Cross-Border Money Transfers: Key Requirements Every U.S.-Based Nonprofit Needs to Know

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Venable LLP, Washington, DC

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Agenda

- General Concerns for U.S.-Based Nonprofits Operating Abroad
- Understanding U.S. Sanctions and Embargo Programs
- Understanding the Recent Ukraine-Related / Russian Sanctions
- Taxation of Foreign Operations
  - Tax Issues
  - Information Reporting Issues
  - Transfer Pricing Issues
  - Accounting Issues

General Concerns for U.S.-Based Nonprofits Operating Abroad

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General Considerations and Concerns

- Facing foreign exchange control fluctuations when undertaking business activities overseas
  - Can you contract in U.S. dollars?
  - Are there reinvestment or remuneration limitations?
- Additional banking controls and accountability
  - Ensure proper recordkeeping for all expenditures
  - Heightened risks for cash transactions
  - Challenges to or prohibitions against nonresidents as signatories on bank accounts?
  - Controls over disbursements and “slush” funds
- Accountability: Locally and to U.S. “HQ” entity
  - Implementing a standard, global policy that meets local requirements
  - Implement, train, and audit

New Heightened Scrutiny on Foreign-Based Organizations

- Greater scrutiny on foreign-based entities for taxation, accounting, and foreign funding
  - Requirements for local/domestic entities receiving funding from abroad
    - Reporting required under local law or lose right to receive foreign funds
    - India’s Foreign Contribution Regulation Act
  - *E.g.*, India, China, Russia…under the microscope

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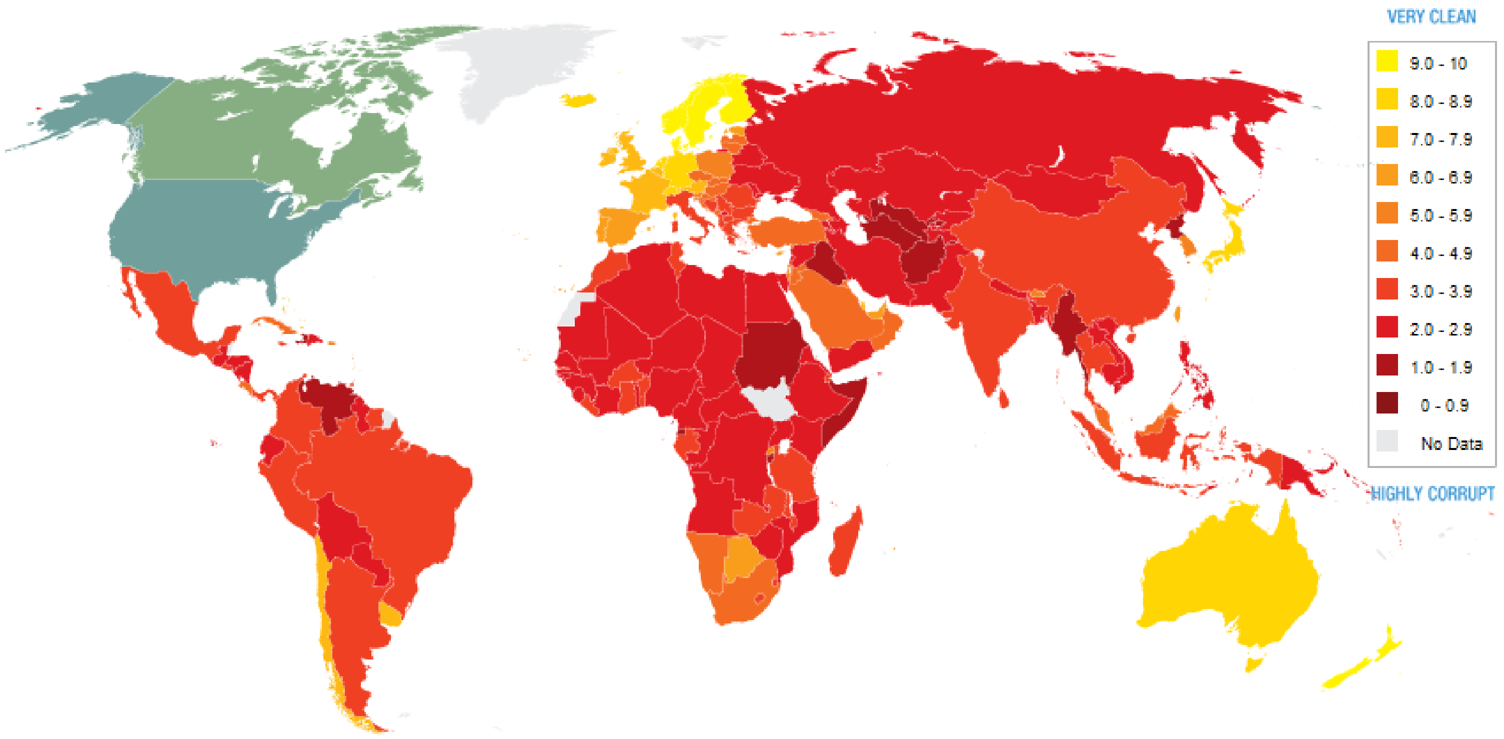
Anti-Corruption and the US Foreign Corrupt Practices Act (FCPA)

