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S. Hrg. 109–845

FAILURE TO IDENTIFY COMPANY OWNERS IMPEDES LAW ENFORCEMENT

HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
HOMELAND SECURITY AND
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

NOVEMBER 14, 2006

Printed for the use of the Committee on Homeland Security
and Governmental Affairs

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FAILURE TO IDENTIFY COMPANY OWNERS IMPEDES LAW ENFORCEMENT

TUESDAY, NOVEMBER 14, 2006

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:32 p.m., in room 342, Dirksen Senate Office Building, Hon. Norm Coleman, Chairman of the Subcommittee, presiding.

Present: Senators Coleman, Levin, and Carper.

Staff Present: Raymond V. Shepherd, III, Staff Director and Chief Counsel; Mary D. Robertson, Chief Clerk; Mark D. Nelson, Senior Counsel; Elise J. Bean, Staff Director and Chief Counsel to the Minority; Robert L. Roach, Counsel and Chief Investigator to the Minority; Laura Stuber, Counsel to the Minority; Zachary Schram, Professional Staff to the Minority; Steven Groves, Senior Counsel; John McDougal (Detailee, IRS); Kate Bittinger (Detailee, GAO); JoAnna I. Durie (Detailee, ICE); Cindy Barnes (Detailee, GAO); Emily Germain, Intern; Jennifer Boone (Senator Collins); Robin Landauer (Senator Coburn); Teresa Meoni, Intern; Mark LeBron, Intern; and John Kilvington (Senator Carper).

OPENING STATEMENT OF SENATOR COLEMAN

Senator COLEMAN. This hearing of the Permanent Subcommittee on Investigations is called to order.

Good afternoon, and thank you for attending today's hearing. I informed Senator Levin that I have to be on the floor of the Senate at 2:50, so I will give my opening statement and turn the gavel over to Senator Levin. He will do the introduction of the first panel and then I will come back.

I said I was kind of easing myself into passing the gavel over, so it is not like cold turkey in January.

I also want to personally thank the Senator and to say very publicly that this investigation—Senator Levin has really been driving this. He has been driving this issue about transparency, both internationally and if we are dealing with it internationally, we have to deal with it at home. So I want to commend him for his continued efforts in addressing the abuses of shell companies, both here and abroad.

The purpose of today's hearing is to examine the lack of information collected by various States regarding the ownership of nonpublicly traded companies, and the extent to which U.S. shell com-

panies are being used to conceal the identities of those engaged in illicit activity.

In the United States, State governments authorize the formation of nearly 2 million new domestic companies each year. Although the vast majority of these companies are formed to serve legitimate commercial purposes, the potential for abuse is great. The absence of ownership disclosure requirements and lax regulatory regimes in many of our States make U.S. shell companies attractive vehicles for those seeking to launder money, evade taxes, finance terrorism, or conduct other illicit activity anonymously.

In fact, we generally have no idea who owns the millions of U.S. companies formed each year because most States do not ask for this information. In a recent report prepared at the request of this Subcommittee, the Government Accountability Office found that none of the 50 States requires applicants to disclose who will own a new corporation and only a few States require this information for a new limited liability company (LLC).[1]

Moreover, although most States require corporations and LLCs to file periodic reports, only three States require corporations to report ownership information in these filings, and only five States require the same of LLCs.

Perhaps most troubling, the GAO found that none of the States screens company information against criminal watch lists or verifies the identity of company officials. This lack of transparency not only creates obvious vulnerabilities in our financial system, but it also threatens our homeland security.

GAO reports that the FBI has 103 open investigations involving financial market manipulation. Most of these cases involve U.S. shell companies. A Department of Justice report revealed that Russian officials used shell companies in Pennsylvania and Delaware to unlawfully divert $15 million in international aid intended to upgrade the safety of former Soviet nuclear power plants.

Schemes like these are not uncommon. But without sufficient company ownership information, it is often difficult for law enforcement to identify and prosecute the criminals behind them. For example, Immigration and Customs Enforcement (ICE) officials reported that over a 2-year period one Nevada-based corporation received more than 3,700 suspicious wire transfers totaling $81 million. This case has not been prosecuted, however, because ICE was unable to identify the corporation's owners.

Clearly, our failure to identify the owners of U.S. shell companies is a significant deficiency in our anti-money laundering and terrorist financing efforts. I am concerned that the competition among States to attract company filing revenue and franchise taxes has, in some instances, resulted in a race to the bottom.

Internet searches reveal that in the race to provide faster, cheaper company formation processes, States that collect company ownership information are at a competitive disadvantage. Numerous websites laud the advantages of incorporating in States that protect privacy and limit information reporting requirements.

Company formation and service of process agents in these States advertise packages that include nominee shareholders, nominee di-

[1] See Exhibit 2 which appears in the Appendix on page 149.

rectors, local telephone listings, live receptionists, and other devices designed to provide the veneer of legitimacy to shell companies that employ no one and have no physical presence other than a mailing address. That these formation and support services rival those offered in some of the most notorious offshore tax and financial secrecy havens is simply unacceptable.

This is an issue again that this Subcommittee has explored, and Senator Levin has been really passionate about rooting out that level of corruption.

The United States should never be the situs of choice for international crime, but that is exactly what the lax regulatory regimes in some of our States are inviting. U.S. shell companies have been used to obscure the ownership and purpose of billions of dollars in international wire transfers and to facilitate criminal activity throughout the world. The FBI believes that U.S. shell companies have been used to launder as much as $36 billion from the former Soviet Union. The U.S. Treasury's Financial Crime Enforcement Network—FinCEN—found that between April 1966 and January 2004, U.S. financial institutions filed 397 suspicious activity reports concerning a total of almost $4 billion that involve U.S. shell companies and Eastern European companies.

It is embarrassing that foreign law enforcement agencies report being frustrated by the lack of ownership information available on U.S. companies and that the Department of Justice is often unable to respond to requests for company ownership information from our treaty partners. In our fight to win the war on terrorism, opportunities to assist law enforcement efforts of our allies are too precious to sacrifice. International criminal activities that exploit the lack of transparency in our company registrations serve to tarnish our country's reputation internationally and are more costly than ever.

At the same time, there are obvious costs and inefficiencies associated with the collection and verification of ownership information. Many States recognize Federal law enforcement's need for more company ownership information, but the States do not need an unfunded mandate from Congress. The States raise legitimate concerns that collecting ownership information could delay or derail legitimate business deals and drain limited State resources from other, more pressing, needs. Moreover, it is likely that when more stringent disclosure requirements are passed in one State, companies will simply move to those States or countries with less stringent requirements.

It appears to me that what is needed is a level playing field, a system that avoids a race to the bottom. It would be nonsensical for someone to lock the front door but leave the back door wide open and then go to sleep believing that their home is secured. Yet, in our efforts to secure this Nation, we seem to have done exactly that. We have enhanced our security and identification requirements at ports, airports and along the borders, but we have ignored the obvious vulnerabilities created by anonymously-owned U.S. companies. We must find a common sense solution that balances our need to protect our financial system, our homeland, and our international reputation with our need to preserve an efficient, flexible business environment.

I look forward to the testimony we will hear during today's hearing. It is important that we understand the specific nature of the vulnerabilities created by anonymously-owned U.S. shell companies and to hear proposals for steps that we can take to reduce the potential for abuse while preserving a system that does not derail or necessarily delay legitimate business.

After today's hearing and assessing the testimony, I intend to discuss with Senator Levin what follow up action we need to take in order to further address the problems exposed by this investigation.

Again, I want to thank my colleague, the Ranking Member, for his leadership on this issue. I will turn the gavel over to him and will return after I deal with issues on the floor.

Senator LEVIN [presiding]. Mr. Chairman, before you leave, let me just take a moment to thank you. As true of all investigations and inquiries of this Subcommittee, these are partnerships. These are working relationships which are established which are critically important to the success of this Subcommittee.

You have carried on that tradition as Chairman, of working on a bipartisan basis, working together with ranking members and other members of our Subcommittee to try to make progress in areas we look at. But nothing that has happened or could happen without the support of you and your staff and the full partnership of both of you and we thank you for that.

Senator COLEMAN. Thank you, Senator Levin.

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. In 2004 the United States was home to 12 million companies, including about 9 million corporations and 3.8 million limited liability corporations, or LLCs. In that year alone, our 50 States incorporated more than 1.9 million new corporations and LLCs. The vast majority of these companies operate legitimately, but a small percentage do not, functioning instead as conduits for organized crime, money laundering, securities fraud, tax evasion and other misconduct.

In most cases, our States have no idea who is behind the companies that they have incorporated. A person who wants to set up a U.S. company typically provides less information than is required to open a bank account or get a drivers license. In most cases, they do not have to provide the name, address or proof of identification of a single owner of the new company. That is because our States have been competing with each other to set up new companies not only faster than ever, at less cost than ever, but with greater anonymity for the company's owners.

Most U.S. States offer electronic services that incorporate a new company and many will set up a new company in less than 24 hours. The median fee is less than $100. In Delaware and Nevada, for an extra $1,000, an applicant can set up a company in less than an hour. Colorado, which incorporates about 5,000 companies each month, told the Subcommittee that it now sets up 99 percent of its companies by computer without any human intervention or review of the information provided. Incorporating all of these new companies generates annual revenues totaling hundreds of millions of dollars for our States.

