



TERRORISM, INC.

HOW SHELL COMPANIES AID TERRORISM, CRIME AND CORRUPTION

WHAT'S THE PROBLEM?

Terrorists are creating fake companies in the United States and Europe to launder money and finance their activities. And it's not just terrorists. Drug lords, human traffickers, sanctions busters, and corrupt officials also move their money around using shell companies that are registered in countries with highly developed legal and banking systems.

Unlike regular people, who must prove their identity when applying for a driver's license, opening a bank account, or registering to vote, companies generally are not required to say who owns, controls, and profits from the company in order to receive the advantages and protections of our laws. Even law enforcement authorities have great difficulty in tracking down this information about who owns what.

The dangers of allowing such secrecy are well known. According to UK Prime Minister David Cameron, "A lack of knowledge about who ultimately controls, owns and profits from companies leads to aggressive tax avoidance, tax evasion and money laundering, undermining tax bases and fuelling corruption across the world."¹

Terrorists and other criminals are exploiting Western legal systems by creating shell companies to disguise and finance their activities.

Countries should collect and publish basic information about who really owns and controls companies.

"Shells are the No. 1 vehicle for laundering illicit money and criminal proceeds," said Lanny Breuer, who headed the criminal division of the U.S. Department of Justice.² Most importantly, there are no legitimate reasons for companies to hide their identities.

WHO IS ADVERSELY IMPACTED?

The world's poorest people are too often the ones who pay the price for poor oversight in the world's richest nations. Developing countries are estimated to lose \$120-\$160 billion a year of potential tax revenue from citizens who hide their wealth offshore.³ In fact, Africa loses *twice as much* in tax evasion as it receives in international aid.⁴ Despite international requirements for banks to conduct due diligence on the source of deposits, many individuals continue to get away with

¹ Letter to Herman Van Rompuy and the European Council, April 24, 2013.

² Leslie Wayne, "How Delaware Thrives as a Corporate Tax Haven," *New York Times*, June 30, 2012.

³ James Henry, *The Price of Offshore Revisited: New Estimates for Missing Global Private Wealth, Income, Inequality, and Lost Taxes*, Tax Justice Network, 2012.

⁴ Tim Smedley, "'Unsexy' Tax Reform Can Change Development Dynamics," *The Guardian*, August 15, 2013.

laundering money through shell companies. The notorious son of Equatorial Guinea’s longtime dictator, Teodoro Obiang, bought a \$30 million mansion in Malibu and a Gulfstream jet using shell companies based in California and the British Virgin Islands (despite having only a modest government salary.)⁵ Opaque corporate structures also have been implicated in the loss of billions of dollars in revenues from Congolese copper and cobalt mines and Zimbabwean diamond contracts.⁶

But it’s not just the poor who suffer the consequences. Hezbollah financed its activities in part by using shell companies in North Carolina to smuggle cigarettes.⁷ Arms trafficker Viktor Bout used at least 12 American shell companies to cover his tracks.⁸ Shell companies have been used to bribe Russian officials, defraud the E.U., and evade Iranian sanctions.⁹

The World Bank, in a review of big corruption cases over the last 30 years, found that 70 percent of them disguised their ownership through the misuse of corporate entities, such as anonymous shell companies.¹⁰

Despite international anti-money laundering and anti-terrorism standards, independent researchers found that it was easy to find corporate service providers (firms that help people set up companies) who were willing to flout the rules—even when the fictitious company posed an obvious criminal risk.¹¹ Surprisingly, the key offenders were not tax havens—bank secrecy jurisdictions with low or no taxes—or developing countries.¹² The United States was the worst performer; the consequences of this poor performance are particularly significant given the fact that 10 times more legal entities are formed in the United States each year than in all 41 tax haven jurisdictions combined.¹³

HOW CAN WE STOP THE ABUSE OF SHELL CORPORATIONS?

A low-cost, high impact solution would be for countries to collect and maintain basic information about who really owns and controls companies in order to stop illegal money laundering and tax evasion. Each country should make this data, known as *beneficial ownership information*, publicly available in an easy-to-use machine-readable format so that governments, businesses, the media, and ordinary citizens can use that information to prevent and detect crime and bring perpetrators to justice. The same information should be collected for trusts and foundations, which may not be technically considered companies in all countries, but frequently are used to hide financial crimes.