- U.S. law enacted by Congress in 1977 to halt rampant bribery of foreign government officials.
- Anti-bribery provisions:
  - Prohibits the paying of, offering, promising to pay (or authorizing to pay or offering) money or “anything of value”
  - With corrupt intent, directly or indirectly
  - To a “foreign government official” or political party official
  - For the purpose of (i) influencing an official act or decision; (ii) causing the official to fail to perform his lawful duty; or (iii) obtaining or retaining business or to secure any improper advantage
- Certain limited exceptions and affirmative defenses exist.

The Global Heat Map: Where Are You Doing Business?



RANK	COUNTRY/TERRITORY	SCORE
1	New Zealand	9.5
2	Denmark	9.4
2	Finland	9.4
4	Sweden	9.3
5	Singapore	9.2
6	Norway	9.0
7	Netherlands	8.9
8	Australia	8.8
8	Switzerland	8.8
10	Canada	8.7
11	Luxembourg	8.5
12	Hong Kong	8.4
13	Iceland	8.3
14	Germany	8.0
14	Japan	8.0
16	Austria	7.8
16	Barbados	7.8
16	United Kingdom	7.8
19	Belgium	7.5
19	Ireland	7.5
21	Bahamas	7.3
22	Chile	7.2
22	Qatar	7.2
24	United States	7.1
25	France	7.0
25	Saint Lucia	7.0
25	Uruguay	7.0
28	United Arab Emirates	6.8
29	Estonia	6.4
30	Cyprus	6.3
31	Spain	6.2
32	Botswana	6.1
32	Portugal	6.1
32	Taiwan	6.1
35	Slovenia	5.9
36	Israel	5.8
36	Saint Vincent and the Grenadines	5.8
38	Bhutan	5.7
39	Malta	5.6
39	Puerto Rico	5.6
41	Cape Verde	5.5
41	Poland	5.5
43	Korea (South)	5.4
44	Brunei	5.2
44	Dominica	5.2
46	Bahrain	5.1
46	Macau	5.1
46	Mauritius	5.1
49	Rwanda	5.0
50	Costa Rica	4.8
50	Lithuania	4.8
50	Oman	4.8
50	Seychelles	4.8
54	Hungary	4.6
54	Kuwait	4.6
56	Jordan	4.5
57	Czech Republic	4.4
57	Namibia	4.4
57	Saudi Arabia	4.4
60	Malaysia	4.3
61	Cuba	4.2
61	Latvia	4.2
61	Turkey	4.2
64	Georgia	4.1
64	South Africa	4.1
66	Croatia	4.0
66	Montenegro	4.0
66	Slovakia	4.0
69	Ghana	3.9
69	Italy	3.9
69	FYR Macedonia	3.9
69	Samoa	3.9
73	Brazil	3.8
73	Tunisia	3.8
75	China	3.6
75	Romania	3.6
77	Gambia	3.5
77	Lesotho	3.5
77	Vanuatu	3.5
80	Colombia	3.4
80	El Salvador	3.4
80	Greece	3.4
80	Morocco	3.4
80	Peru	3.4
80	Thailand	3.4
86	Bulgaria	3.3
86	Jamaica	3.3
86	Panama	3.3
86	Serbia	3.3
86	Sri Lanka	3.3
91	Bosnia and Herzegovina	3.2
91	Liberia	3.2
91	Trinidad and Tobago	3.2
91	Zambia	3.2
95	Albania	3.1
95	India	3.1
95	Kiribati	3.1
95	Swaziland	3.1
95	Tonga	3.1
100	Argentina	3.0
100	Benin	3.0
100	Burkina Faso	3.0
100	Djibouti	3.0
100	Gabon	3.0
100	Indonesia	3.0
100	Madagascar	3.0
100	Malawi	3.0
100	Mexico	3.0
100	Sao Tome and Principe	3.0
100	Suriname	3.0
100	Tanzania	3.0
112	Algeria	2.9