The problem with incorporating nearly 2 million new U.S. companies each year without knowing anything about who is behind them is that it becomes an open invitation for criminal abuse. Take a look at a few websites from firms in the business of incorporating companies around the world.[1]

This website, which is hard to read so I will quote from it, from an international incorporation company promotes setting up companies in Delaware by saying "Delaware, an offshore tax haven for non-U.S. residents." One of the cited advantages is that "owners' names are not disclosed to the State."

Another website from a United Kingdom firm called formacompanyoffshore.com lists a number of advantages to incorporating in Nevada. The cited advantages include "no IRS information sharing agreement" and "stockholders are not on public record, allowing complete anonymity."

These are just two of the dozens of websites that portray our States as welcoming those who want to operate U.S. companies with anonymity.

That anonymity is exactly what this Subcommittee has been criticizing offshore tax havens for offering to their clients. In fact, our last Subcommittee hearing lambasted offshore jurisdictions for setting up offshore corporations with secret U.S. owners engaged in transactions designed to evade U.S. taxes, leaving honest taxpayers to pick up the slack. Some U.S. company formation firms advertise the same type of anonymity and take the same type of actions that this Subcommittee has been criticizing in the offshore jurisdictions for years.

Take a look, for instance, at a Nevada firm called Nevada First Holdings.[1] Nevada First advertises on the Internet, offering for sale an aged or a shelf company or companies that were set up in Nevada years earlier, pointing out that an older company can lend credibility to an operation.

It sells these companies that are no longer functioning to companies, to anyone, who can pay the price without obtaining any information on the true owners of the companies since there is no obligation to do so.

Nevada First offers a host of services to further hide the identity of a company's owners. For example, Nevada First employees can serve as a company's nominee director or officer to enable the true owners to "retain a higher level of anonymity." A Nevada First employee, acting as a company officer or director, can provide his own name and Social Security number to open a company bank account or obtain an Employer Identification Number from the IRS. So the true owners do not have to use their name. That is why that employee of Nevada First uses his name, in order to keep the real owners anonymous.

Nevada First will also allow a company to use Nevada First's own business address and provide a company with mail forwarding and telephone services, all the bells and whistles needed to make a phony operation look like it is actually operating in Nevada.

Nevada First told the Subcommittee it has already assigned 1,850 addresses for so-called "suites" within its offices to the com-

[1] See Exhibit 1 which appears in the Appendix on page 144.

panies it has formed and at least 850 of those shell companies are still in operation.

Now there is a picture here of that building where 850 companies have their offices. And you can see, just by the relationship to the automobiles in front of that building, that is truly a facade. There is no room in that building for 850 companies' offices. It reminds me very much of that building in the Caymans where thousands of addresses were linked to a building that nobody ever went to or saw.

The potential for abuse in this situation, where the companies do not actually operate out of these offices, is obvious. It is compounded by the fact that Nevada First is far from unique in offering these services, none of which by the way is illegal on its face. The key to this entire charade is the lack of any U.S. requirement to get the names of the true owners of the U.S. companies that are being formed.

Law-enforcement officials testifying today are expected to describe how U.S. companies are being used for money laundering, drug sales, securities fraud, and other misconduct and how, in too many cases, when law-enforcement agents try to find out who the company owners are they run smack into a blank wall. In most cases, the States that set up the companies ask no questions about the true owners and therefore have no ownership information for law enforcement to investigate.

Here are just a few examples of the problems that have resulted. Immigrations and Customs Enforcement officials reported that a Nevada-based corporation received more than 3,700 suspicious wire transfers totaling $81 million over 2 years but the case was not pursued because the Agency was unable to identify the corporation's owners. The FBI told the GAO that anonymously held U.S. shell companies are being used to launder as much as $36 billion from the former Soviet Union.

The FBI reported that they have 103 open cases investigating stock market manipulation, most of which involve anonymously-held U.S. shell companies.

U.S. Treasury's Financial Crimes Enforcement Network reported that between April 1996 and January 2004 financial institutions filed 397 suspicious activity reports involving a total of almost $4 billion deposited in or wired through U.S. financial institutions by anonymously held U.S. shell companies.

A Department of Justice report revealed that Russian officials used anonymously held shell companies in Pennsylvania and Delaware to unlawfully divert $15 million in international aid intended to upgrade the safety of former Soviet nuclear power plants.

For decades, the leading international body fighting money laundering, called the Financial Action Task Force on Money Laundering has warned countries not to set up companies without first finding out who was really behind them. In a set of 40 recommendations that have become international benchmarks for strong and effective anti-money laundering laws, the Financial Action Task Force has urged countries to identify the beneficial owners of the companies that they establish.

FATF recommendation number 33: Countries should ensure that there is adequate, accurate, and timely information on the bene-

ficial ownership and control of legal persons—which includes companies—that can be obtained or accessed in a timely fashion by competent authorities.

The United States is a leading member of that Financial Action Task Force. It has worked with that organization to convince countries around the world to comply with those 40 recommendations of that task force.

Today even a number of offshore secrecy jurisdictions, such as the Caymans, Bahamas, Jersey, and the Isle of Man, at least obtain the information that is part of those recommendations. They comply with the recommendation to identify the owners of companies that they establish. But the United States does not comply and we were just formally cited for that failure in the year 2006 in that task force review of U.S. anti-money laundering laws.

So now we have 2 years to comply with recommendations that we supported in a task force that we helped create or else we risk expulsion from that task force.

We should not need the threat of expulsion from that task force, which is aimed at ending the abuses of money laundering, to force us to address this problem. We ought to correct this problem for our own sake, to eliminate a gaping vulnerability to criminal misconduct.

Criminals are using U.S. companies inside our borders to commit crimes. They are also using U.S. companies to commit crimes outside of our borders, which will not only give us a bad name but also means that U.S. companies are being used to facilitate crimes related to drug trafficking, financial fraud, corruption and other wrongdoing that harm our national interest.

Four reports issued in the past year describe the law enforcement problems caused by U.S. companies with unknown owners, and these reports are described in my statement, which I will insert in the record in full.

It is difficult to judge the scope of this law-enforcement threat since we do not know how many companies are involved in wrongdoing, but if just one-tenth of 1 percent of the 12 million existing U.S. companies are engaged in misconduct, that would mean that 12,000 suspect companies are loose in this country and the world with no record of their beneficial ownership. That is an unacceptable risk to our national security and our treasury.

Our lax standards have created real problems for our country in the international arena. The United States has been a leading advocate for transparency and openness. We have criticized offshore tax havens for their secrecy and lack of transparency. We have pressed them to change their ways. But look what is going on in our own backyard. The irony is that we do not suffer from a lack of transparency, there is just no information to disclose. And when other countries ask us for company owners, we have to stand red-faced and empty-handed. It undermines our credibility and our ability to go after offshore tax havens that help rob honest U.S. taxpayers.

It also places us in the position of being in noncompliance with the guidelines of the very international organization promoting our message of openness and transparency.

There are a number of possible solutions to this problem and we can perhaps explore them at the end of this hearing so that we can get on with the hearing. But we must address this problem for the sake of our law enforcement, for the sake of our security, and for the sake of our international reputation in trying to enforce laws which will promote transparency and attack money laundering and other crimes.

Again, I want to thank our Chairman for the strong position that he has taken, for the support that he and his staff have provided for the partnership that they have always provided, and for maintaining a strong bipartisan reputation of this Subcommittee, which will continue in the years ahead.

[The prepared statement of Senator Levin follows:]

PREPARED STATEMENT BY SENATOR CARL LEVIN

In 2004, the United States was home to 12 million companies, including about 9 million corporations and 3.8 million limited liability corporations or LLCs. In that year alone, our 50 states incorporated more than 1.9 million new corporations and LLCs. The vast majority of those companies operate legitimately. But a small percentage do not, functioning instead as conduits for organized crime, money laundering, securities fraud, tax evasion, and other misconduct.

In most cases, our states have no idea who is behind the companies they have incorporated. A person who wants to set up a U.S. company typically provides less information than is required to open a bank account or get a driver's license. In most cases, they don't have to provide the name, address, or proof of identification of a single owner of the new company. That's because our states have been competing with each other to set up new companies faster than ever, at less cost, and with greater anonymity for the company owners.

Most U.S. states offer electronic services that incorporate a new company, and many will set up a new company in less than 24 hours. The median fee is less than $100. In Delaware and Nevada, for an extra $1,000, an applicant can set up a company in less than an hour. Colorado, which incorporates about 5,000 new companies each month, told the Subcommittee that it now sets up 99% of its companies by computer, without any human intervention or review of the information provided. Incorporating all these new companies generates annual revenues totaling hundreds of millions of dollars for the states.

The problem with incorporating nearly two million new U.S. companies each year—without knowing anything about who is behind them—is that it becomes an open invitation for criminal abuse. Take a look at a few websites from firms in the business of incorporating companies around the world. [Show chart.] This website from an international incorporation company promotes setting up companies in Delaware by saying: "DELAWARE—An Offshore Tax Haven for Non US Residents." One of the cited advantages is that "Owners' names are not disclosed to the state." Another website from a United Kingdom firm called "formacompany-offshore.com" lists a number of advantages to incorporating in Nevada. [Show chart.] The cited advantages include: "No I.R.S. Information Sharing Agreement" and "Stockholders are not on Public Record allowing complete anonymity." These are just two of dozens of websites that portray our states as welcoming those who want to operate U.S. companies with anonymity.

