

Goal 5:

PROMOTE TRANSPARENCY IN THE OWNERSHIP OF LEGAL ENTITIES*Threats and Vulnerabilities*

The organization and registration of certain business entities, such as corporations, limited liability companies, and trusts can be accomplished in all State jurisdictions with minimal public disclosure of personal information regarding controlling interests and ownership. The current lack of transparency prevents financial institutions from identifying suspicious transactions and hinders law enforcement investigations and prosecutions. Using a State-registered business entity as a front is one way that money launderers gain access to U.S. banks and other domestic financial institutions.¹⁸

Strategy

FinCEN will enhance awareness of the misuse of legal entities for money laundering, and, with OFAC and other offices of the Treasury, will work with State administrators to explore options to increase transparency in the beneficial ownership of legal entities. FinCEN, OFAC, the IRS, and the Federal functional regulators will issue guidance on the risks of providing financial services to shell companies. Law enforcement agencies will target for prosecution individuals who use the incorporation process to facilitate money laundering.

Action Items

- FinCEN, OFAC, the IRS, and the Federal functional regulators will develop guidance for financial institutions alerting them to the risks inherent in providing financial services to shell companies and other legal entities, and will suggest ways to mitigate those risks consistent with applicable AML and customer identification program regulations.

- FinCEN will publish an analytical study of the use of domestic legal entities, focusing on limited liability companies, in financial crime and money laundering.
- Offices of the Treasury, including FinCEN and OFAC, will develop and implement outreach programs with State authorities and relevant trade associations to explore legislative and administrative options to require the disclosure of ownership information in the company registration process. Outreach efforts will focus on those States with the most significant organization activity and those that are most often cited in Suspicious Activity Reports involving shell companies and other legal entities.
- The Treasury, in conjunction with FinCEN and the Federal functional regulators, will provide necessary guidance to clarify points of question about the customer identification program rule.
- The Federal Bureau of Investigation (FBI) is developing an internal working group that will focus on service providers that form companies on behalf of offshore criminal interests. The working group will identify and develop actionable leads, initiate investigations, and work cooperatively with domestic and foreign law enforcement agencies to combat threats to the United States posed by criminal organizations operating through U.S. shell companies and other legal entities.

¹⁸ For more information on the money laundering threats associated with legal entities see Appendix A.

Chapter 8

SHELL COMPANIES AND TRUSTS

Legal jurisdictions, whether states within the United States or entities elsewhere, that offer strict secrecy laws, lax regulatory and supervisory regimes, and corporate registries that safeguard anonymity are obvious targets for money launderers. A handful of U.S. states offer company registrations with cloaking features – such as minimal information requirements and limited oversight – that rival those offered by offshore financial centers. Delaware, Nevada, and Wyoming are often cited as the most accommodating jurisdictions in the United States for the organization of these legal entities.

The use of bearer shares, nominee shareholders, and nominee directors function to mask ownership in a corporate entity. While these mechanisms were devised to serve legitimate purposes, they can also be used by money launderers to evade scrutiny.

In general, shell companies have no physical presence other than a mailing address, employ no one, and produce nothing. One controversial but legitimate function for shell companies is to serve as a holding company for intellectual property rights. When franchisees or licensees are billed for their use of intellectual property, such as a brand name or trademark, earnings are shifted to the location of the holding company which affects where earnings are recognized and taxes are paid.

Intermediaries, called nominee incorporation services (NIS), establish U.S. shell companies and bank accounts on behalf of foreign clients. NIS may be located in the United States or off-shore. Corporate lawyers in the United States often use NIS to organize companies on behalf of their domestic and foreign clients because such services can efficiently organize legal entities in any state. NIS must comply with applicable state and federal procedures as well as any specific bank requirements. Those laws and procedures dictate what information NIS must share about the owners of a legal entity. Money launderers have also utilized NIS to hide their identities. By hiring a firm to serve as an intermediary between themselves and the licensing jurisdiction and the bank, a company's beneficial owners may avoid disclosing their

identities in state corporate filings and in the documentation used to open corporate bank accounts.

