Testimony of Jack A. Blum, Esq.

before

The United States Senate Committee on Homeland Security and Governmental Affairs

on

S.569, the Incorporation Transparency and Law Enforcement Assistance Act

November 5, 2009

My name is Jack Blum. I am a Washington attorney specializing in money laundering compliance and issues of offshore tax evasion. I am appearing on behalf the Tax Justice Network-USA and Global Financial Integrity. Both organizations endorse the bill sponsored by Senator Levin, S. 569, the Incorporation Transparency and Law Enforcement Assistance Act.

The single most important tool in the toolkit of people trying to hide money from law enforcement and tax collection is the anonymous shell corporation. These shell corporations have no physical place of business, use nominee officers and directors, and as a rule do no business in the place of incorporation. Their sole purpose is hiding where money is, who controls it, and where it is moving, from law enforcement and tax collectors. These shell companies should not be allowed remain anonymous.

States that offer corporations to individuals without insisting on information on beneficial ownership are undermining the efforts of law enforcement to prevent crime, recover stolen assets and collect tax. They are also putting the United States out of compliance with international standards for customer identification. From our perspective gathering basic information about ownership for government use is essential to protect national security and to limit financial crime and tax evasion.

Anti-money laundering compliance is dependent on 'know your customer .' Without that knowledge financial institutions cannot evaluate the legitimacy of a transaction. Knowing that one shell corporation is owned by another shell corporation is not helpful. Having the details of the "owner's" directors who are usually professional directors who work for a corporate service company in another jurisdiction is useless. Financial institutions need to know who is behind a company to judge whether the transactions they monitor are suspicious. They need to know whether the beneficial owner is on the OFAC list, the other sanctions lists is a politically exposed person.

The proposed legislation would end the all too frequent use of loopholes in State incorporation laws to hide money.

In supporting this legislation and asking for an end to corporate anonymity let me explain my concerns and alternatively what is not at issue.

I am not talking about making beneficial ownership information part of a public record. I am talking about having it available to law enforcement and tax authorities upon appropriate request. Personal privacy is not at issue.

I am not talking about all corporations. I am focused on corporations that have a small number of owners -- under ten -- and especially those that have a single owner. In those small corporations all I am concerned about is the identity of owners with more than a ten percent interest. Public corporations are not the problem.

Opponents of this bill have complained about the burdens it will impose on small business. As someone who has advised clients setting up a small business, I can say from broad practical experience that gathering ownership information at the time of incorporation and reporting ownership changes on an annual return is the least of a small business's problems. The numerous other agencies demanding information for licenses and permits, and the regular filings regarding employees, employee benefits and unemployment insurance dwarf corporation ownership issues.

Incorporation agents should bear the same responsibility as financial institutions under the anti-money laundering laws. We now require jewelers, auto dealers, money transmitters and other businesses that can be used to launder money to have an anti-money laundering program and to report suspicious activity. The required program is risk based. Each firm must do a risk assessment and develop a program in line with that assessment. It makes sense to impose a similar regime on incorporation agents.

The burden of setting up an AML compliance program would fall most heavily on corporate formation agents who offer their services to all comers through the internet. They have no other business relationship with the corporate principals. They deal with strangers on the web. Thus, if a request for a corporation came to a web based agent from a country such as Moldova, the risk would be high. The level of due diligence required of the agent would be high. The AML program would have to be robust. The agent would have the responsibility of establishing the identity of the customer and should have some knowledge about the legitimacy of the corporate purpose. The agent would have the responsibility or running the customer's name against the various sanctions lists and checking his political exposure.

In contrast a local lawyer who does few incorporations, and does them for regular business clients would not be seriously burdened. That lawyer runs little or no risk of helping a criminal.

Opponents of the legislation have argued that keeping corporate data updated will impose an unfunded mandate on the states. I disagree. The incorporation business is a profit center for the states and a profit center for the incorporation agents. If the states and the incorporation agents want to maintain existing profit levels, a very small fee increase would more than cover the cost of adding a few lines of information to the corporate data base. In many cases there is existing data on directors and officers but the states in question allow nominee names. The nominee names could be replaced with real ones at no cost.

A further argument is made that people will still be able to conceal the identity of the beneficial owner by lying on the forms. Of course they are correct. Lying on the forms is a possibility. But the lies will entail risks. If it is later determined that someone lied on the form to conceal ownership, the fact of the lie will become evidence of criminal intent in a financial fraud or tax evasion scheme. The lie itself could become a prosecutable offense.

I have been asked to explain how the availability of shell corporations has undermined law enforcement and tax collection.

The most dangerous of the groups using United States incorporation services are foreigners who want anonymous shells to facilitate financial crime, money laundering and tax evasion. They like the prestige of an American incorporation. Fraudsters use the fact a that a company is incorporated here to impress their victims.

The United States has been inundated with requests from foreign law enforcement authorities seeking information about corporate ownership and activities in connection with cases of fraud and money laundering. Many of the requests wind up on the miscellaneous docket of the Delaware District Court where they languish because US law enforcement cannot identify the people behind the corporation or obtain records relating to its activities. US legal attachés in our embassies around the world are routinely asked for help in investigations involving US companies. I have attached a partial list of such requests to my testimony and ask that it be made part of the record.

Several years ago I spoke at an anti-money laundering forum in Panama City. I berated the Panamanians for their anonymous shell corporations. Eduardo Morgan, a partner in the Law Firm of Morgan & Morgan, and former Panamanian ambassador to the United States, told the audience that he knew that the best corporation to use for hiding assets was a Delaware corporation. He argued that people around the world assumed that a Delaware corporation carried legitimacy and that its activities were policed by the state and federal government.