That type of anonymity is exactly what we've been criticizing offshore tax havens for offering to their clients. In fact, our last Subcommittee hearing lambasted offshore jurisdictions for setting up offshore corporations with secret U.S. owners engaged in transactions designed to evade U.S. taxes, leaving honest taxpayers to pick up the slack.

Some U.S. company formation firms advertise the same type of anonymity and take the same type of actions that this Subcommittee has been criticizing in the offshore community for years. Take a look, for example, at a Nevada firm called Nevada First Holdings. Nevada First advertises on the Internet, offering for sale "aged" or "shelf" companies that were set up in Nevada years earlier, pointing out that an older company can lend credibility to an operation. It sells these companies to anyone who can pay the price, without obtaining any information on the true owners of the companies, since it has no legal obligation to do so.

Nevada First offers a host of services to further shield the identity of a company's owners. For example, Nevada First employees can serve as a company's nominee di-

rectors or officers to enable the true owners to "retain a higher level of anonymity." A Nevada First employee, acting as a company officer or director, can provide his own name and social security number to open a company bank account or obtain an Employer Identification Number from the IRS, so the true owners don't have to. Nevada First will also allow a company to use Nevada First's own business address, and provide the company with mail forwarding and telephone services—all the bells and whistles needed to make a phony operation look like it is actually operating in Nevada. Nevada First told the Subcommittee that it has already assigned 1,850 addresses for "suites" within its offices to the companies it has formed, at least 850 of which are still in operation. None of those companies, of course, actually operates out of those offices. The potential for abuse in this situation is obvious, and is compounded by the fact that Nevada First is far from unique in offering these services—none of which, by the way, is illegal on its face. Key to this entire charade is the lack of any U.S. requirement to get the names of the true owners of the U.S. companies being formed.

Law enforcement officials testifying today are expected to describe how U.S. companies are being used for money laundering, drug sales, securities fraud, and other misconduct, and how, in too many cases, when law enforcement agents try to find out the company owners, they run smack into a blank wall. In most cases, the states that set up the companies asked no questions about the true owners and therefore have no ownership information for law enforcement to investigate. Here are a few examples of the problems that have resulted:

- Immigration and Customs Enforcement officials reported that a Nevada-based corporation received more than 3,700 suspicious wire transfers totaling $81million over 2 years, but the case was not pursued, because the agency was unable to identify the corporation's owners.
- The FBI told GAO that anonymously-held U.S. shell companies are being used to launder as much as $36 billion from the former Soviet Union. The FBI also reported that they have 103 open cases investigating stock market manipulation,most of which involve anonymously-held U.S. shell companies.
- The U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) reported that, between April 1996 and January 2004, financial institutions filed 397suspicious activity reports involving a total of almost $4 billion deposited in or wired through U.S. financial institutions by anonymously-held U.S. shell companies.
- A Department of Justice report revealed that Russian officials used anonymously-held shell companies in Pennsylvania and Delaware to unlawfully divert $15million in international aid intended to upgrade the safety of former Soviet nuclear power plants.

For decades, the leading international body fighting money laundering, called the Financial Action Task Force on Money Laundering or FATF, has warned countries not to set up companies without first finding who is really behind them. In a set of 40 recommendations that have become international benchmarks for strong and effective anti-money laundering laws, FATF has urged countries to identify the beneficial owners of the companies they establish. Recommendation 33 states: "Countries should ensure that there is adequate, accurate and timely information on beneficial ownership and control of legal persons"—that includes companies—"that can be obtained or accessed in a timely fashion by competent authorities."

The United States is a leading member of FATF and has worked with that organization to convince countries around the world to comply with FATF's 40 recommendations. Today, even a number of offshore secrecy jurisdictions such as the Cayman Islands, Bahamas, Jersey, and Isle of Man comply with the recommendation to identify the owners of the companies they establish. But the United States doesn't comply, and we just got formally cited for that failure in a 2006 FATF review of U.S. anti-money laundering laws. We now have two years to comply, or we risk expulsion from FATF which, by the way, the United States was instrumental in forming.

We shouldn't need the threat of expulsion from FATF to force us to address this problem. We should correct it for our own sake, to eliminate a gaping vulnerability to criminal misconduct. Criminals are using U.S. companies inside our borders to commit crimes. They are also using U.S. companies to commit crimes outside of our borders, which not only gives us a bad name but also means U.S. companies are being used to facilitate crimes related to drug trafficking, financial fraud, corruption, and other wrongdoing that harm our national interest.

Four reports issued in the past year describe the law enforcement problems posed by U.S. companies with unknown owners. The first is the *U.S. Money Laundering Threat Assessment,* a joint report issued in December 2005 by the Departments of

Justice, Treasury, Homeland Security, and others, to identify the most significant money laundering problems we face. It devotes an entire chapter to law enforcement problems caused by anonymously-held U.S. shell companies and trusts. Next was the April 2006 report prepared by the Government Accountability Office (GAO) at the request of the Subcommittee, entitled *Company Formations: Minimal Ownership Information Is Collected and Available,* which reviewed the laws of all 50 states, determined that most states have no information on the true owners of the companies being set up within their borders, and described a variety of related law enforcement concerns. A third report, issued in June 2006 by FATF, entitled the *Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America,* criticizes the United States for failing to obtain beneficial ownership information for U.S. companies and flatly states that the U.S. is not in compliance with this FATF standard. Most recent is a report released last week by the Department of Treasury's Financial Crimes Enforcement Network which focuses squarely on the problem of LLCs with unknown owners.

Together, these four reports paint a picture of rogue U.S. companies breaking laws inside and outside of U.S. borders, operating with inadequate government records that make it hard for law enforcement to find the companies' true owners, conduct investigations, and cooperate with international requests. It is difficult to judge the scope of this law enforcement threat, since we don't know how many companies are involved in wrongdoing. But if just one-tenth of one percent of the 12 million existing U.S. companies are engaged in misconduct, that means about 12,000 suspect companies are loose in this country and the world with no record of their beneficial ownership. That's an unacceptable risk to our national security and our treasury.

Our lax standards have also created problems for our country in the international arena. The United States has been a leading advocate for transparency and openness. We have criticized offshore tax havens for their secrecy and lack of transparency, and pressed them to change their ways. But look what's going on in our own backyard. The irony is that we don't suffer from lack of transparency—there is just no information to disclose. And when other countries ask us for company owners and we have to stand red-faced and empty-handed, it undermines our credibility and our ability to go after offshore tax havens that help rob honest U.S. taxpayers. It also places us in the position of being in non-compliance with the guidelines of the very international organization promoting our message of openness and transparency.

There are many possible solutions to this problem if we have the will to act. FinCEN is considering issuing new regulations requiring company formation agents to establish risk-based anti-money laundering programs which would require careful evaluations of requests for new companies made by high-risk persons. Another approach would be for Congress to set minimum standards, so that no state would be placed at a competitive disadvantage when asking for the name of a company's true owners. This nationwide approach would also ensure U.S. compliance with international anti-money laundering standards. Still another approach would be to expand on the work of a few states which already identify some ownership information, and ask the National Conference Committee on Uniform State Laws to strengthen existing model state incorporation laws by including requirements for beneficial ownership information, monetary penalties for false information, and annual information updates.

These and other solutions become possible only if we are first willing to admit there is a problem. I thank our Chairman, Senator Coleman, for his and his staff's strong support of this effort and for their ongoing work to help find solutions to the law enforcement problems created by anonymously-held U.S. companies.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Thank you, Mr. Chairman.

Senator LEVIN. Almost.

Senator CARPER. The once and future king.

Thank you, Mr. Chairman, and to Chairman Coleman as well, first of all for your diligence on your issue.

I want to welcome our witnesses today. Thank you for joining us and for your input.

I want to thank both Senator Levin and his staff and the Chairman of the Subcommittee for working closely with my staff, with

our Secretary of State's office in Dover, Delaware as you studied this topic and put this hearing together.

As some of you may know, this is an important issue in my State. Business in corporations and related fees account for roughly 25 percent of Delaware's general fund revenues. We have been successful, as Delaware Assistant Secretary of State Rick Geisenberger is going to put out later today, I think for a number of reasons. We have a very highly regarded judicial system and a commitment to excellence on the part of our elected leaders and Mr. Geisenberger and his staff, on the part of their predecessors as well. I continue to be proud that Delaware is the leading home of incorporations for businesses in this country.

I am also proud that Delaware has also been a leader in addressing some of the issues and the concerns that we are going to be discussing here today. In fact, our General Assembly passed legislation earlier this year that strengthens qualification standards for the firms that help businesses to organize or register under Delaware State law.

I hope we can come away from this hearing later today with a number of constructive ideas from Delaware and elsewhere on how we can prevent the varying State laws on business formation from being abused. Whatever solutions that we do pursue, it is important that we are careful though not to hinder legitimate business activity.

