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U.S. Government Accountability Office (GAO)

Presentation on GAO's Report *Company Formations: Minimal Ownership Information is Collected and Available*

Presented by Kay Kuhlman, Assistant Director
Financial Markets and Community Investment, GAO

IACA Conference
May 16, 2006

- About GAO
- Why GAO Was Asked to Do the Study
- Overview of the Report

- GAO is an independent agency in the legislative branch of the federal government (created in 1921).
- GAO is headed by the Comptroller General of the United States, who is appointed to a 15-year term by the President from candidates proposed by Congress. This long tenure gives GAO a continuity of leadership and independence that is rare within government.
- Most GAO work is done at the request of congressional committees or subcommittees or is mandated by public laws or committee reports. GAO also undertakes research under the authority of the Comptroller General.
- GAO supports congressional oversight through audits, investigations, program evaluations, policy analyses, and legal decisions (such as bid protest rulings).

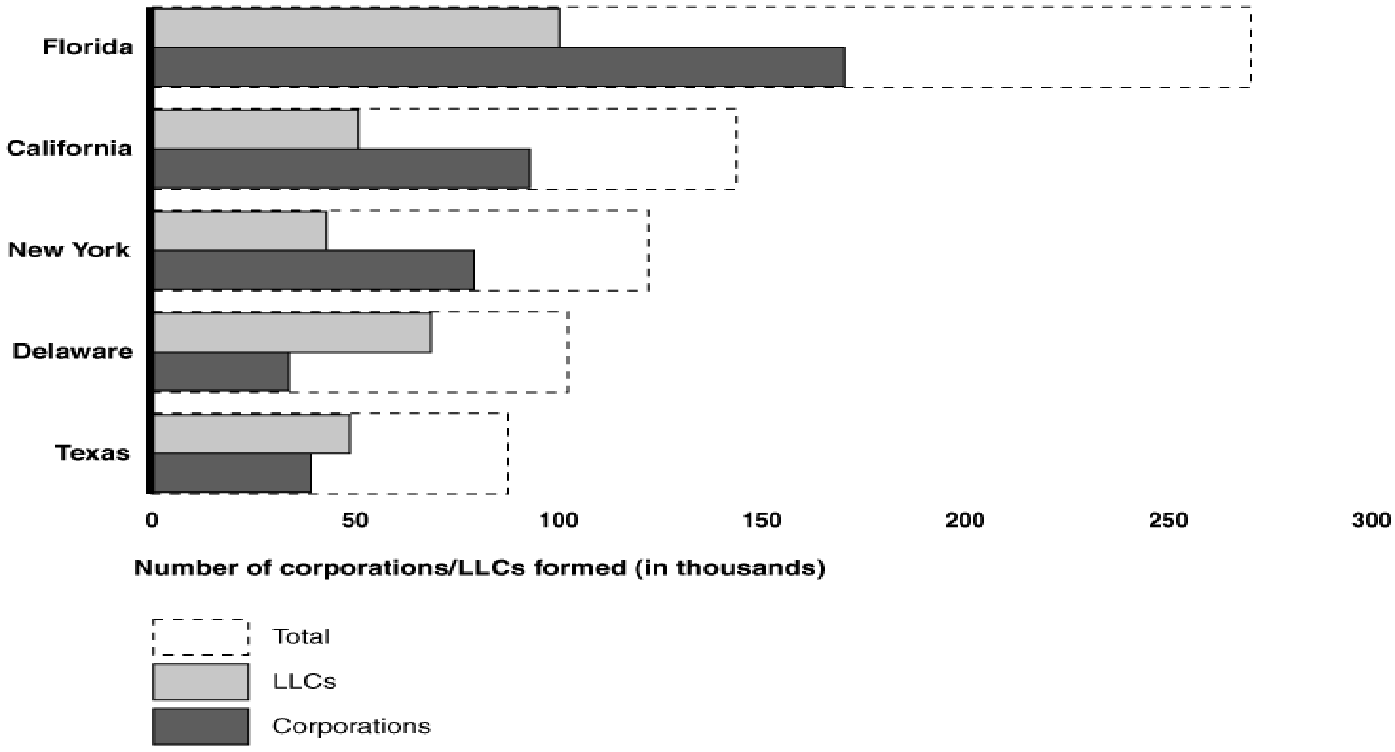
Why was GAO asked to study this issue?

