Unraveling the Tangled Webs of Corruption with Action on Anonymous Shell Companies

By Mary Beth Goodman December 5, 2014

November 2014 may be remembered as the most significant month to date in the movement to fight the abuse of corruption and tax evasion through the use of anonymous shell companies. Change in this field may be incrementally slow, but the G-20 ramped up its engagement in a major way at the 2014 G-20 Leaders' Summit in Brisbane, Australia. The body released new international commitments to collect information on the actual person—called the beneficial owner—behind anonymous companies and trusts.

Given the significant number of agenda items vying for attention on the global stage—ranging from the crisis in Ukraine to the U.S.-China climate change agreement to the advances of the Islamic State of Iraq and al-Sham, or ISIS—it is no surprise that the wonky G-20 financial transparency commitment went largely unnoticed in the mainstream. However, this new commitment represents a concerted G-20 effort to fight corruption, tax evasion, and money laundering by exposing the abuse of anonymous company ownership. The United States will now need to enhance efforts to protect its financial system from abuse by criminals, drug traffickers, warlords, and other corrupt officials.

The beneficial ownership problem

There is no dispute that corruption weakens confidence in public institutions, damages the private investment climate, and ruins delivery mechanisms for poverty alleviation programs. Steps to combat fraud and kleptocracy are long and cumbersome but ultimately rely on unmasking the identity of beneficial owners—the natural person who owns or controls a corporate structure or trust. People who wish to transfer funds or assets while concealing their involvement in bribery, embezzlement of public funds, or other forms of corruption rely on shell companies to facilitate their actions. Shell companies are a favorite tool to hide the assets and accounts of terrorist organizations, money launderers, tax evaders, drug kingpins, perpetrators of mass atrocities, traffickers and those who benefit from corruption.

The theft of public assets from developing countries is a crime and a chronic barrier to development. Given that most instances of corruption are never reported or discovered due to the inherently secret nature of the acts, it is extremely difficult to estimate the value of public money siphoned off each year. According to a 2007 World Bank report, the amount of money stolen from developing and transition countries and hidden in foreign jurisdictions totals an estimated $20 billion to $40 billion each year—a figure equivalent to 20 percent to 40 percent of official development assistance flows.[1]

Currently, establishing a company with anonymous, or hidden, ownership is the norm around the world; in fact, the regulations pertaining to company registration in most countries actually enable it. This opacity is used for both legal and illegal purposes. On the legal side, for example, developers use shell companies to purchase real estate in order to thwart speculative price gauging in advance of the announcement of new plans. On the illegal side, a 2011 study by the Stolen Assets Recovery Initiative, or StAR, reported that 150 of 213 grand corruption cases from 1980 to 2010 investigated worldwide involved the use of at least one corporate vehicle to hide information about beneficial owners, with the estimated proceeds of corruption in these cases totaling $56.4 billion.[2]

The United States is not immune to these schemes and is often the jurisdiction of choice for corrupt officials seeking to profit from the stability and credibility of its financial system and the ease of doing business. For instance, one recent case brought by the U.S. Attorney of the Southern District of New York exposed how anonymous companies were used to violate the U.S. sanctions imposed against Iran.[3] In this case, two shell companies—one incorporated in New York and the other in the U.K. Crown Dependency of Jersey—allowed the Republic of Iran to secretly own a 36-story skyscraper in downtown Manhattan in violation of sanctions.[4] The skyscraper—as well as several other properties in California, Virginia, Texas, Maryland, and New York—were bought and managed through shell companies that were ultimately linked to direct oversight by Iranian government officials in Tehran.[5] In this instance, the use of anonymous shell companies allowed Iran to launder money and conceal actions that were in direct violation of U.S. sanctions aimed at halting Iran's facilitation of terrorism and nuclear development program.