There are a number of reasons for us to encourage more transparency with respect to who is really in control of a business that might form in Delaware or might form in Michigan or might form in Minnesota. At the same time, we need to recognize that the vast majority of businesses set up in most States are created with absolutely no intention whatsoever of breaking the law. We do not want to do anything that would put so many burdens on legitimate business and the people in State Governments across the country who work with them that we see less economic activity and less job creation as a result.

So to my friend, Senator Levin, and to our Chairman, Chairman Coleman, I just want to say thanks again. Thank you for your commitment to getting to the bottom of this problem and for working constructively to find the right solutions or maybe the right set of solutions as we attempt to address them today and in the months ahead.

Thanks very much.

Senator LEVIN. Thank you very much, Senator.

We will now proceed to swear in our first panel.

I want to welcome the four witnesses, Stuart Nash, the Department of Justice's Associate Deputy Attorney General and Director of the Organized Crime Drug Enforcement Task Force; Steven Burgess, the Director of Examination of the Small Business/Self-Employed Division of the IRS; Yvonne Jones, Director of the Government Accountability Office's Financial Markets and Community Investment Team; and finally, Jamal El-Hindi, the Associate Director for Regulatory Policy and Programs of the Financial Crimes Enforcement Network, FinCEN.

I welcome each of you here today. We look forward to your testimony.

Pursuant to Rule 6 of the Subcommittee, all witnesses who testify before the Subcommittee are required to be sworn. At this time, I would ask each of you to please stand and raise your right hand.

Do you swear the testimony you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God.

Mr. NASH. I do.

Mr. BURGESS. I do.

Ms. JONES. I do.

Mr. EL-HINDI. I do.

Senator LEVIN. Thank you all.

We will be using a timing system today. Approximately one minute before the red light comes on you will see the light change from green to yellow, which would give you an opportunity to conclude your remarks. We ask that each if you limit your testimony to not more than 5 minutes to give us a chance to ask questions and to have time for the second panel. Your written testimony will be printed in the record in its entirety.

Mr. Nash, we will have you go first, followed by Mr. Burgess, then Ms. Jones, then Mr. El-Hindi. Thank you, Mr. Nash.

TESTIMONY OF STUART G. NASH,[1] ASSOCIATE DEPUTY ATTORNEY GENERAL AND DIRECTOR, ORGANIZED CRIME DRUG ENFORCEMENT TASK FORCE, U.S. DEPARTMENT OF JUSTICE

Mr. NASH. Thank you. My thanks to Chairman Coleman, to Senator Levin, and to all the Members of the Subcommittee. I am pleased and honored to appear before you today to discuss an important topic, the abuse of the company formation process in this country, especially in the context of the highly informative report that this Subcommittee commissioned from GAO earlier this year.

In the time that I have this afternoon, I would like to address how the abuse of the corporate formation process in this country has had a negative impact on our law enforcement efforts here and abroad. Corporate vehicles play an important and legitimate role in the global economy. Nevertheless, they may be used for illicit purposes, including money laundering, corruption, financing of terrorism, insider dealing, tax fraud, and other illegal activities.

The use of shell corporations to facilitate criminal schemes has evolved over time. Initially, in the 1970s and 1980s, criminals opened shell corporations and trusts in offshore jurisdictions to conceal their ownership of assets. They would then open bank accounts in the United States and abroad in the names of these corporations or trusts.

As banks and law enforcement began to scrutinize off-shore shell corporations more closely, criminals realized that they could obtain some of the same benefits of offshore corporations from U.S. domestic shell corporations with the added benefit that the U.S. corporations would not receive the same level of scrutiny.

The recent prosecution of Garri Grigorian illustrates this development. In the Grigorian case, a 43-year-old Russian national laundered $130 million on behalf of the Moscow-based Intellect

[1] The prepared statement of Mr. Nash appears in the Appendix on page 49.

Bank and its customers through bank accounts located in the small town of Sandy, Utah. As part of the scheme, Grigorian and his associates established three U.S. shell companies and then opened bank accounts in Utah in the names of these companies. The shell companies never did any actual business. They existed merely to provide a veil of legitimacy to explain the huge amount of money flowing through the U.S. accounts.

When Federal investigators tried to identify the beneficial owners behind these shell corporations, they learned that records from the pertinent Utah State agency provided only limited details. Public documents for two of the companies provided no information about the beneficial owners of the companies. While the records of the third company did identify an owner, no address other than Moscow, Russia was listed for that owner.

Subsequent investigation revealed that this so-called owner was nothing more than a straw owner in any case. State law imposed no obligation on anyone to verify in any way the information provided during the company formation process.

It was only because the true owners established bank accounts in the names of the shell companies, and the fact that the bank maintained information that was not maintained by the State agency, that the true perpetrators of this scheme were eventually identified.

The use of domestic shell corporations has continued to evolve. After the implementation of enhanced customer identification requirements that resulted from the USA PATRIOT Act, U.S. banks began to require more information about domestic corporations that opened accounts at their institutions. This additional scrutiny resulted in the most recent phenomenon, whereby criminals, domestic and foreign, are opening shell corporations in the United States and then opening bank accounts on behalf of these shell corporations in foreign countries where U.S.-based corporations have an aura of legitimacy and where U.S. anti-money laundering regulations do not apply.

Not only has the use of U.S. shell corporations hampered our ability to conduct our own criminal investigations, it has also frustrated our ability to assist foreign law enforcement agents. In cases where criminals use U.S.-based shell corporations to open foreign bank accounts, a foreign law enforcement agency investigating a crime within its jurisdiction may obtain information about the foreign bank that identifies a U.S. corporation as the account holder. Having identified a U.S. corporation, the foreign agency will seek assistance from the United States, most commonly through a Mutual Legal Assistance Treaty request to identify the beneficial owners of a U.S. shell corporation.

Our Office of International Affairs (OIA) has received an increasing number of incoming requests for assistance involving U.S. shell corporations. In 2004, for example, OIA received 198 legal assistance requests from Eastern European countries, of which 122 involved requests related to U.S. shell corporations. In 2005, these figures increased to 281 requests, of which 143 involved U.S. shell corporations. In most of these cases OIA, has had to respond by saying that the information about the beneficial owners of these U.S. shell corporations was simply unavailable.

Finally, I would like to address the impact of our corporate formation policies on our standing and reputation in the global community. In June 2006, the Financial Action Task Force (FATF), the preeminent multilateral group that addresses worldwide money laundering issues, presented its evaluation of the U.S.'s anti-money laundering regime.

Its evaluation confirmed that the United States had strong and effective money laundering laws, some of the strongest in the world. Nonetheless, FATF found that the U.S. anti-money laundering regime was noncompliant in areas implicated by today's hearing, including the States' collection and maintenance of information related to the beneficial ownership of companies formed in the United States.

Many foreign jurisdictions, including several that have in the past developed reputations as money-laundering havens, have taken steps in recent years to bring themselves into compliance with FATF recommendations in this area.

I conclude by expressing the gratitude of the Department of Justice for the continuing support that this Subcommittee has demonstrated to anti-money laundering enforcement. The Department believes that both the Federal Government and the States must continue to strengthen and adapt our anti-money laundering laws to confront new challenges in drug trafficking, terrorist financing, white-collar crime, and all other forms of criminal activity that generate or utilize illegal proceeds.

We look forward to working alongside our Treasury and Homeland Security colleagues, with this Subcommittee, and with Congress as a whole to address the issues identified at this hearing.

Thank you and I would welcome any questions you might have.

Senator COLEMAN [presiding]. Thank you, Mr. Nash. Mr. Burgess.

TESTIMONY OF K. STEVEN BURGESS,[1] DIRECTOR OF EXAMINATIONS, SMALL BUSINESS/SELF EMPLOYED DIVISION, INTERNAL REVENUE SERVICE, ACCOMPANIED BY ROBERT NORTHCUTT, ACTING DIRECTOR, ABUSIVE TRANSACTIONS OFFICE, SMALL BUSINESS/SELF EMPLOYED DIVISION, INTERNAL REVENUE SERVICE

Mr. BURGESS. Good afternoon, Chairman Coleman, Ranking Member Levin, and other Members of the Subcommittee. I am accompanied this afternoon by Robert Northcutt, the Acting Director of Small Business/Self Employed Abusive Transactions Office. He has first-hand knowledge of some of the issues that will be discussed this afternoon and will also be available for questions.

This Subcommittee has a long and distinguished history of investigating abuses of the tax code. Last August we held an important hearing regarding offshore tax shelters. But as you are already well aware, it is not just the secrecy laws in these foreign tax havens that can be exploited by persons to evade taxes or conceal transactions. Within our own borders, the laws of some States regarding the formation of legal entities have significant transparency gaps

[1] The prepared statement of Mr. Burgess appears in the Appendix on page 75.

which may even rival the ownership secrecy afforded in the most attractive offshore tax havens.

This domestic transparency gap is an impediment to both U.S. law enforcement and the enforcement of the tax laws in other countries. The lack of transparency inherent in shell companies, whether in the form of corporations, trusts, limited liability companies or other entities, enables countless numbers of taxpayers to hide their noncompliance behind a legal entity. This noncompliance would include such things as the non-filing of proper returns and the concealment of taxable income.