He then went on to say that the corporation would not have to file a Federal or state tax return if it did no business in Delaware. Even if a return were required there would be no way for IRS to enforce the requirement. "Pass through" entities need not file returns and need not have taxpayer identification numbers. IRS cannot match incorporation lists at the state level with returns filed. I had assumed that all corporations were required to filed Federal income tax returns. I was wrong.

If I were a terrorist seeking to make funds available for use in the United States I would use a foreign shell corporation set up a corporation in any one of a number of states that offer anonymity. I would then open an account with a U.S. brokerage firm. I would file an IRS form W-8 with the broker indicating that the beneficial owner of the account was the foreign corporation, and then in response to further information requests from the broker produce the passport photos and other documentation regarding the identity of the nominee officers and directors of the offshore shell.

The final step would be to obtain a debit card attached to the brokerage account. The holder of the card could then use funds wired in from almost anywhere in the world. If the right bank and the right jurisdictions are selected there will be no information on the wire explaining who sent the money.

Tax evaders use these corporations as well. I have seen cases in which a US person used a US shell set up by a foreign shell to conceal the movement of money from the US to a hedge fund operated from the US but incorporated abroad. In the first instance the money went from the taxpayer's US account to the account of US shell and from there to the hedge fund. The US shell had no taxpayer ID number and there was no ownership information available for it.

Similar problems arise when states attempt to track down corporations doing business in their jurisdiction to collect taxes due. California, for example, has had a difficult time collecting tax from corporations doing business in California but incorporated in Nevada and not registered in California. Without information identifying a real person and beneficial ownership the hunt for the tax cheat is almost hopeless.

Although Nevada now requires some information on its incorporation reports it still permits nominee officers and directors and its incorporation agents still advertise anonymity on the web.

Wyoming, another state which was in the anonymous incorporation business has just improved its laws by eliminating bearer share corporations and by requiring the corporation to have a registered agent who is presumed to know how to contact the beneficial owner of the corporation.

The problem with the Wyoming solution and with the proposal advanced by the State Secretaries of State is the issue of "tipping off." If law enforcement has to contact the corporation's registered agent in order to then find the beneficial owner of the corporation, the target will have time to move the money out of reach. Money moves with the speed of light -- law enforcement requests do not. A key objective in fraud and tax evasion cases is seizing the proceeds of crime. Giving the criminal time to move the money makes no sense.

The way Wyoming got into the shell company business is instructive. Jerome Schneider, a purveyor of tax evasion schemes lobbied hard and talked the legislature into passing the secrecy laws. Schneider was later convicted for his many efforts to help US persons evade tax by moving assets offshore.

My experience with following the money trail is that time is of the essence and that each piece of information leads to requests for further information. If gathering ownership information takes weeks because of delays in locating the responsible party and then turning it over to a government agency that will then forward it to law enforcement ,important, time sensitive, investigations may be derailed. I can imagine a terrorism investigation which turns on learning the source of funding for a terror suspect being delayed long enough for the terrorist to have the chance to carry out his mission.

Some members of the bar are concerned that imposing AML responsibility of lawyers who act as incorporation agents will violate lawyer client privilege. I believe that there is a bright line between giving a client legal advice, which is protected by privilege, and performing transactional work that

requires interaction with government agencies. If a lawyer explains to a client that he must gather certain information and turn it over to the government as a condition of incorporation the client should have no expectation of confidentiality.

If a lawyer handles an incorporation in a situation where that lawyer knows the corporation will be used as part of a money laundering scheme then the lawyer ceases being a lawyer and becomes a co-conspirator. Under those circumstances neither the lawyer nor the client deserves protection.

This committee should be aware that the United States now lags behind much of the rest of the world in obtaining beneficial ownership information. I was recently on the Island of Jersey where I met with trust company officials who showed me the questionnaire they require of anyone wanting to set up a Jersey structure. The principals must show proof of identity and indicate the source of their wealth. To nail down the identity of the person providing the funds, a copy of the passport or other government identification is required and its authenticity must be certified. For proof of address the principals are asked to produce utility bill and other evidence that the residence address they list is truly theirs. Information on the grantors who set up foundations is kept by the local agent. Every agent is required to provide the government with the basic information. I have attached a sample of a Jersey formation agent's questionnaire to my testimony.

We should be able to meet the standard they have set.

Finally, I would argue that anonymous shell corporations are not in any way related to the legitimate historical purpose of the corporation -- encouraging people to take entrepreneurial risks without risking everything they have.

Historically, corporations were considered to be a privilege granted by the state. Sates controlled the limits of corporate operations and limited their activities by insisting on narrow language in their charters. Early corporations could not operate outside the boundaries of the state of incorporation. Early corporations had a limited life span. Today corporations also serve the purpose of allowing the business entity to outlive the participants and to survive the departure of one or more of the officers directors and employees.

Corporations were also required to have a stated paid in capital so that creditors would be able to understand the risks they were taking in doing business with the corporation. The modern corporation is an essential part of the economy and the ability to form and operate a corporation across state lines has enabled out economy to develop. Because of its importance the corporation has been given substantial rights under US law including constitutional status for certain purposes.

Secrecy has no place in this picture. There is no business purpose served by allowing people who are not actually running a business to hide their activities behind a corporate form. The corporations we are talking about here are secrecy shells and nothing more. To the extent that they have other legitimate purposes nothing in the proposed legislation will cause them problems.

It is obvious to me that we need to attach the name of a real person who is responsible for the corporation to the act of forming the company and to insist that the identity of the real person is updated on the annual corporate filing.

I urge the committee to report out S.569 so that it can be enacted into law. It is a national embarrassment for us to tell the rest of the world what it must do to control money laundering and financial crime at the same time we continue to provide money launderers and criminals with anonymous shell companies -- companies that we have told others facilitate crime.

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