

How Anonymous Shell Companies Finance Insurgents, Criminals, and Dictators

The United States is one of the primary facilitators of anonymous shell companies, which are often used to fund terrorism and crime that threaten U.S. interests.

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The Panama Papers leak of eleven million documents in April 2016 revealed that former Iraqi Prime Minister Ayad Allawi, the brother-in-law of Chinese President Xi Jinping, longtime friends of Russian President Vladimir Putin, drug kingpins, and even a soccer megastar had something in common: they all channeled money through anonymous shell companies. Anonymous shell companies are entities that usually employ few or no workers, do not conduct any substantive business, and allow their owners to store or route money while hiding their identities.

Because of the secrecy they can provide, anonymous companies represent an important nexus of corruption, money laundering, transnational organized crime, and terrorism, which directly harm U.S. interests. As one of the main facilitators of anonymous companies, the United States should pass legislation to disclose ownership information for all companies, increase federal contract transparency, and boost other business and government transparency mechanisms at home and abroad. Doing so would significantly cut back on the ability of terrorists, criminals, and their ilk to use American corporations, real estate, and trusts to finance activities that harm the United States and its foreign interests.

What Are Anonymous Shell Companies?

Anonymous shell companies are often no more than a title in a corporate registry and a name plate on a door; the actual person or persons who own and control the company—the so-called beneficial owners—are either concealed or not recorded at all. These companies enable the powerful and connected to hide their assets from law enforcement, tax authorities, or other interested parties, frequently by nesting these companies inside a complex web of businesses incorporated in different jurisdictions.

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Often, shell companies are established through a corporate service provider—a company that can incorporate on behalf of one or more individuals, a firm, a charity, or some other party. Instead of recording the actual beneficial owners, the company can be registered to someone who rents out his or her identity, known as a nominee. This nominee can be a lawyer, law firm, relative, or other person connected to the real owner, or even another company or trust, which itself may be anonymously owned. Recent data from Global Witness and DataKind UK show that three thousand companies in the United Kingdom listed their beneficial owner as another company incorporated in a tax haven—a jurisdiction different from the one where the company is based, that levies low or no taxes, and whose legal and regulatory frameworks often deliberately provide a veil of secrecy regarding who owns or controls a company.

Some people use the anonymity afforded by these types of companies with no intention of breaking the law, such as Hollywood stars and corporate executives who use anonymous shell companies to shield the locations of their residences from the

general public. However, for most people who establish shell companies, the fact that the company can be formed anonymously is irrelevant to the overall benefits of incorporating via a shell company. Therefore, actions to reduce anonymous ownership will not harm most owners. And although privacy concerns are important, the harm anonymous shell companies cause by facilitating criminal activity and corruption outweighs the privacy benefits.

The Problem With Shell Companies

Anonymous companies facilitate criminal networks by helping them launder money throughout the international financial system. For example, thirty-three companies and people that had been blacklisted by the U.S. government were exposed in the Panama Papers, along with drug kingpins, fraudsters, and arms dealers. Notorious arms dealer Viktor Bout also used anonymous American and foreign shell companies to run his worldwide smuggling enterprise.

Anonymous shell companies are especially useful for money laundering through real estate transactions. The U.S. Department of the Treasury recently found [PDF] that approximately 30 percent of high-end, all-cash real estate purchases in six major metropolitan areas involved a “beneficial owner or purchaser representative that is also the subject of a previous suspicious activity report.” The use of anonymized real estate ownership can have national security ramifications: earlier this year, the General Accounting Office was unable to identify the ownership information for about a third of the high-security buildings leased by the U.S. government due to a lack of beneficial ownership information. As a result, many U.S. government agencies may have no idea whether they are renting their facilities from a hostile foreign government or criminal organization.

Anonymity makes these shell companies useful tools to launder the proceeds of corruption, thereby undermining democratic governance and stability around the world. Funds intended for healthcare, education, and other public services are diverted to kleptocrats’ personal accounts through shell companies with hidden

owners. A UN panel has estimated [PDF] that at least \$50 billion is lost annually through a variety of illicit financial flows from Africa, with the panel citing the need for public registries of beneficial ownership to help stem this flow. The International Consortium of Investigative Journalists found that from 2007 until at least 2013, over \$2 billion has moved between banks and shell companies linked to associates of Russian President Vladimir Putin, even as Russia suffered a recession and the devaluation of the ruble as oil prices—the backbone of the Russian economy—tumbled.

Anonymous shell companies also helped facilitate the state-sponsored corruption that helped spur the Arab Spring, destabilizing American allies throughout the region and igniting conditions for the Syrian civil war and the rise of the self-declared Islamic State. Likewise, anonymous companies helped enable the kleptocratic Ukrainian regime, the downfall of which encouraged the Russian incursion into Crimea and eastern Ukraine and put a potential confrontation with Russian forces on the border of the North Atlantic Treaty Organization (NATO).