State laws govern the legal formation of business entities within respective State boundaries as well as the informational and reporting requirements imposed on such entities. While requirements vary from State to State, in each instance a minimal amount of information is required in order to form the new entity. Generally, information concerning the beneficial ownership of the entity is not required.

The money-laundering threat assessment, issued jointly by several government law-enforcement agencies late last year, cited three States as being the most accommodating jurisdictions for the organization of these legal entities: Delaware, Nevada, and Wyoming.

From an IRS perspective, we see two major problems arise as we investigate companies registered in these States. First, Nevada and Wyoming are the only two States that permit bearer shares, which are very effective in hiding corporate ownership. Bearer shares are issued by the corporation upon formation and actually deem ownership of the corporation to the holder of the shares. To determine ownership, one must actually find who has physical possession of these shares.

Second, the use of nominee officers in Nevada and Wyoming also make it easy for noncompliant taxpayers to establish a corporation and remain completely anonymous. While most States require that corporate officers have some meaningful relationship to the corporation, that is not required in Nevada and Wyoming.

We have authorized several investigations into promoters of Nevada corporations and resident agents. These investigations have revealed widespread abuse as well as problems in curtailing it. For example, our office has obtained client lists. They are being used as a source for potential non-filer audits. An initial sampling of the client list reflected a range of 50 to 90 percent of those listed were currently or have been previously noncompliant with Federal tax laws.

We have also seen instances where a promoter advises its clients to place their stock ledger and bearer shares in an offshore entity, thereby further ensuring that the identity of the beneficial owners remains anonymous, thus thwarting a Nevada requirement that the resident agents know the location of the stock ledger. If asked who owns a particular entity, the resident agent can say that all he or she knows is that it is owned by an entity in an offshore country.

There is also a problem for our tax treaty partners. Most of the tax treaty requests for exchange of information involving U.S. shell companies are received from Eastern European countries and the

Russian Federation. These U.S. shell companies, organized mainly in Delaware, Nevada, Arkansas, Oklahoma, and Oregon, are used extensively in Eastern Europe and the Russian Federation to commit value-added tax or VAT fraud. While assisting as much as we can, we are generally unable to determine the beneficial owner of these U.S. shell companies.

Moving forward, we are looking at a number of strategies to target the widespread tax noncompliance by many of the shell companies represented by resident agents and promoters. One of the key elements is the establishment of an issue management team (IMT), similar to teams we have formed in other significant areas of potential noncompliance. We also expect to continue audits of both promoters and their clients. We may also consider utilization of John Doe summonses to promoters similar to what we did with the credit card issuers that issued cards to offshore customers.

We will continue coordinating our efforts with those of other Federal agencies. The lack of corporate transparency is a problem for many governmental agencies, including the FBI, FinCEN, and the Department of Homeland Security.

In summary, Mr. Chairman, the issue of disguised corporate ownership is a serious one for the IRS in terms of its ability to enforce the tax laws and our efforts to reduce the tax gap. Our experience has shown us that the clearer the transaction and the identity and the role of the parties to that transaction, the higher the rate of compliance with the tax laws and the anti-money-laundering statutes.

I appreciate the opportunity to be here this afternoon, and Robert and I will be happy to respond to any questions you may have.

Senator COLEMAN. Thank you very much, Mr. Burgess. Ms. Jones.

Senator LEVIN. I wonder if I could just interrupt Ms. Jones for one minute? I know that I am speaking for all of us in thanking the GAO for this report, which really lays out the problems in very clear detail. The Government Accountability Office, as always, has performed an absolutely essential function for the Senate and we are grateful to you.

TESTIMONY OF YVONNE D. JONES,[1] DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT TEAM, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Ms. JONES. Thank you very much, Senator.

Mr. Chairman and Members of the Subcommittee, we are here today to talk about the information that is available on the ownership and management of non-public companies, corporations, and limited liability companies, LLCs. The majority of companies in the United States are legitimate businesses that carry out an array of vital activities. But companies can be used for illicit purposes like money-laundering or shielding assets from creditors. Government and international reports have said that shell companies have become popular tools for criminal activity because people owning or managing the company cannot easily be identified.

[1] The prepared statement of Ms. Jones appears in the Appendix on page 83.

In my statement today, I will talk about three main points. First, I will describe the ownership information that States collect and their efforts to review and verify it. Next, I will address the concerns of law enforcement agencies about how those companies are used to hide illicit activities. I will also discuss how information on those companies or the lack of it can affect investigations. Finally, I will discuss the implications requiring that States and others collect information on the owners of companies formed in each State.

Please look at the chart to your left on ownership information that States collect.[1] As you can see in figure one, in the map on the left, all States that are colored white did not require ownership information in the articles of incorporation. For periodic reports like annual reports, please look at the map on the right. None of the States that are colored white ask for ownership information in the reports.

Now please look at our next figure, which is Figure 2.[1] Figure 2 is the management information that States require on articles and periodic reports. In the map on the left more than half of all States, the white ones, do not ask for management information in the articles of incorporation. Roughly 25 percent of the States, the gray ones, require this information for LLCs only. For periodic reports, the map on the right shows that 28 States, the black ones, require management information for corporations and LLCs. Roughly a third of the States, the gray ones, require management information for corporations only.

Besides States, third-party agents collect information on companies for billing and for sending legal and tax documents. Most agents told us that they rarely collect information because the States do not require them to, and the States do not ask them to verify the information they collect.

A few agents said that they verify identities by asking for passports or checking against the OFAC lists.

States themselves do not review filings to verify identities. They review findings for accuracy of the information they request on applications.

Besides States and agents, a few other places might have information on company ownership and company management. Financial institutions have some information but they said that they already have significant reporting requirements to their regulators. The IRS is also a potential source but it does not have information on all companies. Also, statutes prevent sharing of some IRS information with law enforcement agencies.

Law enforcement agencies, we learned, feel some sense of frustration because they are unable to collect information that they need from the States and from third-party agents for many of the reasons that have been mentioned earlier.

Occasionally law-enforcement agencies can collect relevant information from State websites or articles of incorporation and sometimes they may find information about agent clients. Occasionally, some of the owners of these companies actually put their names

[1] The chart referred to appears in the prepared statement of Ms. Jones in the Appendix on page 84.

[1] Figure 2 referred to appears in the prepared statement of Ms. Jones in the Appendix on page 91.

and addresses on their incorporation documents or in their periodic reports.

To summarize, any requirement that States, agents, or both collect more ownership information would need to balance these conflicting concerns between law-enforcement officials, States, and agents. Those conflicting concerns include potentially increased costs that the States or the agents might incur if they had to collect more information. It might also require, in some States, that State statutes be changed. It may also require that data collection systems be changed in some States.

What would need to happen is that the conflicting concerns between law-enforcement officials and States and agents would need to be balanced and any changes would need to be uniformly applied in all U.S. jurisdictions. Otherwise, people wanting to set up shell companies for illicit activities could simply move to the jurisdiction with the fewest obstacles. This would undermine the intent of the requirements.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or other Members of the Subcommittee may have at this time.

Senator COLEMAN. Thank you, Ms. Jones. Mr. El-Hindi.

TESTIMONY OF JAMAL EL-HINDI,[1] ASSOCIATE DIRECTOR FOR REGULATORY POLICY AND PROGRAMS, FINANCIAL CRIMES ENFORCEMENT NETWORK, VIENNA, VIRGINIA

Mr. EL-HINDI. Thank you. Chairman Coleman, Senator Levin and distinguished Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the Financial Crimes Enforcement Network's (FinCEN) ongoing efforts to address money laundering and terrorist financing concerns associated with the lack of transparency in the ownership of certain legal entities.

We appreciate the Subcommittee's interest in this important issue and your continued support of our efforts to help prevent illicit financial activity.

I am also pleased to be testifying with my colleagues from the Department of Justice and Internal Revenue Service. Each of these agencies plays an important role in the global fight against money laundering and terrorist financing, and our collaboration on these issues has greatly improve the effectiveness of our efforts.

FinCEN's mission is to safeguard the financial system from the abuses of financial crime, including terrorist financing, money laundering, and other illicit activity. Key to our mission is the promotion of transparency in the U.S. financial system so that money-laundering, terrorist financing, and other economic crime can be deterred, detected, investigated, prosecuted, and ultimately prevented. Our ability to work closely with our regulatory, law-enforcement and international partners assists us to achieve consistency across our regulatory regime and consequently to better protect the U.S. financial system.

As mentioned in my written testimony, FinCEN has been evaluating the vulnerabilities to the financial system by the misuse of

[1] The prepared statement of Mr. El-Hindi appears in the Appendix on page 107.

legal entities. While a lack of detailed reporting or disclosure requirements under most State laws allows for expeditious formation of legal entities, this practice poses potential risks for money laundering and other financial crime.

In response to concerns raised by law-enforcement regulators and financial institutions regarding the lack of transparency associated with the formation of shell companies, FinCEN prepared an internal report in 2005 on the role of domestic shell companies, and particularly LLCs, in financial crime and money laundering. An updated version of this report was publicly released last week.

The study concludes that the lack of transparency in the formation process of shell companies, the absence of owner disclosure requirements, and the ease of formation of these legal entities make these corporate vehicles attractive to financial criminals to launder money or conduct illicit financial activity. This, in turn, poses vulnerabilities to the financial system both domestically and internationally.