- Senate Permanent Subcommittee of Investigations (PSI) has a long history of investigating money laundering issues (correspondent banking, private banking, etc.)
- PSI had requested the October 2000 GAO report, *Suspicious Banking Activities: Possible Money Laundering by U.S. Corporations Formed for Russian Entities*
- Request for this study asked GAO to conduct a review of all states on the extent to which they collect and verify beneficial ownership information on non-publicly traded companies and to determine what information registered agents collect and verify.

Scope of study

- Broadened scope to determine what kinds of company information is collected by states to provide some context for understanding the extent to which ownership information is collected for company formations.
- Focused on corporations because they have been the dominant business form and limited liability companies because they are growing in popularity.
- Included a limited review of the use of shell companies for illicit activities to describe why some people are concerned about whether ownership information is collected.

Number of Domestic Corporations and LLCs Formed In the Top Five States in 2004



Source: GAO survey of state officials responsible for company formation.

Objectives of the Study

- What kinds of information—including ownership information—do the 50 states and DC collect during company formation and what are the states' efforts to review and verify the information?
- What are the roles of third-party agents, such as company formation agents, and what kinds of information do they collect on company ownership?
- How do shell companies facilitate criminal activity and to what extent is company ownership information available to law enforcement and useful in their investigations?
- What are the potential effects of requiring states, agents, or both to collect company ownership information?

Methodology

- Surveyed officials from 50 states and DC.
- Met with state officials from Delaware, Florida, Nevada, Arizona and Oregon; also met with officials from DC, Maryland, Virginia and Maine to pretest the survey.
- Reviewed state statutes and forms from state websites.
- Interviewed academics, companies that provide filing and related services for businesses, law firms, and financial institutions.
- Interviewed officials from Isle of Man and Jersey.
- Interviewed federal officials from Justice (FBI, DEA, US Attorneys), DHS(ICE), Treasury (IRS, FinCEN, OFAC).

Most States Collect Limited Information on Company Ownership and Management

- No states collect ownership information for corporations and four states collect some information on members of LLCs.
- Less than half of the states collect information on company management or directors of corporations on formation documents.
- Most states collect information on corporate officers and directors and managers of LLCs on periodic reports.
- States review formation documents and periodic reports but do not verify information on owners, directors, members or managers.

Agents Facilitate Company Formation but Are Not Required to Collect Ownership Information or Verify Information on Clients

- Agents collect the information that states require; therefore, most do not collect ownership information.
- A few agents we spoke with told us that they collected additional information, such as copies of passports, for non-U.S. persons forming a company in the U.S.
- Limited oversight of agents.
    - Wyoming requires agents serving more than five corporations to register with the state annually, providing contact information and indicating whether any company principal has ever been convicted of a felony.
    - Delaware contracts with approximately 40 agents, who can directly enter or access company information in the state database for an access fees and requires them to have been operating for at least 1 year, to be in good standing, and to serve more than 50 clients.

Law Enforcement Officials Can Obtain Some Company Information from States and Agents, but a Lack of Ownership Information Obstructs Some Investigations

- Recent reports have highlighted the concern about the U.S. shell companies.
- Example of investigations that used company public record documents that shows how the information can help in an investigation.
- Example of cases that tried to used company public record documents that shows how the lack of information hinders and investigation.

Case in which company documents helped.

- IRS investigated four people in Michigan who formed 15 shell corporations in Michigan and Indiana. Using these shell companies, the co-conspirators established 37 lines of credit at a bank and charged a number of large purchases, including real property, several luxury cars, jewelry, boats, and a motor home. The bank incurred losses of approximately $9.6 million. The IRS investigators found key pieces of evidence, including the identity of the co-conspirators, on the articles of incorporation and annual reports maintained by the states where the corporations were formed. Two of the co-conspirators were sentenced to 45 months and 51 months in prison and ordered to pay $327,500 and $2.8 million in restitution, respectively.

