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INEQUALITY & DEMOCRACY

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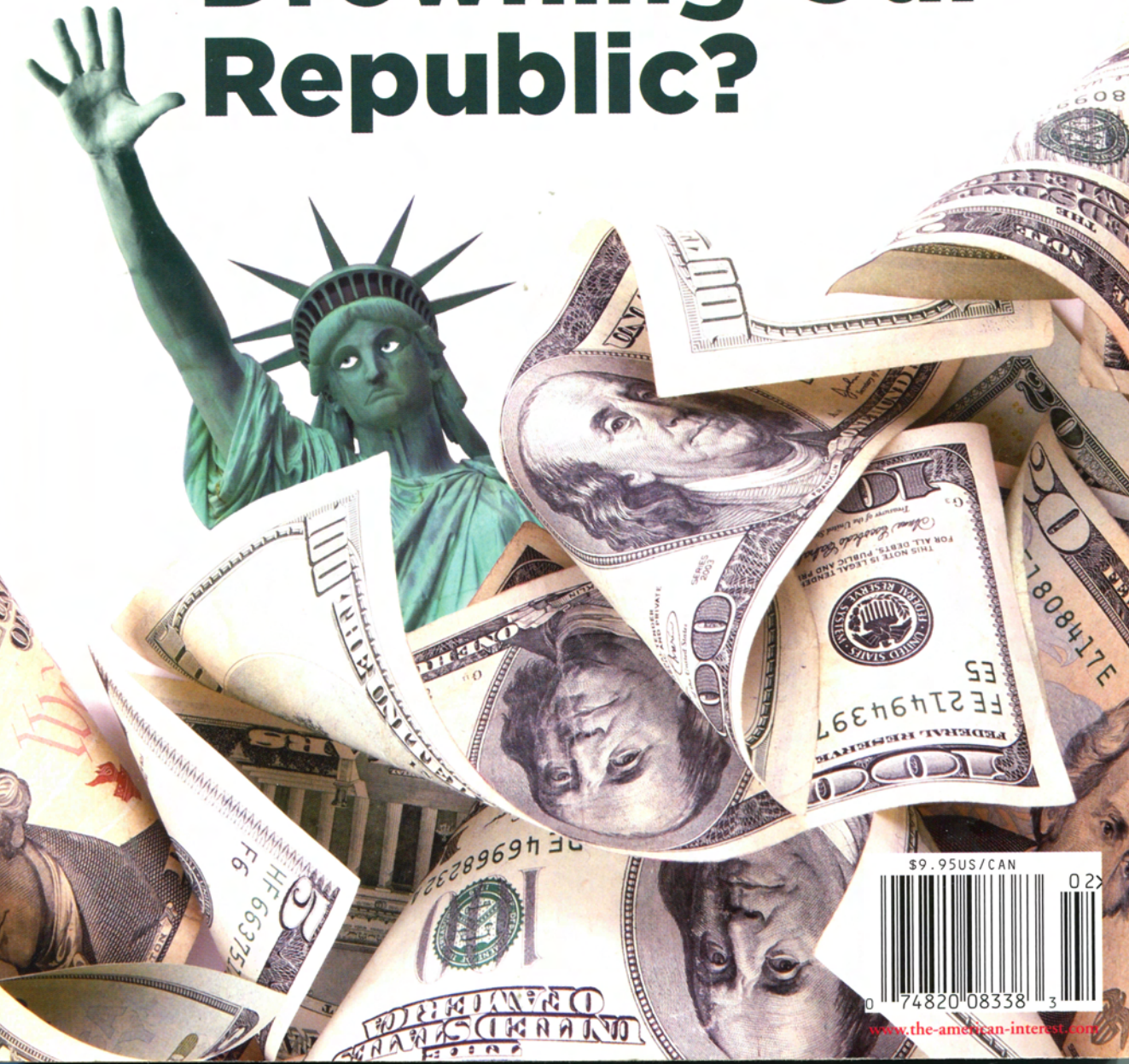