112	Egypt	2.9
112	Kosovo	2.9
112	Moldova	2.9
112	Senegal	2.9
112	Vietnam	2.9
118	Bolivia	2.8
118	Mali	2.8
120	Bangladesh	2.7
120	Ecuador	2.7
120	Ethiopia	2.7
120	Guatemala	2.7
120	Iran	2.7
120	Kazakhstan	2.7
120	Mongolia	2.7
120	Mozambique	2.7
120	Solomon Islands	2.7
129	Armenia	2.6
129	Dominican Republic	2.6
129	Honduras	2.6
129	Philippines	2.6
129	Syria	2.6
134	Cameroon	2.5
134	Eritrea	2.5
134	Guyana	2.5
134	Lebanon	2.5
134	Maldives	2.5
134	Nicaragua	2.5
134	Niger	2.5
134	Pakistan	2.5
134	Sierra Leone	2.5
143	Azerbaijan	2.4
143	Belarus	2.4
143	Comoros	2.4
143	Mauritania	2.4
143	Nigeria	2.4
143	Russia	2.4
143	Timor-Leste	2.4
143	Togo	2.4
143	Uganda	2.4
152	Tajikistan	2.3
152	Ukraine	2.3
154	Central African Republic	2.2
154	Congo Republic	2.2
154	Côte d'Ivoire	2.2
154	Guinea-Bissau	2.2
154	Kenya	2.2
154	Laos	2.2
154	Nepal	2.2
154	Papua New Guinea	2.2
154	Paraguay	2.2
154	Zimbabwe	2.2
164	Cambodia	2.1
164	Guinea	2.1
164	Kyrgyzstan	2.1
164	Yemen	2.1
168	Angola	2.0
168	Chad	2.0
168	Democratic Republic of the Congo	2.0
168	Libya	2.0
172	Burundi	1.9
172	Equatorial Guinea	1.9
172	Venezuela	1.9
175	Haiti	1.8
175	Iraq	1.8
177	Sudan	1.6
177	Turkmenistan	1.6
177	Uzbekistan	1.6
180	Afghanistan	1.5
180	Myanmar	1.5
182	Korea (North)	1.0
182	Somalia	1.0

Due Diligence on All Involved Parties

- Ensure that any agent, business representative, or independent contractor/service provider performing work on your behalf:
  - Is properly vetted
  - Agrees to abide by your Code of Conduct, the FCPA, and any other applicable anti-corruption laws
- Consider your:
  - Employees
  - Venture partners
  - Service providers
- Remember your other overseas affiliates too!
- Consider all parties with whom you interact overseas

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Considerations for Your Employees

- Appropriate, risk-based due diligence requires your employees to consider a variety of factors:
  - Is the target country prone to corruption?
  - Does representative have a corrupt/questionable reputation?
  - Are representative's demands for fee/commission excessive or unusual?
  - Does representative have close relationships with foreign officials?
  - Are payment methods questionable?
  - Was representative recommended by government official?
  - Is the role of the representative unclear?
  - Does representative lack the skill, qualifications, or resources to undertake representation of your organization?

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What Due Diligence May Be Needed?