Beneficial ownership is a highly technical topic that, until recently, was largely reserved for academics and terrorism finance experts who meet through the Financial Action Task Force, an intergovernmental policymaking body that sets standards and promotes effective implementation of legal, regulatory, and operational measures for combating money laundering, terrorist financing, and other related threats to the integrity of the international financial system.[6] However, the issue is now the topic du jour of experts focused on international taxes, transparency, accountability and corruption, illicit financial flows from Africa, and asset recovery investigations and prosecutions, as well as money laundering and terrorism finance. The global activists waging the fight against

corruption have latched onto this issue and raised its profile by translating the technical language associated with beneficial ownership into an advocacy issue, highlighting, for instance, the links between corruption and suboptimal development outcomes that impact the lives of millions of people.[7]

The collection of additional information on the natural person behind legal entities will provide officials with important information about the legal structures used to conceal illicit activity and assets, thereby supporting accountability and breaking down structural impunity for criminal activity.

G-20 action in Brisbane

The G-20 Leaders' Communiqué from the Brisbane summit included a short but impactful sentence on beneficial ownership: "We commit to improve the transparency of the public and private sectors, and of beneficial ownership by implementing the G20 High Level Principles on Beneficial Ownership Transparency."[8] The G-20 High Level Principles on Beneficial Ownership Transparency provide the strongest pledge yet for collective action to improve the transparency of company ownership.[9] This acknowledgment by the G-20 leaders creates an opportunity for follow-up at the highest levels within each G-20 country. The G-8 adopted similar principles in 2013,[10] but the G-20's diverse country membership and economic heft presents a significant boon to the global effort.

Since action by the G-20 is based on the consensus of all parties, this collective endorsement of greater transparency for corporate entities—and, particularly, shell companies—is a significant step forward. Building enhanced action toward greater transparency with countries ranging from China, South Africa, and Brazil to Indonesia, Saudi Arabia, and Turkey will create a truly global standard for others to emulate.

The G-20 principles largely track what experts in the field advocated for, including:

- Identification of the natural person who owns and controls corporate structures and trusts
- Enhanced and timely cooperation among jurisdictions
- Specific risk assessments for each G-20 country from a domestic and international perspective
- Requirements that information is adequate, accurate, current, and held onshore Timely access for "competent authorities"—defined as law enforcement, prosecutorial authorities, supervisory authorities, tax authorities, and financial intelligence units[11]

Additionally, the G-20 countries committed to draft country-specific plans that outline the steps necessary to implement the principles at the domestic level. The G-20 principles also include a specific reference to the importance of collecting beneficial ownership information to prevent tax evasion, which marks a notable difference in the stated rationale motivating action between the principles adopted by the G-20 and the G-8.

The G-20 High Level Principles require all G-20 countries to identify high-risk sectors for enhanced due diligence. In combination with the G-20 Anti-Corruption Working Group's Action Plan for 2015–2016, which outlines future topics for G-20 cooperation to fight corruption, this commitment could lead to concrete action in these high-risk sectors: extractives, fisheries, forestry, construction, and customs.[12] Each of these sectors constitutes a major gap in compliance and transparency that allows the criminally inclined to obscure ownership and stolen funds.

The Australian G-20 team diligently steered the High Level Principles on Beneficial Ownership Transparency through the maze of G-20 negotiations and approvals—despite reports that China attempted to block the adoption of these principles just prior to the summit.[13] Additionally, the G-20 representatives of the Anti-Corruption Working Group undoubtedly battled their own bureaucracies to ensure that this incredibly technical topic was not sidelined before reaching the Leaders' Summit, where issues are more likely to muster sufficient political will for action. Turkey and the United States have assumed the co-chairmanship of the Anti-Corruption Working Group for 2015 and will be responsible for ensuring that these principles are translated into follow-up action and implementation.

Fusion with other international forums

References to other international forums that affect the transparency of beneficial ownership were woven throughout the technical language of the Brisbane G-20 Leaders' Communiqué. G-20 endorsement and reference to the technical work of experts in various fields provides a vital connection to enhance the impact of the G-20's body of work. Negotiations over the complexities of international tax measures and asset recovery investigations are better left in the hands of subject-matter experts rather than diplomats, but technical issues need to receive high-level political endorsement to create real change on the international system and create a binding commitment for implementation.