WHAT HAS BEEN DONE SO FAR?

⁵ *Anonymous Companies: How Hidden Company Ownership Is a Major Barrier in the Fight against Poverty and What to Do About It*, Global Witness, May 2013.

⁶ *Ibid.*

⁷ Dennis M. Lormel, “It’s Time to Pry Criminals Out of Their Shell (Companies),” *Cleveland Plain Dealer*, August 16, 2013.

⁸ Douglas Farah and Stephen Braun, “The Merchant of Death,” *Foreign Policy*, November 1, 2006; and Stefanie Ostfeld, “Shell Games: Hidden Owners and Motives,” CNN Opinion, September 11, 2012.

⁹ *Anonymous Companies*, May 2013.

¹⁰ *The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It*, World Bank, Stolen Asset Recovery Initiative, 2011.

¹¹ *Global Shell Games: Testing Money Launderers’ and Terrorist Financiers’ Access to Shell Companies*, by Michael Findley, Daniel Nielson, and Jason Sharman, 2012.

¹² *Ibid.*

¹³ *The Puppet Masters*, pp. 92-93.

Many countries have taken or are considering measures to establish registries of beneficial ownership. They are exploring whether such registries should be open to the public. At the June 2013 summit in Lough Erne, Northern Ireland, G-8 leaders agreed on eight common principles to prevent the misuse of companies and legal arrangements, which include making beneficial ownership information on companies and express trusts accessible to law enforcement, tax administrators, and other relevant authorities.¹⁴ Following the summit, all the G8 countries have announced their own national action plans to comply with the principles.

- In the **UNITED KINGDOM**, the Department for Business Innovation & Skills is considering a range of proposals to enhance the transparency of UK company ownership and increase trust in UK businesses. The key question is whether or not to open the planned registry of beneficial ownership to the public. MP Michael Meacham has introduced a private member's bill to provide for public disclosure of beneficial ownership.
- In the **EUROPEAN UNION**, the European Commission has launched a proposal for a new Anti-Money Laundering Directive (AMLD), which obligates companies to know their own beneficial owners and to make this information available to the appropriate authorities for due diligence checks. The proposal is under consideration by the Council and the Parliament.
- In the **UNITED STATES**, the Obama administration has pledged to “forcefully advocate for comprehensive legislation to require the disclosure of beneficial ownership information.” Senators Carl Levin (D-Mich.) and Chuck Grassley (R-Iowa) have introduced legislation that would require states to obtain the identities of those who are behind the corporations formed under their laws.
- The **EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (EITI)** adopted a new standard in May 2013 recommending that implementing countries maintain a publicly available register of the beneficial owners of the corporate entities that bid for, operate, or invest in extractive assets.¹⁵ It also requires that all state-owned enterprises disclose their level of beneficial ownership in oil, gas, and mining companies operating within the country.
- A broad coalition of **NGOS, BUSINESS LEADERS, AND LAW ENFORCEMENT OFFICERS**—including nearly 23,000 business owners who signed a petition to the leaders of the G8¹⁶—have stated their support for public registries of beneficial ownership.

The United Kingdom, the European Union and the United States are starting to take important steps to stop the abuse of shell corporations.

OPEN, PUBLIC REGISTRIES OF BENEFICIAL OWNERSHIP WOULD HELP...

1. **PREVENT CRIME.** If you don't know who you're doing business with, you could be complicit in or victimized by crime. You could be violating international sanctions, helping a corrupt politician to launder stolen assets, succumbing to a Ponzi scheme, or lending

¹⁴ <https://www.gov.uk/government/publications/g8-action-plan-principles-to-prevent-the-misuse-of-companies-and-legal-arrangements>.

¹⁵ *The EITI Standard*, EITI International Secretariat, 11 July 2013.

¹⁶ http://www.avaaz.org/en/business_signon_letter/

too much money to seemingly separate entities that, in fact, are all related. An open registry of beneficial ownership would help small businesses and consumers protect themselves.

2. **DETER CRIME.** Criminals will avoid setting up their operations in countries that force companies to declare who owns and controls them. Making this information public will increase the odds of being caught, which will make flouting the law more difficult and expensive. For some, the risks simply won't be worth the rewards.