- Red flags trigger the need for further inquiry and greater vigilance on the part of your organization. Consider:
  – Third-party due diligence
  – Interviews and physical inspections of offices/facilities
  – Obtaining an opinion from counsel or another reliable source, such as the local U.S. embassy or consulate, about the representative's reputation and qualifications
- Do your documents and agreements put other parties operating with you or on your behalf on notice that you hold them responsible for compliance with FCPA?
  – Establish your first line of defense
  – Think Morgan Stanley
- **Educate, Train, Audit…Repeat**

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Additional FCPA Considerations

- Anti-corruption risks follow you overseas:
  - Oversight and Control: Important concepts
  - Successor Liability: Acquiring a problem
  - Consider operations in current “red flag” countries
  - N.B.: Nonprofits are not exempt
  - Who is a “foreign official”? Broadly defined.
  - “Agency” relationship with partners abroad → U.S.-based nonprofit or association can be held liable for the acts of partners abroad under FCPA
  - Provision of “samples” or other incentives
- Recent enforcement efforts of anti-bribery laws
  - Local laws / UK Bribery Act / OECD
  - Joint enforcement is the new trend

Understanding U.S. Sanctions and Embargo Programs

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Do U.S. Export Control Laws Impact Our Activities?

- U.S. export controls and economic sanctions
  - Controls on “exports” or release of U.S.-origin goods, technology, and services to certain destinations, entities, and end users
  - Are you exporting computers, technology, or other goods in support of your overseas venture? (Materials for a trade show/ hand-carry items can be subject to controls.)
- U.S. economic sanctions (OFAC)
  - U.S. sanctions are constantly changing and may affect ability to do business in certain countries and with nationals or entities based in those countries
    - Iran, Syria, Cuba, Sudan, North Korea
    - Other “targeted” sanctions
  - Comprehensive sanctions prohibit most transactions with entities, persons, or governmental entities in those countries
  - “Targeted” Sanctions: Specially Designated Persons
  - “Informational Materials” exemption
  - Transactional prohibitions

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Understanding U.S. Sanctions and Embargo Programs

- U.S. Dept. of Treasury’s Office of Foreign Assets Control (OFAC)
  - Know the scope and reach of jurisdiction
  - U.S. persons/entities – how defined?
  - What activities are covered?
  - Keep current, as not static!
- License authorization required for certain activities
  - Pursue transactions and payments to persons/entities subject to sanctions
  - Exporting/reexporting items for humanitarian support
  - Policy of “denial” typically applies
- Remember: Corresponding jurisdiction by State and Commerce Departments under U.S. export controls

Understanding the Recent Ukraine-Related / Russian Sanctions

Development of the Ukraine-Related Sanctions

- Complex set of Orders, Directives, and General Licenses
  - Executive Orders (EO): 13660 (Mar. 6, 2014); 13661 (Mar. 16, 2014); 13662 (Mar. 20, 2014)
  - International Emergency Economic Powers Act (IEEPA)
  - 31 C.F.R. Part 589 Ukraine-Related Sanctions Regulations
- EO 13662 Directives (as amended Sept. 12, 2014)
  - Directives 1 – 4 each with sectoral focus
  - Sectoral Sanctions Identifications (SSI) List
    - Persons operating in Russian economy identified by Treasury
    - Prohibitions on dealings with SSI list persons/entities
- Particular industry focus within the directives

Recent Sanctions against Russia

- Complex set of Orders, Directives, and General Licenses: Sectoral Sanctions Identifications (SSI)
  - Directive 1: Financial Services – New debt (30 days) & equity
  - Directive 2: Energy Sector – New debt (90 days)
  - Directive 3: Defense & Material Sector – New debt (30 days)
  - Directive 4: Energy Sector – Oil production (directly or indirectly)
  - For prohibited activities of SSI named persons (SDNs too)
  - All now include prohibitions for evasion and conspiracy
- Two General Licenses
  - General License 1A for derivatives prohibited by Directives 1, 2, and 3
  - General License 2 authorizing certain activities prohibited by Directive 4

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Unraveling the Complex Ownership Provisions and Presidential Discretion