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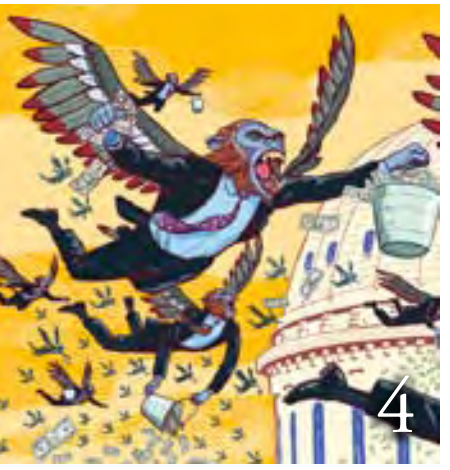

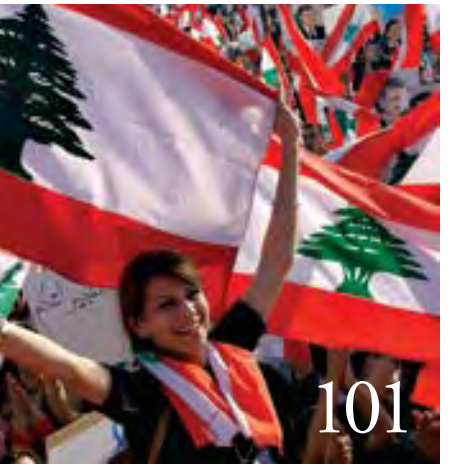

PLUTOCRACY & DEMOCRACY

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NATION-BUILDING IN AMERICA

REVIEWS

NOTES & LETTERS

The plutocracy is hard at work devising new ways to avoid paying taxes—and new ways to convince the government to turn a blind eye to their efforts as well.

Shells, Shams and Corporate Scams

Lucy Komisar

Corporate secrecy, which involves hiding the identities of company owners from tax and other legal authorities, is itself no secret. It is well known that offshore banking centers such as Switzerland, Liechtenstein and the Cayman Islands have for many years enabled fraudsters all over the world to carry out scams, launder illicit profits, stash stolen loot and hide money from tax authorities. The basic method is simple: Shell companies with no real business functions are created for the exclusive purpose of hiding the identities of the owners of valuable assets. The legal fiction works because offshore secrecy jurisdictions, by definition, do not require the real owners to identify themselves to the banks and other financial institutions with which they deal.

That some Americans evade their government's regulations and taxes by sending money offshore is to some extent common knowledge. What most people do not know, however, is that there is a vast and growing *American* offshore. Foreign crooks prize states such as Nevada, Wyoming and especially Delaware for state laws that don't require them to list owners or even company officials when a new company is formed. Martin Woods, a former policeman who follows the paper trails left behind by illicit cash for Hermes Forensic Solutions Ltd. in London, recently quipped at a conference, "Internationally, Delaware is an acronym. It stands for *Dollars, Euros Laundered And Washed At Reasonable Expense*."[1]

Here's how the U.S. secrecy system works. Most states collect basic information from anyone seeking to establish a corporation. They allow individuals with ownership interest—including investors who control the corporation or partnership—to remain anonymous to state authorities and the public. However, most require the name and address of the company, the name of a registered agent who represents it, and a list of officers or directors. Sometimes that is finessed when lawyers and corporation formation agents list their own staffs as nominees to obfuscate connections to real managers. Adding to the sham, incorporation agents may use "aged shelf companies", which had been set up years earlier, to make investors, banks and regulatory authorities believe that a company has longevity and hence legitimacy. They get away with it because state officials don't check the facts. Delaware, Nevada and Wyoming take this all a step further by allowing total anonymity of owners