That is why finding a way to address the misuse of legal entities in the context of the Bank Secrecy Act has been and continues to be a priority for FinCEN.

FinCEN is undertaking three key initiatives to deal with and mitigate the risks associated with misuse of legal entities. Concurrent with the findings of our report, FinCEN issued an advisory to financial institutions highlighting indicators of money laundering and other financial crime involving shell companies. The advisory emphasizes the importance of identifying, assessing, and managing the potential risks associated with providing financial services to such entities.

FinCEN is continuing its outreach efforts and communication with State governments and trade groups for corporate service providers to explore solutions that would address vulnerabilities in the State incorporation process, particularly the lack of public disclosure and transparency regarding beneficial ownership of shell companies and similar entities.

Finally, FinCEN is continuing to collect information and studying how best to address the role of certain businesses specializing in the formation of business entities and what role they might play in addressing the vulnerabilities that are the subject of this hearing.

In conclusion, Mr. Chairman, we are grateful for your leadership and that of the other Members of this Subcommittee on this issue, and we stand ready to assist in continuing efforts to ensure the safety and soundness of our financial system.

Thank you for the opportunity to appear before you today. I look forward to any questions you have regarding my testimony.

Senator COLEMAN. Thank you very much, Mr. El-Hindi.

You indicated that money-laundering and terrorist financing are the concerns, I just want to reiterate that. These are national security issues that are raised by the lack of transparency; is that correct?

Mr. EL-HINDI. That is correct.

Senator COLEMAN. Ms. Jones, you indicate that a majority of companies are certainly legitimate. This is not casting an aspersion. But the challenge then becomes, and the challenge of the Sub-

committee is how do we deal with the potential for abuse out there because of the lack of information? Mr. Burgess talks about the connection between transparency and accountability. If we had more transparency, we would get compliance.

I would presume on the next panel we are going to hear from folks who are going to talk about the importance of speed in these transactions and the fact that most companies are legitimate.

Help me figure out a way, I am trying to figure out a way that we work through this. Are there specific changes in Federal law that could be made. If you were in a position to simply change an existing statute, what would be the change that you would make to increase the measure of transparency, accountability, and compliance without undermining some of the business concerns that have been raised? Whoever wants to respond to that. To me, that is the $64,000 question.

Mr. NASH. Mr. Chairman, I think you are right, that is the $64,000 question. And we are not yet in a position to propose specific statutory fixes. I think, as you pointed out in your opening statement, there are a number of interests that need to be balanced here. And I do not want to minimize for a second the problem. The problem, from a law enforcement perspective, is a hugely significant problem and we are having investigations, and important investigations, that are hitting brick walls because there is no one out there that has the information regarding beneficial ownership that we need to pursue those investigations.

But certainly balanced against the magnitude of the problem are issues related to both federalism concerns with respect to the States, this has been traditionally an area that States have regulated at that level. And so I think a Federal response should be viewed as the last alternative, and we are not quite there yet to say that we are ready for the last alternative.

And then the third group of concerns is, of course, the fact that the vast majority of these corporate institutions are legitimate business institutions, and we would not want to be doing anything to disrupt the formation of legitimate businesses for legitimate commercial activities.

Senator COLEMAN. I want to just, if I can though, push back a little bit. And by the way, it is not just hitting a brick wall in our investigations, but it is impacting our relationships with other countries. Other folks are coming in and saying hey, can you give us information? Our answer is no, because we do not have it.

Mr. NASH. That is absolutely right.

Senator COLEMAN. I am still going to ask you to respond to my question for specific changes, but I will throw one additional question on the table. I understand the sensitivity about a Federal response, but it seems from what we have been looking at, reading the various reports, that one of the problems you have, absent a Federal uniform standard, is that the States who step forward to be accountable put themselves at a financial disadvantage. Is there a need for minimal Federal standards?

Are there some things that we can do at the Federal level that would provide a level playing field, would help us in our ability to get greater transparency, but would not undermine legitimate business activity? Mr. Burgess, would you want to offer anything here?

Mr. BURGESS. I echo the comments of my colleague. I think the sensitivity is while we have been discussing a number of issues, there are not any one thing that I can propose. I would venture to say it is probably going to be a combination of a lot of factors. I heard one of my other colleagues from FinCEN talk about outreach. I know that there is efforts by the States in terms of understanding the problems it presents.

So I would venture to say there is probably no one solution. But I can say, not being in the policy arm of the IRS, I am not able today to offer you a recommendation.

Senator COLEMAN. Thank you. Ms. Jones.

Ms. JONES. Mr. Chairman, as you and the other Members of the Subcommittee are aware, our work actually focused on how companies are formed in each State and identifying the information which is currently collected. Given the State/Federal issue, it was actually outside the scope of our work to look at other possible options or changing existing laws.

Senator COLEMAN. And I understand the hesitancy. I am asking you to rely upon your own good common sense, without putting you at risk in terms of policy for department or anything. You have looked at the problem. You have studied the problem. I am just trying to get a little guidance here of a couple of things that we can put on the table and then we will ultimately sort it out ourselves.

Mr. El-Hindi, do you want to be a little bolder here?

Mr. EL-HINDI. I think what we are focusing on are the things that we can actually do within the existing statutory framework. And we have identified some things that we can do. Outreach and changing the culture of what is going on in the United States is key, and making sure that people are aware how these vehicles can be misused.

We also will be considering a regulatory approach in terms of trying to work with the Bank Secrecy Act and identifying ways in which its promotion of transparency and the entities covered under that could be used, as well.

You mentioned the issue of change in laws. One of the things that we point out in our study, in our preliminary study, is our preliminary assessment of the laws in place right now. Our study indicates that the States changing those laws to increase transparency does not necessarily lead to a flight away from those jurisdictions.

Senator COLEMAN. Thank you, Mr. El-Hindi. Senator Levin.

Senator LEVIN. I would like to ask you to be a lot bolder, frankly.

This has been a problem for how long, Mr. Nash?

Mr. NASH. Well, there has never been a regime in place where beneficial ownership——

Senator LEVIN. I am talking about law-enforcement's problem in getting information it needs. How long has that been a problem?

Mr. NASH. I think it has been a problem since at least the late 1970s and probably before.

Senator LEVIN. With the IRS, Mr. Burgess, how long has this been a problem?

Mr. BURGESS. I think the first State to pass that statute was in 1977. So I would say starting from that point forward.

Senator LEVIN. When can we expect some recommendations from the Executive Branch to get at this problem, which is we cannot

determine who the real owners are of corporations. Therefore, they not only escape tax liability but it opens up the misuse of corporations to abuse, to money laundering and so forth. When can we expect some specific recommendations from your agencies?

Mr. NASH. There has been a multi-agency task force that was set up right in the wake of the FATF finding that found us non-compliant with respect to Recommendation 33. They are in the midst of putting together their thoughts on this and coming up with a recommendation. I cannot give you a time frame as to when their work will be completed, but I do not want you to come away from this with the impression that this is a matter that the Administration is throwing up their hands and identifying the problem and not going to be in a position to come forward with recommendations. I fully expect we will have recommendations. I just do not have them for you today.

Senator LEVIN. Could you give us some kind of an idea as to when those recommendations would be forthcoming?

Mr. NASH. Other then to tell you that the time frame that FATF has given us to come within compliance is—they are going to look again at us in 2 years. And so clearly we want to be in a position to present any recommendations to Congress well in advance of that 2-year time frame. I would expect you could expect something within the next calendar year.

Senator LEVIN. Mr. Burgess, when is the IRS going to give us some recommendations to address this law-enforcement problem which you and Mr. Nash have very appropriately described as a very significant law-enforcement problem?

Mr. BURGESS. Senator, one of the things we have underway, as I mentioned in my testimony, is an issue management team. And that is a collection of issue specialists from every realm. And what we are doing is looking into the scope of this, trying to basically size the problem up from every angle.

One of the outcomes of that team would be recommendations going forward through our legislative channels through Treasury.

As to an exact time frame when they will work their way to this Subcommittee, I cannot give you an exact time. Hopefully, it would be some time during the next year, in terms of those being obviously shared with Treasury. There is a lot of discussion.

One thing I might share with you—I know there was some preliminary discussion in preparation, and we have given a lot of thought to this—about things that we could currently do? One of the suggestions was requiring when someone requests an Employee Identification Number to also reveal who the beneficial owner is.

There is a lot of merit to that, but when you look at it, it is not quite so simple. First of all, all of these entities did not have to have an Employer Identification Number. The second thing is ownership of these entities changes. We have no way of tracking ownership. Some of the things that I described in my testimony, like the bearer shares and some of the other things, are frequent by changing.

The third problem, as Ms. Jones discussed in her testimony, is that the information would become part of tax-related information. Certainly under Section 6103, it could not be freely disclosed. So what I am saying is sometimes under the surface of things, it is

not quite so simple. But we are definitely pursuing the issue and there is much discussion going on in terms of ideas we can hopefully advance to you.

Senator LEVIN. There is always complexity to issues. There is not an issue that I know of that we deal with that is not complex. But you have been dealing with this problem for two decades or more.

