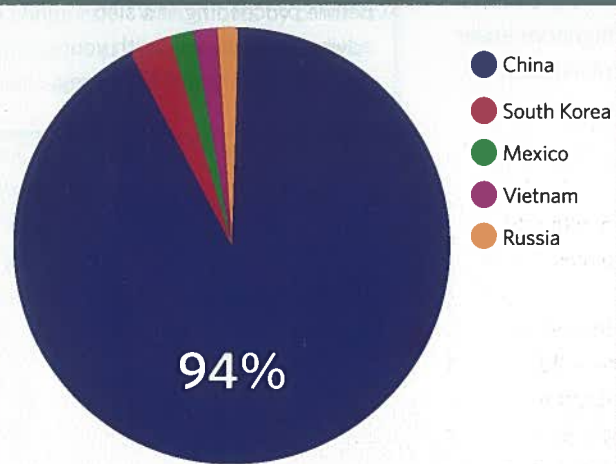
# Reauthorizing the U.S. EB-5 Regional Center Program

**Number of regional centers**  
(selected years)



Source: USCIS; Brookings Institution

**Top five countries receiving EB-5 conditional visas (FY2014)**



Source: State Department preliminary data (FY2014)

The EB-5 Immigrant Investor Program is designed to stimulate the U.S. economy through job creation and capital investment by foreign investors. In exchange for making a minimum investment into a new U.S. business that results in the creation of at least 10 jobs, foreign investors may secure legal residency for themselves and their families.

Typically, foreign investors find it advantageous to participate in the program by means of an authorized Regional Center—an economic entity (public or private) that promotes economic growth and job creation and adheres to the terms of the EB-5 Regional Center Pilot Program.

Since 2003, EB-5 Regional Centers have invested over \$3.1 billion of foreign capital into the U.S. economy, creating over 65,000 jobs for U.S. workers. By stimulating the economy, the EB-5 program also stimulates real estate markets across the U.S.

## Reauthorization

The EB-5 Regional Center Program was originally set to expire last September. Six distinct reauthorization bills were introduced in 2015, all attempting to usher in reforms that would make the program more transparent, accountable, and permanent.

In spite of intense negotiations with the EB-5 Investment Coalition (NAR is a member of this coalition) and other stakeholders, it became clear that the details of a complex and difficult EB-5 immigration reform bill could not be resolved prior to the deadline. Among the goals under review:

**Fraud and security risks** - Increase Regional Centers' financial disclosure requirements and the use of background checks on Regional Center principals, participants and project developers.

**Job creation** - Eliminate certain ambiguities on job creation numbers.

**National security** - Ensure the vetting process for visa applicants is adequate.

At the last moment, the EB-5 Regional Center Pilot Program was **extended until September 2016**, giving the U.S. Congress more time to hammer out permanent reforms. 🌐

To view NAR's policies on immigration and other advocacy issues, visit [realtor.org/political-advocacy/all-advocacy-issues](http://realtor.org/political-advocacy/all-advocacy-issues).





## TAXING MATTERS:

# FIRPTA Withholding Rate Increased to 15 Percent for High-End Properties

**Good news for the U.S. commercial real estate industry: The Protecting American Taxpayers from Tax Hikes (PATH) Act includes two very positive FIRPTA provisions that are conservatively estimated to boost foreign investment in U.S. commercial real estate by \$20-\$30 billion per year.**

However, as part of a package of tax changes to “pay for” the two provisions, Congress also included an increase in the FIRPTA withholding rate from 10 percent to 15 percent. It should be noted that residences purchased from foreign persons will not be affected by the higher withholding rate unless the purchase price exceeds \$1 million.

### What is FIRPTA?

FIRPTA is the Foreign Investment in Real Property Tax Act of 1980. This legislation was enacted as a result of widespread concerns that foreign investors were purchasing U.S. real estate and then selling it at a profit without paying any tax to the United States. To solve the problem, FIRPTA established a general requirement on the purchaser of real estate interests owned by a foreign seller to withhold 10 percent of the purchase price and remit it to the Internal Revenue Service at the time of closing unless certain exceptions are met.

Usually, the settlement agent is the party that withholds and remits the funds to the IRS, but the buyer is legally responsible. In certain circumstances, the buyer’s agent can also be held liable. Under the FIRPTA law, there is no withholding requirement if the sales price does not exceed \$300,000 and the residence is intended for the buyer’s personal use. Properties between \$300,000 and \$1 million are subject to a 10 percent withholding tax. Now, with the 2016 changes to FIRPTA, properties over \$1,000,000 are subject to the 15% withholding tax.

### How will commercial property benefit?

First, the new law doubles (from 5 percent to 10 percent) the maximum amount of stock ownership that a foreign investor may have in a U.S. publicly-traded real estate investment trust (REIT). Second, the new law permits certain foreign pension funds to invest in REITs without having FIRPTA treatment apply.

### What are your FIRPTA withholding obligations?

If you represent either the buyer or a seller of real property that is subject to FIRPTA withholding, you could find yourself liable for the tax that should have been withheld by the buyer in certain circumstances.

If the buyer of the real property receives a certificate from the seller that the seller is not a foreign person, and is therefore exempt from withholding, and you as the agent for either the seller or the buyer have knowledge that the certificate is false, you must notify the buyer of this fact. Failure to do so could mean that you, as the agent, are liable for the tax that should have been withheld but was not (limited to the amount of commission earned).

In addition, if you as an agent serve as a “withholding agent,” you may be personally liable for the full amount of FIRPTA withholding tax required to be withheld, plus interest and penalties. 🌐

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