- Revised guidance (Aug. 2014) by OFAC expands scope
  - Sanctions interpreted to include "Entities owned 50% or more in the aggregate by more than one blocked person."
  - Blocked property defined to include "any property or interest in property (tangible or intangible) including present, future or contingent interests, as well as those 'direct or indirect.'"
- Interests Owned by Blocked Persons:
  - Included is any interest in property of an entity in which blocked person owns, individually or in aggregate, directly or indirectly, 50% or more interest.
- Entities Owed by Blocked Persons:
  - Any entity owned 50% or more (in the aggregate, directly or indirectly) is itself a "blocked person."
- Thus, property and interests in such property are blocked irrespective of whether entity is named in Annex, and OFAC license required
- Ukraine Freedom Support Act of 2014: gives Presidential discretion on imposing New Sanctions

Practical Tips Given New Complex Ownership Provisions

- Due diligence for Russian transactions critical:
  - Understand whether any Listed Person/Entity owns 50% or more of the target
  - Watch out for significant ownership interest of less than 50%
  - Consider whether Listed Person/Entity "controls" by means other than ownership interest
    - Officer, director involvement?
    - Signatory to contracts and agreements?
    - Obtain certification as to ownership and control rights?
  - Not blocking actions: More complex and difficult in practice
- Also, remember BIS restrictions involving Russia
  - Additions to the Entities List
  - Restrictions on military end uses and end-users

Compare and Contrast with Other Country/Regional Sanctions Provisions

- EU Sanctions (Mar. 2014):
  - EU nationals and companies may not buy or sell new bonds, equity, or similar financial instruments with a maturity >30 days, issued by:
    - 5 major state-owned Russian banks, their subsidiaries outside of the EU, and those "acting on their behalf or under their control"
    - 3 major Russian energy and defense companies.
  - Services related to issuance of financial instruments (*e.g.*, brokering) prohibited
  - Loans to 5 major Russian state-owned banks prohibited
  - Embargo on import/export of arms and related material from/to Russia, including all items on EU common military list
  - Prohibits exports of dual-use goods and technology for military use in Russia or to Russian military end-users and exports to 9 mixed defense companies
  - Exports of certain energy-related equipment and technology to Russia subject to prior authorization, with policy of denial for restricted oil projects and exploration
  - Prohibits Services for named oil exploration / production activities

Other Country and Regional Sanctions Programs

- Similar restrictions targeting sectors at issue by Western countries:
  - *E.g.*, Australia, extended to Overseas Territories, Bermuda
  - Don’t see 50% ownership provisions
- Some EU member states decline to impose sanctions:
  - Finland, Slovakia
- Sanctions not static and track political developments, stay tuned!

Taxation of Foreign Operations:

Tax Issues

Taxation of Foreign Operations

- Choice of entity
  - Foreign corporation wholly owned by U.S. nonprofit entity
    - Separate legal entity
    - Registered with the local governmental authorities
    - Separate board of directors and separate officers
      - Some may be directors and/or officers of the U.S. nonprofit
  - Foreign branch office of the U.S. nonprofit entity
    - Generally registered with the local governmental authorities, but not always
    - Practical issues of not registering

Taxation of Foreign Operations

- U.S. tax issues
  - Foreign operations of a branch office of a U.S. nonprofit should continue to be exempt from U.S. tax if the activities of the branch are consistent with the tax-exempt purpose of the U.S. nonprofit
  - UBTI rules still apply to foreign branches of U.S. nonprofits
  - Subject to U.S. information reporting requirements in addition to Form 990 reporting requirements
    - File Form 5471 for each foreign subsidiary
    - No separate reporting for foreign branches

Taxation of Foreign Operations

- Foreign tax issues
  - Qualification as a nonprofit for U.S. tax purposes may not be respected by the foreign country when conducting operations as a branch office
  - May need different or additional registrations to comply with applicable foreign law requirements
  - Need to consider VAT and GST tax implications as well as possible income tax implications of proposed activities

Taxation of Foreign Operations

- Double taxation agreements (DTAs)
  - The U.S. has entered into DTAs with many countries
  - The purpose of a DTA is to generally reduce the withholding taxes on cross-border payments of dividends, interest, rents, royalties, and other similar payments, as well as the treatment of employees and independent contractors
  - A few DTAs, including Canada and Germany, specifically address the tax treatment of charitable organizations
    - Generally provide for a reciprocal exemption
  - Most DTAs, including China, India, and Russia, do not address the tax treatment of charitable organizations

Taxation of Foreign Operations: Information Reporting Issues

U.S. Compliance

- The U.S. imposes significant information reporting requirements on U.S. taxpayers with overseas operations.
- Those requirements apply to nonprofits just as they do to for-profit entities.
- The IRS and the Department of Justice are very focused on international information reporting, even by nonprofits.