I think the people who pay taxes in this country and who are abused by money laundering and who are less secure because of the abuses of money laundering and other problems have a right to our agencies and to us acting. And it is not good enough, frankly, to simply say you are studying it and it is complex. Been there, done that.

I think we ought to expect from your agencies some kind of an estimate as to when we could expect proposals to address problems which you acknowledge. I mean, we have a GAO report which is one of a series of reports. Your agencies have come up with reports. We all know it is a major problem. Your testimony is clear about the problem. And it seems to me that we have a right to expect from your agencies an estimate as to when you will be proposing corrections for what are acknowledged to be significant threats to our financial security and to our national security.

Can we expect that you would tell us for the record, after going back and consulting with your agencies, approximately when we could expect recommendations? Is that a request, Mr. Nash?

Mr. NASH. That is a fair request.

Let me just say, Senator Levin, that one reason you have not got requests before now is that it is only recently that this has become the largest problem that we face in the realm of trying to get information related to money laundering investigations, in large part because of the good work of this Subcommittee and Congress, in general. Up until now or up until very recently the significant problem was getting information out of financial institutions. And a number of the measures that were passed in the PATRIOT Act and in response to law-enforcement concerns in this realm that have come up in recent years have taken some of the more significant issues off the table that have left this as a very significant issue that is yet to be addressed.

I just throw that out in defense of our agencies and that this has gotten to the top of the to do list only because some of the more significant issues that were above it have gotten crossed off.

Senator LEVIN. My time is up. Thank you.

Senator COLEMAN. Thank you, Senator Levin. Senator Carper.

Senator CARPER. Thanks, Mr. Chairman.

Ms. Jones, thank you for your testimony and for the submission and the work that GAO has done.

On page 12 of your testimony, I read in bold print on the left-hand margin of that page. It says more company ownership information could be useful to law-enforcement but concerns exist about collecting it. And then you have four bullet points along the side of the second half of that page.

Just run through those again for me. And what I am really interested in are what are those costs? What are the benefits if those costs are incurred by States and others? And are the benefits worth the costs?

Ms. JONES. Senator Carper, I can speak about the costs. We actually did not try to do a cost-benefit analysis but I can give you a little bit more detail about the costs that the States could incur.

First of all, a number of States told us that it could require more time, therefore more staff effort. That is where the cost comes in. It could increase the workloads for State offices and agents if they were required to collect more information.

Because a lot of companies place a lot of emphasis today on creating corporations in a short amount of time, the States were concerned that requiring more information could mean that some companies would feel that the amount of time required to create the corporation might not be worth the effort to do so.

Some of the State officials felt that they could lose State revenue, particularly if all 50 States information requirements were not uniform. They felt that the States with more stringent requirements could lose business to other States or to other countries.

And they also mentioned that there might be a loss of business for agents because individuals can form their own companies. They might choose that option. And agents also thought that it could be difficult to collect and verify more company information if they were required to do so.

Senator CARPER. This is sort of an observation. We are reluctant in Congress, on the part of the Federal Government, to impose unfunded mandates on States, ask them to do certain things and to incur certain costs, unless we know what those costs are somehow made up for.

I agree with you that there are costs, and I think you have summarized them pretty well. It would be interesting to know what the benefits are and how we could quantify those relative to the costs.

I do not know who to direct that to but I would just raise that as an issue.

I would like to ask, and this can be for anyone on the panel, are you all aware of any States that have taken action on their own to address some of the problems in their laws on business formation, on incorporation and registration of new businesses, that can lead to things like money laundering and to tax evasion?

Mr. EL-HINDI. With respect to Delaware, for example, we have completed our initial assessment in 2005. And part of the update of our study for the public release enabled us to assess changes that had occurred in Delaware. It is referenced in our report where, for example, standards of conduct with respect to corporate agents or corporate service providers were bolstered. That is one step, we would say, in the right direction. And we use that as an example of pointing out how outreach to the States and discussing with them this problem can lead to some developments.

Senator CARPER. Are there other States that you picked up as you updated your study?

Mr. EL-HINDI. I could get back to you.

Senator CARPER. Would you do that for the record, please? Thanks. Anybody else?

I think, Mr. Burgess, it was in your testimony that you singled out several States—I think Nevada, Wyoming, and Delaware—as three States that are—I think your term was most accommo-

dating—for those businesses that might want to hide their ownership information for one reason or another.

Is there some reason why these three States or maybe some others should be singled out? Is there any legitimate reason for some of the features these States and others might have in common?

Mr. BURGESS. Let me speak first to Wyoming and Nevada. They are two States that have a number of registered agents that can also serve as nominees, nominee officers, as well as the registered agents, which is unique to that particular State.

There are also, as I mentioned in my testimony, two States that also allow the issuance of bearer shares, meaning that anyone who physically is in possession of those is in ownership of the corporation.

In reference to Delaware, the reference there was primarily due to the requests we receive from our tax treaty countries. Delaware is prominent in that. And one of the reasons it might be, and I will offer this, is because Delaware obviously has a status in terms of being recognized in terms of a U.S. corporation. I think that might be one of the reasons. But there is a prominence. And I was really speaking, when I spoke of Delaware in the testimony, in that regard. It tends to be one of the States that tends to be favored as shell companies are actually sold and resold to others outside of this country, in Eastern Europe and the Russian Federation. It is one of the States that tends to be one of the largest recognized in those requests that we receive.

Senator CARPER. Anyone else want to comment on that?

Would you repeat your answer, Mr. Burgess? [Laughter.]

Mr. BURGESS. That is like asking me to reach over and hit that third rail.

Senator CARPER. I did not count the number of times I heard the term beneficial owner mentioned, but I heard it a lot. And there are obviously beneficial owners and then there are other owners. Can somebody give us a primer on the difference between beneficial owners and some of the other categories of ownership? Why do we focus so much on beneficial ownership?

Mr. BURGESS. Just quite simply, I would say a beneficial owner is actually the person in control—that actually possesses the control over the operations of the corporation. It directs its activities. In many cases, that may not be what appears on the surface. You have a president, for instance, that may be a nominee officer. But it is the person that truly exercises control.

Senator CARPER. My time has expired.

There is a second half to my question. Mr. Chairman, could I just ask them to answer the second half?

Senator COLEMAN. Absolutely.

Senator CARPER. Just mention, other than beneficial ownership, what are some of the other categories of ownership that we should be mindful of?

Ms. JONES. There are directors and managers of corporations and limited liability companies and they can also exercise a high degree of control. So it is important to know who those people are, too.

Senator CARPER. OK, thank you very much.

Senator COLEMAN. Ms. Jones, I think it is very fair to say that your report, particularly the conclusion, is very balanced in the

end. You lay out that on the one hand there are legitimate concerns that are raised by the States. On the other hand, we have a situation here where there are deep concerns, legitimate concerns that law enforcement has.

Let me ask you, in your conversations—I want to get back to solutions if we can. In your conversations with the States, did any of the State officials offer up any ways in which the system could be improved? Did they offer some solutions? I recognize the concerns they have, as I do, about unfunded mandates. But did they come up and say here are some things I think we could do that we are not doing today?

Ms. JONES. Senator Coleman, we spoke to a number of States in the course of doing our work. And at the moment I do not actually recall that any particular State offered solutions. But I would be happy to get back to you on that.

Senator COLEMAN. I would appreciate it if you would. Again, as I said, the report does a very good job of laying out this balance.

INFORMATION PROVIDED FOR THE RECORD FOLLOWS:

Question from Senator Coleman: In your conversations with the States, did any of the State officials offer up any ways in which the system could be improved? Did they offer some solutions?

Response of Ms. Yvonne Jones for the record: In our interviews with State officials, we heard of potential changes to the system from one State, Delaware. We learned in our interview with Delaware officials that the Corporations Division of Delaware's Department of State was discussing with the State legislature various approaches to enhancing the State's authority to oversee registered agents. One approach they were discussing would be to require the Secretary of State to verify the ability of a registered agent to serve process. If the State found that the agent did not have the ability to serve process, then the State would refuse to certify the individual or entity to be a registered agent. Another approach would define specific information about Delaware business entities that registered agents must maintain. They also were discussing the idea of requiring registered agents to know beneficial owners and maintain the ownership information but the economic impact on Delaware was a concern. An official said there was some consensus, however, that registered agents should at least know who seeks their services. An official said another idea discussed with the registered agent community was to have the State license registered agents in Delaware, but the State had not explored what the cost implications of this option would be. The official noted that another idea might be to turn the licensing of agents over to the industry. The official said that both options could pose problems for the small registered agents.

Senator COLEMAN. The problem is the status quo does not reflect the balance. The status quo reflects the concerns. And certainly, as the report indicates, they are very legitimate concerns. But it does not then say is how we are going to address those concerns, here is what we are going to do to deal with the potential we have for money laundering, the potential we have for hiding assets. The problems with nominees, of not knowing who the beneficial owner is. In Nevada, as I think you indicated, Mr. Burgess, there is no requirement that the person listed in the company registration have any connection with the corporation. So you have a sham, a shell owner. That is the problem. You can have shell ownership and no way for law-enforcement to understand where the money is coming from?

So how do we close this information gap—we load up our banks with a whole range of reporting requirements to combat money

laundering. It seems to me we have a big hole here. We have a big hole. And I am looking for some way to fill it, being sensitive to the concerns that are raised.