Several mechanisms operate to provide corporate entities with additional anonymity. Bearer shares are negotiable instruments that accord ownership of a company to the person who possesses the share certificate. Such share certificates do not contain the name of the shareholder and are not registered, with the possible exception of their serial numbers. Accordingly, these shares provide for a high level of anonymity and are easily negotiable.

Nominee shareholders can also be used in privately-held companies to shield beneficial ownership information. The allowance of nominee shareholders undermines the usefulness of the shareholder register or the shareholder list because the shareholder of record may not be the ultimate beneficial owner. Similarly, nominee directors and companies serving as directors of a legal entity may conceal the identity of those persons controlling the company.

Trusts separate legal ownership from beneficial ownership and are useful when assets are given to minors or individuals who are incapacitated. The trust creator, or settlor, transfers legal ownership of the assets to a trustee, which can be an individual or a corporation. The trustee fiduciary manages the assets on behalf of the beneficiary based on the terms of the trust deed.

Although trusts have many legitimate applications, they can also be misused for illicit purposes. Trusts enjoy a greater degree of privacy and autonomy than other corporate vehicles, as virtually all jurisdictions recognizing trusts do not require registration or central registries and there are few authorities charged with overseeing trusts. In most jurisdictions, no disclosure of the identity of the beneficiary or the settlor is made to authorities. Accordingly, trusts can conceal the identity of the beneficial owner of assets and, as will be discussed below, can be abused for money laundering purposes, particularly in the layering and integration stages.

Vulnerabilities

Legal entities such as shell companies and trusts are used globally for legitimate business purposes, but because of their ability to hide ownership and mask financial details they have become popular tools for money launderers.

The use of these legal structures for money laundering is well-established. The United Nations noted in a 1998 report that “the principal forms of abuse of secrecy have shifted from individual bank accounts to corporate bank accounts and then to trust and other corporate forms that can be purchased readily without even the modest initial and ongoing due diligence that is exercised in the banking sector.”¹²³

The competition among certain states to attract legal entities to their jurisdictions has created a “race to the bottom,” and a real money laundering threat. (See Figure 5) While they are often used for legitimate purposes, bearer shares, nominee shareholders, and trusts also provide money launderers with the tools to hide their identity from financial institutions and law enforcement.

As an example, a Delaware-registered company may be owned by a national of any jurisdiction, regardless of his or her place of residence. The company can be operated and managed worldwide, and is not required to report any assets. Eastern European and Russian law enforcement agencies have expressed concern that regional criminal organizations were abusing Delaware shell companies for money laundering.¹²⁴ And German prosecutors have reportedly complained that the secrecy inherent in Delaware’s regime for legal entities has hindered investigations into suspicious financial activity.¹²⁵ But, Delaware is not the most permissive jurisdiction in the United States with regard to company formation. Both Nevada and Wyoming permit companies to have bearer shares and nominee shareholders, which Delaware does not.

The FBI has found that certain NIS form corporate entities, open full-service bank accounts for those entities,

and act as the registered agent to accept service of legal process on behalf of those entities in a jurisdiction in which the entities have no physical presence. An NIS can accomplish this without ever having to identify beneficial ownership on company formation, registration, or bank account documents. The FBI believes that U.S. shell companies and bank accounts arranged by certain NIS firms are being used to launder as much as \$36 billion a year from the former Soviet Union. It is not clear whether these NIS firms are complicit in the money laundering abuse.

Several international NIS firms have formed partnerships or marketing alliances with U.S. banks to offer financial services such as Internet banking and wire transfer capabilities to shell companies and non-U.S. citizens. The FBI reports that the U.S. banks participating in these marketing alliances open accounts through intermediaries without requiring the actual account holder’s physical presence, accepting by mail copies of passport photos, utility bills, and other identifying information.¹²⁶

FinCEN reports that 397 SARs were filed between April 1996¹²⁷ and January 2004 involving shell companies, Eastern European countries,¹²⁸ and the use of correspondent bank accounts.¹²⁹ The aggregate violation amount reported in those 397 SARs totaled almost \$4 billion.