International tax transparency standards

Since the financial crisis in 2009, the G-20 has continually provided a framework for collective response aimed at raising global standards and repairing the global financial system. Declaring that the "era of banking secrecy is over," the 2009 G-20 Leaders'

Statement endorsed tax transparency and collective sharing of tax information.[14] These efforts have continued and, in addition to the specific reference to beneficial ownership transparency, the 2014 G-20 Leaders' Communiqué also gave a nod to these new tax transparency provisions, stating:

> *To prevent cross-border tax evasion, we endorse the global Common reporting Standards for the automatic exchange of tax information (AEOI) on a reciprocal basis. We will begin to exchange information automatically with each other and with other countries by 2017 or end-2018, subject to completing necessary legislative procedures. We welcome financial centers' commitments to do the same and call on all to join us.*[15]

The significance of this commitment to beneficial ownership can only be understood when considered in conjunction with the communiqué from a mundane bureaucratic body known as the Global Forum on Transparency and Exchange of Information for Tax Purposes, which provides a framework for more-concrete engagement from countries around the world. The Global Forum has grown to a total of 122 member jurisdictions and the European Union, together with 14 observers, making it the largest international tax group in the world. Its current membership includes all G-20 countries; Organization for Economic Co-operation and Development, or OECD, member countries; international financial centers; and many developing countries, all of which have committed to adhere to the international standard on exchanging tax information on request.

At the Global Forum's meeting in Berlin on October 29, the body committed to include the collection of beneficial ownership information in the framework of tax information that will be shared through the new international tax transparency provisions.[16] German Finance Minister Wolfgang Schäuble, who hosted the two-day meeting, previewed this commitment, stating that banking secrecy is "no longer appropriate at a time when people can transfer their money all over the world at the press of a button via the Internet."[17]

The Global Forum has become the key international body working on the implementation of the international tax transparency standards. Because a lack of knowledge about who ultimately owns and controls legal entities and arrangements facilitates tax evasion, money laundering, and corruption, beneficial ownership has become a major topic of interest for international tax officials. At the request of the G-20 and OECD member countries, the Global Forum will now include a requirement to maintain beneficial ownership information in the next round of peer reviews "to ensure that all countries have information regarding the beneficial ownership of entities operating in their jurisdictions."[18]

This new obligation means that each of the 89 jurisdictions that have committed to the automatic exchange of information, or AEOI, by 2017 or 2018 will be obligated to collect beneficial ownership information and share this information with other parties for tax-related purposes upon request.[19] The OECD notes that this "robust [AEOI] standard will allow for tracking income and offshore assets. The imminent implementation of AEOI is pushing up voluntary disclosures by tax evaders which have already yielded 37 billion euros of additional revenue in around 25 OECD and G20 countries that have put in place these initiatives."[20] Whether for tax evasion, corruption, or other purposes, governments are seeking access to more information that will shed light on shell companies and reduce the anonymity of those who seek to skirt the law.

Beneficial ownership guides from the Stolen Asset Recovery Initiative

The G-20 Leaders' Communiqué also recognized that their "actions are building cooperation and networks, including to enhance mutual legal assistance, recovery of the proceeds of corruption and denial of safe haven to corrupt officials."[21] The leaders' recognition of efforts to recover the proceeds of corruption underscores the significant increase in cooperative multijurisdictional investigations doing this work. Asset recovery investigations are gaining momentum from Ukraine and Tunisia to Nigeria and China as countries seek to recuperate assets stolen by officials in positions of power. In all of these asset recovery investigations, the issue of anonymous shell companies and beneficial ownership has become a stumbling block.

To facilitate cooperation on this problem, StAR—a joint effort of the World Bank and the U.N. Office on Drugs and Crime—released a series of country-specific guides outlining how to investigate company ownership information.[22] Released at the Arab Forum on Asset Recovery in Geneva, Switzerland, on November 3, these guides have gone largely unnoticed by the civil society organizations that are active in this space. The resources are meant to "provide practical assistance to investigators in knowing how different jurisdictions define beneficial ownership and apply it to the various forms of legal entities and legal arrangements that exist in their respective jurisdictions" for asset recovery in the Arab Spring countries,[23] but they are a useful resource tool for anyone interested in the topic. Frequently, investigations of this illicit activity are seriously hampered by the inability of law enforcement, tax administrators, and other relevant authorities to effectively identify the beneficial owner of the relevant corporate vehicles. Particular challenges can arise in the investigation of serious and organized crimes in which information is held offshore involving companies incorporated in one country but operating in another country.