Law enforcement officials need to know who is behind companies to deter, prevent and detect crime.

3. **DETECT CRIME.** Law enforcement agencies are not sufficiently staffed, funded, or trained to identify and pursue questionable data. In Britain, only about 0.3 percent of the 280,000 annual reports of suspicious transactions are investigated by authorities.¹⁷ The threat of being caught increases exponentially if the data is open to public scrutiny. Crowdsourcing is a much cheaper and more reliable way to ensure that the trove of data and documentation is actually read, verified, analyzed, and acted upon. Public registries also would help researchers to detect suspicious patterns and identify systematic vulnerabilities before they exact a serious toll on society.

4. **APPREHEND CRIMINALS.** There is a greater chance that criminals will receive advance warning of an investigation when ownership information is held by the company itself or an intermediary, such as a company formation agent, and is not directly available to law enforcement agencies, regulators, journalists, or other oversight institutions. A formal request for information made to a formation agent could result in a tip-off to the client, who may flee or cover his tracks.
5. **PROSECUTE CRIMINALS.** The absence of beneficial ownership information can make it impossible to hold anyone responsible for crimes, as the recent European horsemeat scandal demonstrates.¹⁸ In that case, a Cyprus company whose sole shareholder was an anonymous British Virgin Islands firm mislabeled horsemeat as beef and sold it to unsuspecting consumers across Europe.¹⁹ Because the firm was not required to disclose beneficial ownership information, those responsible for the scandal have not been held accountable. If a company pollutes the environment, manufactures defective products, harms its workers, steals wages or pensions, or commits other transgressions, citizens have a right to know who is pulling the strings and controlling the decision-making. Having beneficial ownership information in the public domain allows citizens, journalists, and civil society groups to unmask violators and ensure they are brought to justice. Moreover, public registries would enable citizens of foreign countries to track down

¹⁷ Paul Collier, "In Pursuit of the \$21 Million," *Prospect*, March 27, 2013.

¹⁸ Felicity Lawrence, "Horsemeat Scandal: Fear That Culprits Will Not Face Justice," *The Guardian*, May 10, 2013.

¹⁹ Romana Puiulet, Daniel Bojin, and Paul Radu, *Offshore Secrecy: The Horsemeat Scandal*, Organized Crime and Corruption Reporting Project, February 15, 2013.

evidence of corruption and illicit activities when their own law enforcement officials—who may themselves be implicated in wrongdoing or be under pressure from political leadership—refuse to pursue the case through official channels.

6. **RECOVER STOLEN ASSETS.** The process of mutual legal assistance (the agreement of countries to exchange information in order to enforce laws) is complicated, expensive, and time-consuming on all sides. Particularly for developing countries, which tend to have limited capacity to conduct sustained investigations, the bureaucratic complexities of filing and pursuing official requests for information can be overwhelming. But law enforcement agencies in developed countries also feel the financial and organizational strain. Requests under mutual legal assistance treaties compete with other law enforcement priorities, often take years to complete, and may lead to a dead end or provide evidence too late for successful prosecution. Public registries would reduce the burden not only on the law enforcement officials who seek the information, but also on those who respond to these requests.
7. **IMPROVE COMPLIANCE WITH ANTI-MONEY LAUNDERING LAWS.** Under the international standards recommended by the Financial Action Task Force (FATF), financial institutions are supposed to take reasonable measures to verify the identity of the beneficial owners of client firms. National laws also require banks to know their customers in order to comply with relevant money-laundering, counter-narcotics, and sanctions regimes. But financial institutions know there is a cost to digging too deep to determine beneficial ownership and have little incentive—and sometimes little capacity—to question information they receive from clients. An open public registry would reduce both the costs and the liabilities to financial institutions of investigating and verifying beneficial ownership. As the British Bankers Association wrote, a public registry of beneficial ownership “would help accountants, lawyers and banks, who could use it to aid their due diligence procedures.”²⁰ Similarly, the European Banking Federation stated that it regarded public registries as “imperative if credit and financial institutions are expected to discharge their obligations concerning BO [beneficial ownership] identification” pursuant to EU directives.²¹
8. **SAVE MONEY.** Three separate analyses all indicate that the economic benefits of public registries outweigh the likely costs.²² The UK’s Companies House (the official government registrar of UK companies) has indicated that there would be additional one-time costs of some £300,000 to add beneficial ownership information to its registry.²³ There are virtually no added costs to making a compiled list public. Law enforcement would save the most money because officers would not need to spend hours, days, months, or even

²⁰ Anthony Browne, “A Transparent System of Company Ownership Would Attract Business to the UK,” *City A.M.*, July 18, 2013.