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Additionally, anonymous shell companies have helped arm the very insurgents that American troops are fighting. For example, a U.S.-led investigation [PDF] found that American taxpayer money—at least \$3.3 million of a \$2.16 billion contract—was funneled to the Taliban and a variety of warlords through networks of subcontractors and shell companies. The money was then used to purchase weapons for the Taliban and insurgents, putting American soldiers and civilians in danger and undermining larger strategic military and diplomatic efforts in Afghanistan.

U.S. Laws Support Shell Companies

Anonymous companies are an international challenge. In the United States and globally, failing to require beneficial ownership disclosures stymies law enforcement and national security efforts against terrorist financing, money laundering by criminal organizations, and countries evading sanctions. Finding the owners means peeling back layers of nested companies, often in different jurisdictions. This limits the effectiveness of warrants and forces authorities to make time-consuming, complex, cross-border requests for legal assistance, only to find that the trail leads to another anonymous company in yet another jurisdiction. And while global standards of information exchange have improved, many locations still have strong financial secrecy laws, limiting what is available even with the appropriate legal authorization.

U.S. laws are among the biggest barriers to uncovering the identity of beneficial owners. The United States incorporates more companies each year than any other country, but no U.S. state requires the collection of beneficial ownership information. A 2012 study of 3,700 corporate service providers in 182 countries found that U.S.-based providers had the fewest requirements, providing the easiest way to establish an untraceable company. In many cases, U.S.-based corporate service providers even offered to set up anonymous companies for inquiries that should have raised red flags as possible fronts for terrorism or corruption. The ease of forming anonymous companies puts the United States out of compliance with existing international standards to combat money laundering and terrorist financing set by the Financial Action Task Force (FATF). The task force's December 2016 evaluation [PDF] states that the U.S. regulatory framework does not hold institutions and businesses—such as lawyers, investment advisors, accountants, real estate agents, and trust and company service providers—to minimum international standards and identified the “lack of timely access to adequate, accurate and current beneficial ownership information” as a major impediment to efforts to combat money laundering and terrorist finance.

Recommendations

Congress should pass legislation to require the disclosure of beneficial ownership information upon incorporation. The information should be kept in a regularly updated public registry of all American companies. This is already an emerging international standard: the British and Ukrainian governments publish beneficial ownership information for companies formed in their countries, and European Union member states are following suit. Because company formation in the United States originates at the state level, the federal government can either require states to begin collecting information on beneficial ownership as a condition of receiving essential federal funds for law enforcement assistance, or it can authorize a federal agency such as the Treasury Department to directly collect such information from companies when they are formed.

All federal agencies should require bidders for federal contracts, including subcontractors, and regardless of contract size, to declare their beneficial owners. Government contracting agencies should establish offices to vet contractors and subcontractors to ensure the accuracy of beneficial ownership disclosures. Federal procurement regulations should require clawback clauses, which would require that money that has benefited criminal or terrorist purposes be paid back to the U.S. government.

In compliance with international anti-money laundering standards, the Treasury Department should ensure that investment advisors, bank holding companies, security broker dealers, lawyers, accountants, and trust and company service providers comply with the same anti-money laundering standards and due diligence that banks are held to. Treasury would be the lead department, with support from Congress, the Securities and Exchange Commission, Department of Justice, other relevant agencies, and state and local governments. The American Bar Association should also update its Model Rules of Professional Conduct to require lawyers to carry out anti-money laundering checks.

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The Treasury Department should finally lift a 2002 temporary exemption to the USA Patriot Act that grants “persons involved in real estate closings and settlements” a waiver from conducting anti-money laundering due diligence of their customers. In addition, the Treasury Department’s temporary order requiring title insurance companies in six cities to provide beneficial ownership information for all-cash, high-end real estate purchases should be made permanent and expanded to cover the entire United States.

As the United States adopts these standards at home, it should also push for their widespread adoption abroad. The State, Treasury, and Commerce Departments and the U.S. Agency for International Development (USAID) should use their diplomatic influence and foreign assistance to encourage all countries to create public registries of beneficial owners and promote the widespread adoption of international standards for contract transparency and accountability, especially in government procurement, as spelled out in the Open Government Principles and Open Contracting Principles.

Because it is easy to open and use anonymous shell companies in the United States, it is already a significant entry point for criminal and corrupt proceeds. As the governments of the European Union and United Kingdom continue to adopt more stringent rules on anonymous shell companies, there is evidence that the proceeds of criminal activity and money laundering are increasingly flowing into the United States, making it an even greater money laundering hub. As a result, the United States is increasingly helping to facilitate the very narcotics traffickers, human

smugglers, terrorist networks, and kleptocrats that weaken U.S. national security. Adopting these measures will demonstrate that the United States is no longer a laggard on this issue, minimize U.S. complicity in illicit activity, and provide new tools for law enforcement. If the Donald J. Trump administration is serious about fighting terrorism and transnational crime, then ending anonymous shell companies should be a priority.