So far, the United States,[24] the United Kingdom,[25] the Bailiwick of Jersey,[26] and Liechtenstein[27] have each produced a country-specific guide on beneficial ownership, while France and other countries have pledged to produce guides soon. The U.S. guide is particularly notable because it provides useful annexes that outline the types of corporate entities that can be formed pursuant to the laws of each U.S. state, as well as web links for each of the 50 state registries and a comparison of the type of information the states collect in the company-formation process. This is a useful resource for both investigators and international civil society organizations advocating on beneficial ownership issues. Additionally, the document reveals the added complexities of action on this issue in a federalist system, such as that of the United States.

These beneficial ownership guides provide a practical tool to enhance investigations into corruption and other illicit acts. Given the numerous differences among the legal systems around the world, efforts to simplify the work of investigators with practical how-to advice should be applauded and amplified. Attempts to expand the number of countries willing to produce such a guide would be greatly enhanced by a commitment from each of the G-20 countries to do so in 2015. Perhaps the United States and Turkey could agree to make this a priority for the G-20 Anti-Corruption Working Group in 2015.

Next steps for U.S. domestic efforts

Implementation of the new G-20 High Level Principles on Beneficial Ownership Transparency will require legislative action by the United States. While bipartisan federal legislation on beneficial ownership has been proposed multiple times by Sens. Carl Levin (D-MI) and Chuck Grassley (R-IA),[28] it has been strongly opposed by the American Bar Association[29] and the American Chamber of Commerce.[30] With the impending retirement of Sen. Levin, supporters will need to find a new champion in the Democratic caucus to advocate for this issue in the 114th Congress.

The White House has proposed using tax reporting mechanisms through the Internal Revenue Service, or IRS, as a method for collecting beneficial ownership information.[31] The proposal would require all companies formed in any state to obtain a federal tax employee identification number and tasks the IRS with collecting information on the beneficial owner of these legal entities.[32] In addition, the proposal would permit the IRS to share beneficial ownership information with law enforcement officials to identify and investigate criminals who form and misuse U.S. corporate structures to launder criminal proceeds and finance terrorism through the international banking system.[33]

This proposal has yet to be translated into a legislative proposal with congressional sponsorship, but if passed into law, it would represent a significant step forward in establishing a method of collecting information on beneficial owners in the United States. Meanwhile, there are two other measures that could help alleviate the beneficial ownership problem.

Customer due diligence rules

The U.S. Department of the Treasury is finalizing a federal rulemaking proposal aimed at including a mandatory beneficial ownership requirement in enhanced customer due diligence rules for U.S. financial institutions.[34] There is currently no legal requirement for U.S. financial institutions to gather specific information on the natural person behind a bank account when its opened in the United States, and the Treasury Department's proposal amends the implementing regulations under the Bank Secrecy Act to include a new requirement for financial institutions to identify the beneficial owner or owners of banking accounts—subject to certain exemptions—as part of the mandatory customer due diligence requirements.[35] The proposed definition of "beneficial owner" includes an ownership prong and a control prong, defined as each individual who directly or indirectly owns 25 percent of the equity interests as well as any individual or individuals with significant responsibility to control, manage, or direct the equity interests.[36] The comment period on the proposed rule closed October 3, and it is unclear when the Financial Crimes Enforcement Network, or FinCEN—the implementing arm of the Treasury Department—will issue the final regulations.

Several U.S. financial institutions have argued that the collection of any beneficial ownership information is a costly and difficult burden for banks.[37] However, banks in Europe, Singapore, Switzerland, and Hong Kong have been collecting such information for many years.[38]

Enforcement of the Foreign Account Tax Compliance Act

As the Obama administration attempts to enhance the collection of beneficial ownership information, the Foreign Account Tax Compliance Act, or FATCA, provides another opportunity to take concrete action to infuse more transparency and accountability into the U.S. financial sector. Congress enacted FATCA in 2010 to target noncompliance by U.S. taxpayers using foreign accounts. FATCA requires foreign financial institutions to report information to the IRS about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest.[39]

Compared to the 25 percent threshold in the Treasury Department's proposed customer due diligence rule, FATCA imposes a more ambitious 10 percent beneficial ownership identification threshold to force financial institutions to identify and classify clients accurately and appropriately.[40] This FATCA mandate will undoubtedly require financial institutions to collect more data and to provide better documentation on beneficial owners.