²¹ “EBF Position on the Report from the European Commission to the European Parliament and the Council on the Application of Directive 2005/60/EC on the Prevention of the Use of the Financial System for the Purpose of Money Laundering and Terrorist Financing,” June 12, 2012.

²² *Costs of Beneficial Ownership Declarations*, a report by John Howell & Co., Ltd., for Global Witness, April 2013; “Regulatory Impact Analysis Disclosure of Beneficial Ownership of Unlisted Companies,” HM Treasury/DTI, July 2002; “Cost Benefit Analysis of Transparency Requirements in the Company/Corporate Field and Banking Sector Relevant for the Fight Against Money Laundering and Other Financial Crime,” Transcrime, February 2007.

²³ *Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business*, BIS/13/959, Department for Business Innovation & Skills, July 2013.

years tracking down ownership information. Public registries would also improve reporting of foreign financial assets, thereby enabling the collection of applicable taxes.

9. **LEVEL THE PLAYING FIELD.** The free market works best when all parties have full access to information. For instance, a small business could be cheated by a larger, wealthier firm hiding its massive resources behind an anonymous shell company, or by a company hiding its affiliation with a known fraudster. A public registry would rectify informational asymmetries, thereby helping small companies to negotiate on a more competitive basis and enabling markets to function more effectively.
10. **ENSURE VALIDITY AND COMPARABILITY OF DATA.** Data held by corporate service providers, or by companies themselves, can be uneven in quality, difficult to verify, and time-consuming to obtain. Having an official registry would ensure that the same types and level of information are collected from each company, that the same verification procedures are used, and that the information is comparable and searchable. This is especially true if data is stored in an open, machine-readable format that allows law enforcement, tax authorities, and other oversight institutions to find connections between complex global webs of shell companies.

MYTHS ABOUT PUBLIC REGISTRIES...

1. ***Making this information public would undermine data protection principles and privacy rights.*** As the Court of Justice of the European Union found, the right to protect personal data is not absolute. Rather, this right must be considered in relation to its function in society and be balanced with other fundamental rights, in accordance with the principle of proportionality.²⁴ In other words, the right of people to keep their financial affairs secret must be balanced against the need of society to prevent financial crimes.

For instance, most countries require that political contributions and lobbying activities be publicly reported. Salaries of public officials and real estate sales are a matter of public record. For a public registry of beneficial ownership, all that would be required for each beneficial owner is a *full name, birth date, city of residence, and nationality, as well as a description of how the ownership or control is exercised*, such as the percentage of shares held.

Publicizing information about who is behind companies will not violate privacy rights and will not undermine legitimate businesses.

Documentation used to verify identity, such as a driver's license or passport, would not need to be reproduced or displayed in the registry. This information would be supplied by the

²⁴ "Safeguarding Privacy in a Connected World: A European Data Protection Framework for the 21st Century," Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, January 25, 2012.

companies themselves, in exchange for the privilege of incorporation with limited liability (which protects company shareholders from personal bankruptcy.)²⁵

2. ***Creating public registries would cost too much.*** The costs of setting up a registry would be offset by savings in law enforcement budgets, since law enforcement officials would save a great deal of time and energy spent on simply finding out who owns corporations. A British cost-benefit analysis found that a public registry of beneficial ownership could save £30 million per year in police time alone.²⁶ With the enormous number of new corporations registered each year—estimated at 429,000 in the United Kingdom alone²⁷—even a minimal registration fee would go a long way to covering the costs, most of which would be one-time. And beneficial ownership information could simply be added to existing incorporation and reporting processes, which already require information on legal ownership.
3. ***Public registries would compromise proprietary business practices and information.*** All businesses have a right to know their clients and suppliers, and small businesses in particular are put at a disadvantage if they are unable to know who they're dealing with. There can be no level playing field if one party is allowed to keep its identity a secret. The true ownership of a company is not proprietary information, and that is all that a public registry would convey.
4. ***Collecting beneficial ownership information and keeping it up-to-date is an onerous new burden on legitimate businesses.*** Most small and medium enterprises have no trouble figuring out who their beneficial owners are. Only one percent of companies in the UK are estimated to have beneficial owners who are not the legal shareholders.²⁸ Those who set up the complex multi-jurisdictional structures in which beneficial ownership is separated from legal shareholding tend to be larger companies or wealthy individuals seeking to avoid taxes.²⁹ Companies listed and traded on major exchanges already make this information public and therefore could be left off the registry.