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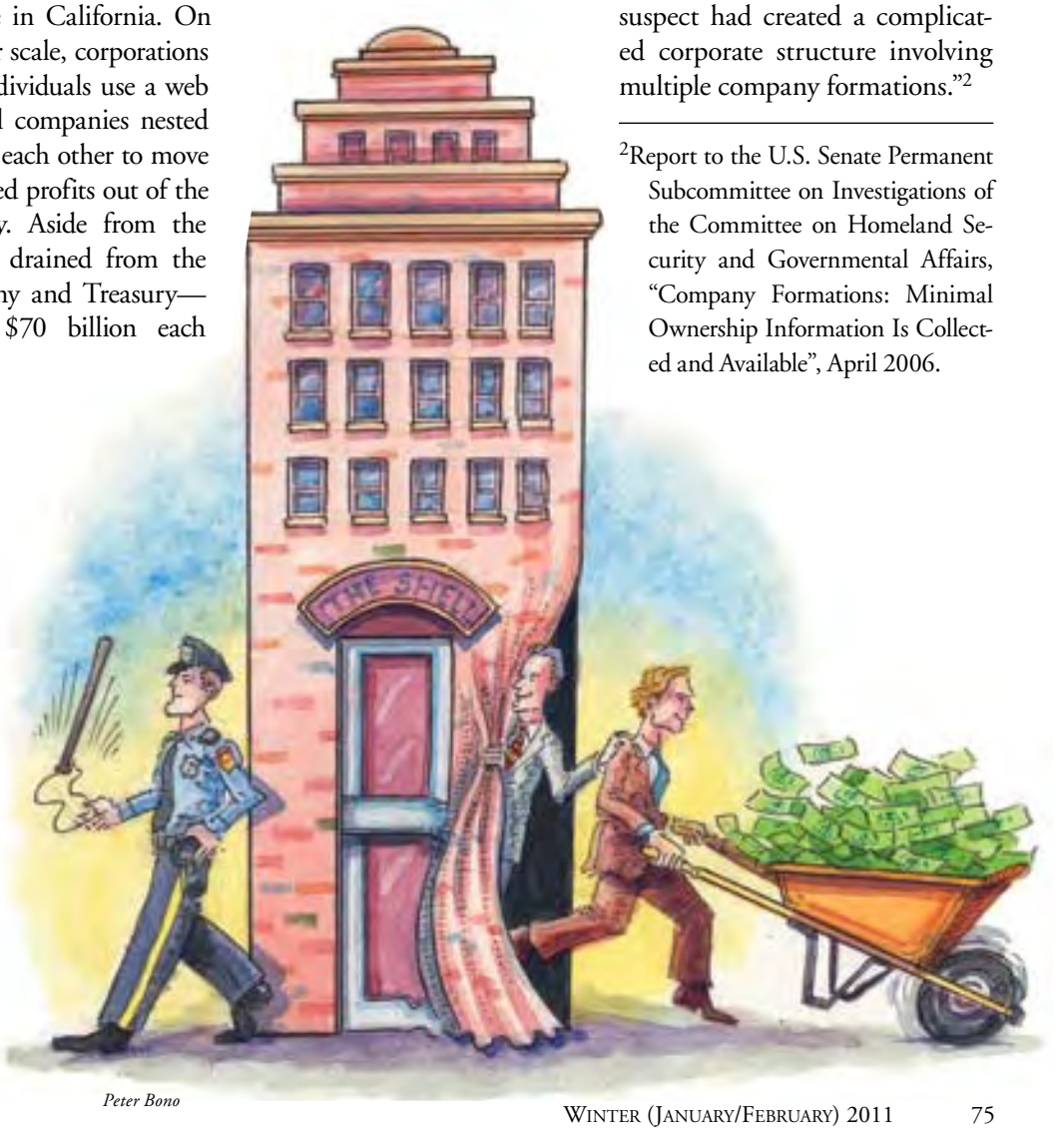
[1] "Offshore Alert", Financial Due Diligence Conference, South Beach, Florida (May 2010).

and officers by statute, with no managers or directors to call in case of suspected law-breaking. When prodded by investigating authorities, company formation agents—having dealt with their clients strictly over the Internet—say they don't know how to find them. After creating their corporations in this fashion, crooked corporate officers then open one or more U.S. bank accounts in the corporation's name. Banks are supposed to verify "beneficial ownership" information on high-risk customers, such as "certain trusts, corporate entities [and] shell entities", according to U.S. guidelines. But American banks routinely ignore the rules and accept without question the passport photos of a shell corporation's straw-man nominees.