The State of New York Banking Department recently noted that Suspicious Activity Reports filed by New York banks indicate an increase in the volume of shell company wire transfer activity through high-risk correspondent bank accounts, both in terms of dollar amounts and the number of transactions.¹³⁰ These reports indicate that money is passing through correspondent accounts

¹²³ United Nations Office for Drug Control and Crime Prevention, “Financial Havens, Banking Secrecy and Money-Laundering,” 1998, p. 57. Accessed at: <http://www.cf.ac.uk/socsi/whoswho/levi-laundering.pdf>.

¹²⁴ Simpson, Glenn R., Laundering Queries Focus on Delaware, Wall Street Journal, Sept. 30, 2004.

¹²⁵ Crawford, David, German Officials Fault U.S. on Money-Laundering Woes, Wall Street Journal, June 18, 2003.

¹²⁶ In addition to furnishing shell companies with bank accounts, intermediaries sometimes set up shell banks – foreign banks that do not maintain a physical presence in any country – that are never licensed with a regulatory authority. Such shell banks customarily attempt to pass themselves off as operating brick-and-mortar banks and gain access to the U.S. banking system through “nested” correspondent accounts. See *supra* Chapter 2, “Banking,” for more information.

¹²⁷ The date financial institutions were mandated to file Suspicious Activity Reports

¹²⁸ The eastern European countries that were identified in Suspicious Activity Report narratives with shell companies included Armenia, Belarus, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Greece, Kazakhstan, Latvia, Lithuania, Moldova, Poland, Romania, Russia, Slovenia, Turkey, Turkmenistan, Ukraine, Uzbekistan, and Yugoslavia.

¹²⁹ During this time period a total of approximately 1.5 million SARs were filed.

¹³⁰ Financial Crimes Enforcement Network, *Suspicious Activity Review, Issue 7, August 2004*.

established for Eastern European banks.

Trusts often constitute the final layer of anonymity for those seeking to conceal their identity. Recent changes in the trust laws of some jurisdictions have aided money launderers in their use of trusts to conceal identity and to perpetrate fraud. In certain jurisdictions, such as the Cook Islands, Nevis, and Niue, the trust laws no longer require the names of the settlor and the beneficiaries to be placed in the trust deed, permit settlors to retain control over the trust, and allow trusts to be revocable and of unlimited duration. In addition, the amended trust laws typically permit the trust deed to include a “flee clause,” a provision triggered by the occurrence of certain events that directs the assets of the trust to be moved to another jurisdiction and new trustees to be appointed.

Regulation and Public Policy

Trust companies are defined as “financial institutions” under the Bank Secrecy Act. Shell companies are not specifically listed in the BSA, but could be regulated under the BSA under one of the two catch-all provisions of 31 USC 5312(a), given an appropriate record.

A Side by Side Comparison of Wyoming and Nevada and Delaware

Figure 2

Benefits	Nevada	Wyoming	Delaware
Minimal annual fees		X	
One-person company is allowed	X	X	X
Stockholders are not revealed to the State	X	X	X
No annual report is required until the anniversary of the incorporation date		X	
Unlimited stock is allowed, of any par value		X	X
Bearer stock can be used	X	X	
Nominee shareholders are allowed	X	X	
Share certificates are not required		X	
Minimal initial filing fees		X	
No minimum capital requirements	X	X	X
Meetings may be held anywhere	X	X	X
Officers, directors, employees and agents are statutorily indemnified	X	X	
Continuance procedure (allows Wyoming to adopt a company formed in another state)		X	
Doesn't collect corporate income tax information to share with the IRS	X	X	

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