Cases in which the lack of information hindered the investigation

- An Arizona law enforcement official charged with helping investigate an environmental spill that caused $800,000 in damage said that the investigators could not prove who was responsible for the damage because the suspect had created a complicated corporate structure involving multiple company formations.

- ICE officials described a subject who allegedly used an agent to establish a Nevada-based corporation that in almost 2 years received 3,774 wire transfers totaling $81 million from locations such as the Bahamas, British Virgin Islands, Latvia, and Russia. However, ICE could not identify the suspect as the beneficial owner of the corporation because other people had handled the transactions.

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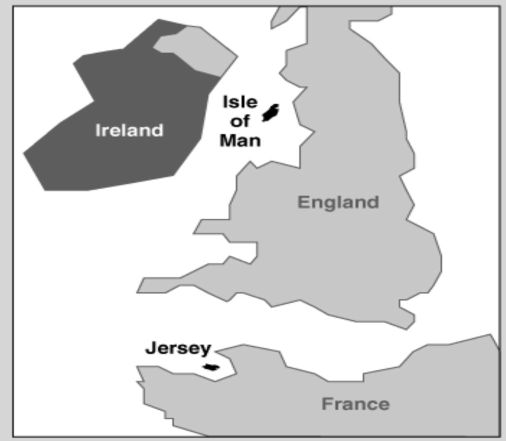
More Company Ownership Information Could Be Useful to Law Enforcement, but Concerns Exist about Collecting It

- Increased time, cost and workload for state offices and agents
- Derailment of business dealings
- Lost state revenue
- Lost business for agents
- Changes could require state legislatures to pass new legislation
- Tension with privacy rights

Two Foreign Jurisdictions Have Had Mixed Experiences with Requiring Ownership Information

- Company service providers remained profitable;
- Information is available to law enforcement;
- Time to form a company has increased;
- Operational costs increased;
- Fewer companies formed in Isle of Man;
- Keeping information up to date is a challenge.

Jersey and Isle of Man



Source: Art Explosion.

Jersey, which lies about 100 miles south of mainland Britain and 14 miles from the coast of France, has an area of 45 square miles. Isle of Man is located in the Irish Sea and has an area of 227 square miles. The two islands are self-governing crown dependencies that do not belong to the United Kingdom and are not members of the European Union. Each has its own parliament and laws. In response to international concern in the mid-1990s about the role of companies formed in offshore jurisdictions such as these two islands in tax evasion schemes and other illicit activities, Jersey and Isle of Man began regulating company service providers in 2001 and 2000, respectively. The Financial Services Commission in Jersey and the Financial Supervision Commission in Isle of Man oversee the regulation of the company service provider industry. Officials from both jurisdictions noted that the regulations were implemented to improve the legitimacy and reputations of companies formed there.

<u>Other Sources of Ownership Information</u>

- Company documents
  - Companies are required to maintain records of shareholders for corporations and an operating agreement for LLCs.
  - However, criminals using a shell company are unlikely to hand over this information.
- Financial Institutions
  - May have ownership information on companies that are considered high-risk.
  - Criminals using shell companies can hide their identity through correspondent accounts or by not using the U.S. financial system.
- Internal Revenue Service
  - IRS may not have information on all companies or information is not up to date.
  - Law enforcement could have difficulty accessing taxpayer information.

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GAO's Concluding Observations

- Study revealed legitimate concerns and conflicting interests among states, agents, and law enforcement.
- In considering any requirements for collecting ownership information, it would be useful for policymakers to balance these conflicting concerns.
- Any requirement would need to uniformly apply to all states and/or agents, because if it were not, those wanting to set up shell companies for illicit activities would simply move to the jurisdiction that presented the fewest obstacles.