The consequences of all this are not modest. Above all, the system promotes tax evasion. California, in severe budget shock, is losing taxes from residents who set up Nevada shells to "own" businesses that operate in California. On a larger scale, corporations and individuals use a web of shell companies nested within each other to move un-taxed profits out of the country. Aside from the money drained from the economy and Treasury—about $70 billion each year, by most estimates—the anonymous company system facilitates stock market corruption, including insider trading and so-called pump-and-dump scams, in which stock manipulators use shell companies to bid up the prices of mostly over-the-counter stocks, spread phony rumors about the stocks' value, and then sell out, leaving unwary investors holding the worthless bag. The FBI told the Government Accountability Office (GAO) that it had 103 open cases investigating market manipulation, most of them involving U.S. shell companies.

And yet the damage from permitting shell companies to function reaches even further. The shell company system of anonymous ownership and operation impedes U.S. law enforcement and legal proceedings. The GAO said in a 2006 report on company formations that investigators could not prove who was responsible for $800,000 in damages caused by an environmental spill, "because the suspect had created a complicated corporate structure involving multiple company formations."[2]

[2]Report to the U.S. Senate Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, "Company Formations: Minimal Ownership Information Is Collected and Available", April 2006.



Peter Bono

Shells have also facilitated the looting of Russia and other countries. According to the Treasury Department's 2005 U.S. Monetary Laundering Threat Assessment, the FBI believes that U.S. shell companies have been used to launder as much as $36 billion from the former Soviet Union. An individual working for fifty Moscow brokers beginning in 1991, when the Soviet system collapsed, set up more than 2,000 Delaware shell companies and opened 236 accounts at Citibank, New York, and Commercial Bank, San Francisco. The brokers or their clients moved $1.4 billion from East European banks through the U.S. banks and back to other East European banks. Closely related, Immigration and Customs Enforcement (ICE) officials told the GAO in 2005 that a Nevada-based corporation received more than 3,700 suspicious wire transfers totaling $81 million over two years from locations such as the Bahamas, British Virgin Islands, Latvia and Russia. The case was not prosecuted because ICE was unable to identify the corporation's owners.

The consequences of a permissive environment for shell companies also extend to global crime, state repression and even terrorism. U.S. shell companies are used by international criminals such as arms trafficker Viktor Bout, the Mexican drug-trafficking Sinaloa Cartel and Russian mobster Semion Mogilevich, considered the "boss of bosses" of most Russian organized crime syndicates. According to 2009 Senate testimony by the Justice Department, a U.S. shell company with anonymous owners figured in a plot to send military cargo, mislabeled as farm equipment, to Iran.[3] The GAO says foreign investigators in 2006 sought information about a shell corporation allegedly used to smuggle a toxic controlled substance between two Eurasian countries.

David S. Cohen, Assistant Secretary of the Treasury for Terrorist Financing, has linked the lax company formation processes in the United States to "[weapons of mass destruction] proliferation, terrorist financing, sanctions evasion, tax evasion, corruption and money laundering." He noted that the ability to form anonymous incorporations was a "pathway for criminal actors to gain access to the international financial system, and creates significant obstacles in our ability to investigate financial crime." Foreign investigators have complained about hitting dead ends because they were unable to obtain beneficial ownership information about U.S. companies. American authorities are unfortunately severely limited in the assistance they can provide.

As significant and multifaceted as the problem is, it could easily be fixed. The solution proposed by Senator Carl Levin (D-MI) is the Incorporation Transparency and Law Enforcement Assistance Act, which he has co-sponsored with Senators Charles Grassley (R-IA) and Claire McCaskill (D-MO) in March 2009. It requires states to collect the names and addresses of the human owners of most non-public registered companies. Stock companies would be excluded. The target is shell companies with no real business functions.