Simon Walker, director general of Britain's premier organization of business leaders, called a central registry of beneficial owners "a worthwhile exercise, given the damage that faceless corporations can inflict on our economy and society. It also makes sense for the register to be fully in the public domain where it can be subject to some degree of public scrutiny."³⁰

5. ***The information in a public registry will be of poor quality and impossible to verify.*** Even just requiring a driver's license, passport, or birth certificate as proof of identity when registering a company would be a vast improvement over the current system. The registry would function even better if the documentation is more fully verified and penalties are established for fraudulent filings. Governments have much better means for ascertaining the validity of this information than do banks or corporate service providers. They could develop risk-based

²⁵ "Corporate Anonymity: Light and Wrong," *The Economist*, January 21, 2012.

²⁶ "Regulatory Impact Analysis," July 2002.

²⁷ World Bank, New Businesses Reported 2011, database.

²⁸ *Ibid.*

²⁹ *Grave Secrecy: A Briefing Paper by Global Witness*, June 2012.

³⁰ Simon Walker, "Government has 'Anti-enterprise Undercurrent'," *The Telegraph*, August 15, 2013.

systems for checking the names against lists of known terrorists, parties that are debarred, suspended, or excluded from doing business with the government, and wanted criminals. Willfully misrepresenting beneficial ownership information should be grounds for a charge of felony fraud, which would provide another avenue for prosecuting criminals when evidence is lacking for more serious offenses. Criminal penalties—including the possibility of imprisonment—for lying about beneficial ownership would also deter people from serving as fronts for shady enterprises. By opening the data to more people with incentives to confirm and use the information, publication of the list will increase the odds that mistakes will be caught and corrected, whether these are simple transcription errors or intentional deceptions.

6. ***Making this information public could expose company owners to threats, harassment, and physical attack.*** Fear of public accountability is not a legitimate excuse for allowing corporations to remain secret. There are a wide variety of brick-and-mortar businesses and organizations whose controversial activities make them subject to strikes, boycotts, and direct actions, but they do not hide their identities. A tightly-defined exemption, however, could be made for publication of personal details where there are legitimate security concerns. Still, the information would have to remain available to law enforcement and tax authorities.
7. ***Undemocratic governments will use this information to target dissidents.*** Most governments already know who their political opponents are. Most of the money that is held secretly abroad is not in the hands of these political opponents, but rather those of corrupt officials, tax dodgers, and other criminals. But accommodations can be made in the registry to protect persons whose human rights and civil liberties are likely to be threatened by the release of this information, such as through a tightly-defined exemption similar to the one for legitimate security concerns.
8. ***If information on ownership of trusts is made public, even middle class people will be put at risk of kidnapping and ransom.*** Criminals don't need to look at beneficial ownership registries to figure out who is rich. Public registries need not include certain personal identification information, such as social security or passport numbers, street or email addresses, telephone numbers, tax information, or credit or bank records that might make their owners attractive targets for crime. And registries would not have to reveal the value of the trust.
9. ***Countries that create open registries will be put at a competitive disadvantage with respect to those who do not publish this information.*** All countries should be expected to adhere to an international standard for maintaining registries of beneficial ownership. The companies that refuse to register in countries that publish beneficial ownership information are the ones that pose the greatest criminal risks, so open registries would perform a public service by weeding them out. Moreover, anonymous shell corporations often have no employees and pay no taxes, so their economic contributions are minimal.

*This report was prepared for the Open Society Foundations by Diana Ohlbaum.
For more information, visit www.opensocietyfoundations.org*