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U.S. Compliance

- FinCEN Form 114 (FBAR)
  - Filed if a person has signature authority over, or a financial interest in, one or more foreign financial accounts with a total aggregate balance of more than $10,000
  - Must be filed, even if the person does not have an actual financial interest in the account(s)
  - For these purposes, the term "person" includes individuals and nonprofits
  - Due electronically by June 30th of each year; a U.S. Treasury Department form, not an IRS tax form

U.S. Compliance

- Form 114 (FBAR) (cont'd.)
  - Considered to have a financial interest if the U.S. person, including nonprofits, owns more than 50% of the equity or other interests in a foreign entity
  - Foreign financial accounts include foreign bank accounts, securities brokerage accounts, mutual funds, hedge funds, private equity funds, and certain insurance contracts
  - Penalty of $10,000 for each unreported foreign financial account; six year statute of limitations

U.S. Compliance

- Forms 926/5471
  - Filed if the U.S. nonprofit owns at least 10% of the stock of the foreign nonprofit entity
  - Form 926 is filed for the taxable year the foreign nonprofit entity is formed
  - Form 5471 is an annual information reporting form used to report the operations of the foreign nonprofit entity (includes a balance sheet, income statement, and other information)
  - Filed with Form 990

U.S. Compliance

- Form 8938
  - A new IRS tax form that became applicable starting with the 2011 tax year
  - At the moment, only applicable to individuals and not nonprofit entities
  - Report specifies foreign financial assets
    - Includes many assets reported on Form 114, but also includes stock of foreign entities and a broader range of foreign financial assets
  - Not filed with Form 990 until the regulations change

U.S. Compliance

- Other forms
  - Form 8865: Filed to report investments in foreign partnerships
  - Form 8621: Filed to report investments in Foreign Passive Investment Companies

Taxation of Foreign Operations: Transfer Pricing Issues

Transfer Pricing

- U.S. entities are required to deal with their affiliates at arm's length under Section 482 of the U.S. Internal Revenue Code
  - Similar arm's length requirements apply in most foreign countries
  - OECD versus BRIC approaches to transfer pricing
  - Services, financing transactions, licenses of intellectual property, *etc.*, are all transactions subject to transfer pricing rules
  - BRIC countries look very closely at payments by local subsidiaries to their foreign parent companies
    - Payments may be subject to local withholding taxes even though the recipient is exempt from tax in the U.S.

Transfer Pricing

- Disputes between tax authorities over transfer pricing issues
  - If the U.S. and the foreign country have a double taxation agreement, then disputes are referred to the "competent authority" of both governments
  - If no double tax agreement, then may end up with reduced deductions at the local subsidiary level and a requirement for the U.S. nonprofit to repay the disallowed amounts
- In the case of a U.S. nonprofit, the main concern is payments by the local subsidiary rather than the allocation of expenses by the U.S. nonprofit

Taxation of Foreign Operations: Accounting Issues

Accounting Issues

- U.S. generally requires that financial statements which are audited be prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP) and Generally Accepted Auditing Standards (GAAS)
- Most other countries require that audited financial statements be prepared in accordance with International Financial Reports Standards (IFRS)

Accounting Issues

- There are significant differences between GAAP and IFRS
  - The Pricewaterhouse Coopers guide to GAAP – IFRS difference runs some 215 pages
  - Differences exist with respect to the balance sheet, the income statement, income recognition, timing of expenses, the statement of cash flows and many other areas
  - There are special GAAP rules for nonprofit entities
  - IFRS rules for nonprofits are not as well developed

Accounting Issues

- Unlike the U.S., many countries require that audited financial statements be prepared for local subsidiaries
  - IFRS standards likely apply
  - Time and expense of such audits can be significant
  - Management representation letters may be required
  - May have to appoint a separate statutory auditor from the accounting firm that audits the U.S. nonprofit

Questions?

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