One purpose of Levin-Grassley-McCaskill is obvious enough: It is very difficult for U.S. officials to make the case against financial chicanery in the Caymans when some U.S. states offer the same kinds of smarmy services to others. It is for this reason that then-Senator Barack Obama co-sponsored similar legislation back in 2008 (S. 2956 introduced on May 1, 2008) to end corporate secrecy by requiring all U.S. states to collect the names of owners of companies they register.

Not surprisingly, corporate and legal lobbyists such as the U.S. Chamber of Commerce, the National Association of Manufacturers and the American Bar Association (ABA) have sought to defeat the Levin-Grassley-McCaskill bill, just as they sought to defeat earlier versions supported by Senator Obama. Clearly, their constituents are worried about losing profits gained from setting up or using anonymous firms. Unsurprisingly, however, this is not the reason they cite in public.

Corporate opponents of the bill and their lobbying proxies object to making owners' names public because, they claim, this would expose the strategies of businesses setting up corporations to secretly buy undervalued assets. The U.S. Chamber of Commerce agrees, arguing that the bill "would put the United

[3]Statement of Jennifer Shasky, Senior Counsel to the Deputy Attorney General before the U.S. Senate Committee on Homeland Security and Governmental Affairs, "Business Formation and Financial Crime: Finding a Legislative Solution", November 5, 2009.

States at a competitive disadvantage in the international community." The Chamber wrote to Homeland Security and Government Affairs Committee Chairman Joseph Lieberman and Ranking Member Susan Collins, with copies to all Senators, arguing that the bill would add an unnecessary layer of government, stifle investment and discourage entrepreneurialism.

The American Bar Association, for its part, opposes requiring lawyers to report suspicions that clients are involved in money-laundering or terrorist financing because, it says, this would violate attorney-client privilege. The National Association of Secretaries of State and the ABA argue further that implementation will cost too much and require expensive new hardware and software. Speaking for the ABA at a November 2009 Senate hearing (and in an interview with me), Kevin L. Shepherd of Venable LLP, Baltimore, worried not only that anti-money laundering requirements might compromise attorney-client privilege, but also that the Treasury Department's invocations of the "no tipping off" rule, which bans lawyers from informing clients that government agents have made inquiries about them, might do much the same.

These sound like legitimate concerns, but they really do little more than run a cover play for real motives. Jack Blum, a former Senate Foreign Relations Committee special counsel and an international expert on offshore corruption, dismisses the negligible cost of adding a line to a form or filling it out and attaching scanned identifications, all of which can be routinely submitted electronically. As he and others see it, it's about the money:

> The sophisticated way of keeping a tax-averse rich guy from being pulled apart in an audit is to have his holdings layered in various corporations which have different status. . . . I might have an LLC showing up on Schedule C and all my income comes from that. It will show consolidated results of other LLCs above it in the chain. What other corporations does this entity own? List two. Those own six more. And some of them are corporations, some are treated as pass-throughs. The

A California Shell Factory

On October 21, 2010, a San Diego attorney named Craig Shaber pleaded guilty in Federal court to tax evasion for failing to pay taxes on the profits of his sale of 18 Nevada and Delaware shell companies for $7.5 million. He had set them up with nominee directors and managers and even SEC registrations. Shaber and his partner, accountant Stephen Wright, who pleaded guilty in August, hid the profits, naturally, in shell company accounts. Shaber had spent the money on a home, a helicopter, a World War II-era Tigercat airplane, a Porsche and artwork. The scam was organized around a Nevada shell called Bonaventure Capital, Ltd.

One of their companies, Moranzo, was incorporated in Delaware in 1994, purportedly to operate several Italian restaurants. In a civil suit it filed in 2003, the Securities and Exchange Commission claimed, however, that "Moranzo's business plan was to create a public shell company and sell the controlling shares." Shaber sold control of Moranzo for $600,000 to a Belize-registered company, which renamed it "2DoTrade, Inc."

