Closing the "All Cash" Loophole: Increased Local and Federal Scrutiny of Non-US Purchasers in New York

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The non-U.S. investor and related foreign monies have long played a crucial role in the expansion of the new development luxury New York condominium market. This is evidenced by our ever-changing skyline. However, both at state and federal levels, there have been governmental and regulatory concerns about the use of shell companies and potential for international money laundering or use of illicit funds.

Back in March 2016, the Financial Crimes Enforcement Network (FinCEN) of the United States Treasury Department began its crackdown on shell companies and use of illicit foreign money being used in luxury residential real estate transactions. This was done via the creation of Geographic Targeting Orders (GTO) temporarily requiring title insurance companies to identify the natural persons behind the shell companies used to pay "all cash" for high-end residential real estate. Initially targeting the Manhattan and Miami markets, FinCEN imposed a disclosure requirement requiring title insurance companies to report to the United States Treasury the identity of individual investors behind the entities buying residential property valued at $3 million and above in Manhattan and $1 million and above in Miami. Such entities include limited liability companies and corporations (domestic and foreign), which are often used to shield investors from liability and taxation.

The purported intent of the FinCEN disclosure requirement was to look behind the curtain of corporate protection and determine who the true investors were and where the money was coming from. Since 2016, the disclosure requirement has been extended several times and has been expanded to included residential properties in Brooklyn, Bronx, Queens, and Staten Island ($1.5 million and above) and properties in certain other counties in various states as well. This requirement, which was initially supposed to be a temporary pilot program for six months, has expanded both in scope and reach.

However, until recently, the most glaring flaw and repeated complaint about the FinCEN GTO was that the requirement effectively had no teeth, as it excluded wire transfers. As most ultra high-end residential purchases involve wires, a substantial portion of the transactions closed in the last year and a half were not subjected to the FinCEN requirement. On August 22, 2017, FinCEN issued an eight page advisory opinion, which effectively closed the loophole. As a result, regulators are now optimistic that the government has tightened the noose and strangled the ability of bad actors to use real estate to transfer illicit or tainted money.

FinCEN's advisory opinion had an immediate impact in New York. On August 28, 2017, the New York Attorney General's Real Estate Finance Bureau published a memorandum describing how the latest revision to the FinCen GTO impacts disclosure requirements for New York City condominium and cooperative offering plans.

According to the guidance memorandum issued by the New York Attorney General, every active and future offering plan in New York City must disclose that title insurance companies are required to report the identity of purchasers in residential real estate transactions when the:

- Purchaser is a legal entity as defined by the FinCen GTO;
- The purchase of residential real estate does not involve a mortgage and/or bank loan;
- Purchaser is buying residential property priced at $3 million and above in Manhattan or $1.5 million and above in Brooklyn, Queens, Bronx, and Staten Island.
- The purchase is made using certified check, cashier's check, traveler's check, business check, money order or a wire/funds transfer.

To be clear, offering plans that have already been filed that do not include this language must be revised to include such at the next substantive amendment. Offering plans that haven't been filed yet won't be accepted unless they contain the FinCEN disclosure language. Seems to me that the FinCEN disclosure requirement just became real. However, as always, those that are trying to evade regulations in order to move illicit funds will be working hard to find the next loophole. As it stands now, buyers could evade this requirement by electing not to procure title insurance. Obviously, this is not recommended for a number of reasons. All in all, time will tell whether this program will be successful.

It is important to note that FinCEN seems to have just hinted that the disclosure requirement may soon be expanded to include commercial real estate transactions where the price tags and frequency of wire transfers are even higher. If this is the case, things will certainly get interesting.

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