Since its passage in March 2010, FATCA has become the global standard for promoting tax transparency. There are now more than 110 jurisdictions that are party to the intergovernmental agreements pursuant to FATCA or in the midst of finalizing the provisions, and

negotiations are underway with additional countries.[41] FATCA requires U.S. financial institutions to withhold a portion of certain payments made to foreign financial institutions that do not agree to identify and report information on U.S. account holders.

Conflicting standards

It is unclear why different parts of the Treasury Department—FinCEN and the IRS—are proposing contradictory standards for determining the appropriate ownership threshold for beneficial ownership. If the 10 percent threshold is appropriate for the IRS to identify tax evaders who presumably do not pose any threat to U.S. national security, then the same standard should also be appropriate for FinCEN's enhanced due diligence for financial institutions, which is used "to identify the assets and accounts of terrorist organizations, money launderers, drug kingpins, weapons of mass destruction proliferators, and other national security threats."[42]

Given the significant number of financial institutions around the world that have to comply with the provisions of FATCA, it would be easier for financial institutions to have one consistent definition for determining the ownership threshold for beneficial ownership requirements. Advocates, as well as some in the financial industry, have questioned why the Treasury Department has proposed two separate standards and definitions for beneficial ownership and agree that a lower threshold for ownership would be advantageous to both law enforcement and tax authorities.[43] FinCEN notes that many financial institutions are already using 10 percent as the threshold for risk assessment purposes.[44] As a result of the interconnectedness of the global financial system, it is impossible to view the U.S. system in a silo, and both the FATCA and the enhanced customer due diligence rule will have a significant impact on U.S. banks and their subsidiaries operating in foreign countries. It would be easier for financial institutions to maintain a 10 percent beneficial ownership threshold across all regulatory obligations, thereby helping financial institutions maintain a higher level of compliance with know-your-customer obligations across the spectrum of regulations imposed by the Treasury Department.

Opportunity to standardize compliance

Given that the customer due diligence rule is not yet finalized, the United States could use this rulemaking opportunity to standardize compliance across various regulatory streams. The additional data and documentation collected as part of this process could be adopted and reused by financial institutions for other regulatory compliance programs, helping raise the overall bar of compliance across all regulations. Standardizing the requirements could actually transform the so-called burden of data collection into an enhanced compliance opportunity, better enabling the United States to meet its G-20 commitment on the issue of beneficial ownership transparency and allowing it to lead by example.

Conclusion

There is no doubt that corporate entities and trusts play an essential and legitimate role in both the United States and the global economy. Enhanced transparency should in no way impede those essential and legitimate interests, and owners who are acting legally have nothing to fear from transparency and accountability mechanisms. However, corporate vehicles also provide an attractive manner for criminals, corrupt officials, and tax evaders to circumvent the legal system, and efforts to unmask the corrupt by ending the secrecy behind anonymous companies can help level the playing field and create safer, more stable, and predictable business environments.

The G-20 action taken in Brisbane is significant; however, to be truly impactful, these beneficial ownership principles need to be implemented domestically in each G-20 country, as well as in other countries outside of the G-20 system. U.S. leadership always has been and always will be instrumental in developing a rules-based system for the global financial system, so it is imperative for the United States to continue to maintain the highest possible standards and lead by example. In this instance, doing so requires ensuring that the U.S. system does not contain loopholes for money launderers, corrupt officials, tax evaders, terrorists, drug traffickers, or other criminal entities. Given the size of its financial system and the use of the dollar as an international currency of choice, the United States needs to be at the forefront of setting and implementing standards to stay a step ahead of those who profit from violent criminal behavior, terrorism, atrocities, and human rights abuse.

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