According to the SEC, the Belize-registered company, which was run by Americans, used 2DoTrade, Inc., for a $1.6 million "pump-and-dump" scheme that sought to take advantage of the post-September 11 anthrax attacks. As part of that scheme, the defendants allegedly promoted 2DoTrade's fictitious plans to distribute an anti-anthrax compound. One of the defendants, a Pennsylvania minister named Barry Gewin, was convicted and received a sentence of nine years in prison and fines totaling $2.4 million.

—Lucy Komisar

> tricks you can play are almost endless. The tax lawyers love this system.

One might think that with a lawyer and former supporter of anti-corporate secrecy legislation in the White House, the scales would be tilted toward passage of Levin-Grassley-McCaskill. One would need to think again: The Obama Administration *agrees* with the opposition to providing owners' names to state incorporation agencies. Specifically, the Obama Justice and Treasury Departments have criticized "the ambiguity and breadth" of the bill's definition of beneficial ownership and its "burdensome disclosure requirements." Treasury, the lead agency in the matter, also opposes the application of anti-money laundering obligations to company formation agents, but neither Justice nor Treasury has provided any substantive analysis supporting these positions.

Senator Levin has agreed to compromises that allow owner information to be held by corporate formation agents in states that have systems for registering the agents, and not to be listed on states' registries. But the Obama Treasury Department has still refused to endorse the bill and has declined to explain why, leading Levin to cancel a mid-July 2010 mark-up on the bill a day before it was to occur. The Administration has not said whether it will support the bill if further changes are made, nor has it specified which changes would induce it to endorse it.

This is unacceptable. The Levin-Grassley-McCaskill bill sets a national minimum standard for state incorporation practices that requires collection of "beneficial ownership" information, which can be kept confidential and provided to law enforcement upon receipt of a summons or subpoena. The information could be retained by the state or, if the state chooses, by a licensed company-formation agent (one of Levin's compromises). Agents would have to establish anti-money-laundering procedures to ensure they were not forming U.S. corporate entities for criminals or other suspect persons. Beyond exempting public companies listed on the stock exchange, the bill exempts banks, broker-dealers, insurance companies, registered investment funds and charities, corporations with a substantial U.S. presence and corporations whose ownership information would not benefit the public interest or assist law enforcement. What's left are shell companies with no legitimate operations.

On the face of it, the proposal seems "a no-brainer", as then-New York District Attorney Robert Morgenthau called it in testimony delivered at a Senate hearing in June 2009. "Exactly what is needed to address the problems associated with shell companies created to hide criminal activity", he said.

The issue, however, has to do not only with brains but with interests as well. Those in opposition stand to lose a lot if Levin-Grassley-McCaskill becomes law. Delaware sucks $700 million a year in revenues from incorporation fees and pays only $10 million a year to run the corporation registry. With a population of 885,122, that works out to $780 a person from the fees, which means that Delaware can afford not to have a state income tax. Delaware Democrat Senator Tom Carper complains that the bill would subject small businesses to financial pressure and regulatory burdens. Carper has suggested substitute language that would allow the "owner" to be another shell company, so a fake could own a fake. His proposal, further, would be contingent on other states amending their own laws, a blocking maneuver, since states could decline to act.

If Barack Obama as a U.S. Senator co-sponsored a measure similar to Levin's, why has his Administration forced a watering down of the bill? Why doesn't the President want to crack down on a system that helps criminals and terrorists? Why doesn't he make a connection with Viktor Bout, who used shell companies from Delaware, Texas and Florida to carry out arms trafficking activities for which the U.S. government extradited him from Thailand?

The underlying problem, says Blum, is that

> half the Treasury wants to stop hot money, the other half wants it to come in because it helps the banking industry. This is the Robert "Citibank" Rubin view. This is typical of the U.S. government, where different interests outside government are mirrored inside of it.

Even the President of the United States cannot untangle this mess unless he truly sets his mind to it and sees the solution through to the end. The mystery is, what is Barack Obama waiting for?