So please, I would ask you to go back, and if there have been specific recommendations, give them to us because we need that.

Mr. Burgess, there has been, I think, a number of individuals. Mr. El-Hindi talked about outreach at least as one of the things that can be done.

Does the IRS has some responsibility? Who is going to do the outreach? If you are going to talk to States and the private sector about some of the concerns and the danger here, who has the responsibility of doing that?

Mr. BURGESS. Within the IRS, we have a stakeholder group, and we do have a working relationship with the States. And let me say, I have not found the States to be uncooperative. I do not think that is the issue that we are saying from that standpoint. But certainly, we do have an arm that can do outreach.

I think one of the other things that the issue management team that I explained to you would also explore is whether there is a role for outreach to the registered agents here? One of the things that I highlighted in my testimony was dealing with registered agents, who also serve as nominees and nominee officers and others. Is there a role there in terms of outreach that we can do with their organization regarding potential guidelines they can mandate for themselves within their own industries.

Senator COLEMAN. I would urge then that we go back and look at this issue of outreach and figure out who has some responsibility and then be prepared to move forward on that. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

We have to get some more examples of these problems that you have summarized in your testimony. And I think there are some folks with you today who can describe to us some specific incidents, examples, cases. Mr. Burgess, are there one or more people with you, for instance, that could tell us what IRS is up against? And then I will turn to you, Mr. Nash.

Mr. BURGESS. Yes, Senator. I have Robert Northcutt accompanying me today. Robert has first-hand experience in dealing with some of these transactions. Robert is our Director of our Abusive Transactions Office. I would be happy to have him answer.

Senator LEVIN. I wonder if you could give us your name. Do we need to swear him in? I am not sure.

Senator COLEMAN. I think we need to.

Do you promise that the testimony you are about to give before the Subcommittee is the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. NORTHCUTT. I do.

Senator COLEMAN. You may proceed.

ROBERT NORTHCUTT, ACTING DIRECTOR, ABUSIVE TRANSACTIONS OFFICE, SMALL BUSINESS/SELF EMPLOYED DIVISION, INTERNAL REVENUE SERVICE

Mr. NORTHCUTT. Yes, sir, you asked my name. It is Robert Northcutt. Currently I am the Acting Director of Abusive Transactions with the Small Business/Self Employed Division.

Senator LEVIN. Of the IRS?

Mr. NORTHCUTT. Yes, sir, with the Internal Revenue Service.

In addition, I am a program manager who is overseeing this particular issue management team that was discussed by Mr. Burgess. It is something that originated approximately 4 or 5 months ago, and essentially what has occurred is, under Code Section 6700 of the Internal Revenue Code, we are allowed to go ahead and pursue promoter investigations.

We have pursued a couple of these investigations with respect to some of these registered agent or nominee incorporating service businesses. We have, at present, a cooperative promoter and an uncooperative promoter. With respect to the cooperative one, we have managed to secure a list of its clientele for every other letter of the alphabet. In fact, we did a non-statistical sample of one letter of the alphabet. And in checking the records of corporate filings and other information, we discovered that roughly 50 percent of the entities that have been formed under the letter O, in fact, had compliance problems, some of them rather extensive.

In one particular case, there were even Federal contracts that had been entered into with various Federal agencies. And this corporation, in fact, was not filing tax returns, and the 100 percent shareholder was not filing tax returns, to the extent of several million dollars.

With respect to the uncooperative registered agent promoter, the difficulty we have is we are not getting access to its clientele. And so we are actually having to go in and trace the money as far as the funds this registered agent received for setting up these corporate entities, and then go backwards from where the money originated, identifying the entities that are actually involved. In that particular case, we are seeing an even higher incidence of noncompliance with the Federal tax laws.

We have recently canvassed our revenue agents and collection officers in the field with respect to obstacles that they have encountered and some of the issues that they have observed. With respect to our collection activities, it is extensive in the sense that any time we have a nominee or shell corporation, it presents an obstacle in trying to levy or lien assets upon which we can collect tax deficiencies. Some of these have recently involved listed transactions, specifically an intermediary transaction, that falls out under Notice 2001–16.

But in addition to that, we have seen these nominee and shell corporations set up to facilitate employee stock option plans, Roth IRA schemes, corporation sole, obviously offshore credit cards and debit cards, LLCs that do not file returns because they, in fact, have a separate filing requirement.

With a limited liability corporation you have what is called a "check the box." You can operate as a sole proprietorship, a partnership, or a corporation. And depending on how the box is checked, it will have a different filing requirement.

Senator LEVIN. The transactions that you made reference to, you are talking there about tax shelters?

Mr. NORTHCUTT. Yes, sir. I am sorry.

Senator LEVIN. But all of these items that you just rattled off, each of those could have some real tax compliance problems?

Mr. NORTHCUTT. That is correct, Senator. And there are other items, as well, and it is not just with respect to Federal taxes. We have also observed situations in which parallel corporations will be established, one with an operating business in one State and then a shell corporation in another State that perhaps has some of the difficulties we have described. And what will occur is the shell corporation will act as a management company for the operating business, and funds will then be transferred from the operating business to the shell corporation.

As I am sure you are aware, there is not a requirement for a 1099 reporting or anything like that between corporations. So the only thing we observe is a canceled check or wire transfer to a separate corporation. In the event that we are looking at the operating company, to conduct an examination, to prove the expenses we would obviously ask for a receipt, an invoice, those kinds of things.

In this environment, those documents are easy to prepare and appear legitimate for our examiners who are looking at the operating company. Very rarely would we have that same examiner cross State lines to examine the company that received the funds or even, for that matter, pursuing whether or not it had, in fact, filed a tax return.

Those are some of the additional things. We have also warehouse banking arrangements, offshore brokerage accounts. And in fact, as I was pointing out, the State schemes are not just defeating our purposes. They also defeat the State income tax and sales tax activities.

Senator LEVIN. The lack of the ownership information here is one of the key problems that you face in tracking and tracing these transactions; is that accurate?

Mr. NORTHCUTT. Yes, sir, it is. That is very accurate, Senator.

Senator LEVIN. So what you need is to know who the beneficial owners, who the real owners are of these entities, and that is not available to you?

Mr. NORTHCUTT. That is correct, Senator.

Senator LEVIN. You can do the tracking if you can find out who the beneficial owners are; is that correct? In other words, the key issue—and this is where, Ms. Jones, it seems to me we have to come back to you. You talk about listing and verifying. I think they probably, for starters at least, would be happy just to have a list of the beneficial owners so they can track these folks down. But if they are using nominees or agents that are registered agents that have no ownership interest or they are using lawyers who say that is a privileged transaction or a privileged matter as to who the owners are, they run into blank walls.

So when you look into cost benefit, which is obviously relevant, you should look not just at the cost of listing, which seems to me to be nominal, but the look at the benefit to knowing who the beneficial owners are. A number of States do it and we insist that other countries do it. And a lot of the tax haven countries do it. They tell us at least they have the information. They will not tell us, but they have the information as to who the beneficial owners are.

We cannot get the States to list the beneficial owners, not even getting to the verification issue, which involves a cost because there is transfer involved and so forth.

So when you go back and look at this on cost benefit, I hope you will look not just at cost of listing and verifying, but just the cost of listing to give at least a leg up to our law-enforcement people so they can start tracking. And of course, if they list fraudulently, or if they do not list the real owners, then you have a fraud issue. You have a false information issue with the local government.

Your testimony, Mr. Burgess, is extreme helpful.

I am way over. Senator Carper, I am holding you up, too.

Mr. Nash, do you have someone here with you who can do the same thing here and give us specific examples?

Mr. NASH. I am afraid I do not have anyone to take my place, but there is one category of cases that I do not think has received quite enough attention in this discussion that I would like to just discuss briefly, which is the terrorist financing cases. I am not sure anyone has quite outlined for the Subcommittee yet why it is that this poses a particular issue in the area of terrorist financing.

That is, as you know, Senator Levin, the way our statutory regime is set up with respect to terrorist financing, it relies on a designation process. And through the State Department and through OFAC, certain entities are named and designated as entities that our government believes are terrorist organizations. And financial transactions with those entities, those designated entities, are therefore prohibited. It is prohibited to give material support to those organizations. And if they appear on the OFAC list, it is a crime to engage in any financial transactions with them.

When you focus on that, it is very easy to see how this particular problem that we are talking about today becomes such a problem in the area of terrorist financing, because obviously a terrorist organization that finds themselves on the State Department list or on the OFAC list, the first thing they are going to want to do is establish an alter ego that is not designated and that to the world is a clean face that can engage in financial transactions and the world can engage in financial transactions with that entity without the stigma of dealing with a designated terrorist organization.

And so in that realm, it is very important for us to be able to track beneficial ownership with respect to company formations so that we can track that back to a designated terrorist organization.

Senator LEVIN. To whom the real owners are, which will be the terrorist organization in your example; is that correct?

Mr. NASH. That is right.

Senator LEVIN. And if they just, for instance, buy an old shell corporation or have it formed by some company that forms corporations for $100 over the Internet, then they appear to have a clean company. It is not on the list. But the real owner, the beneficial owner, is the terrorist organization.

Mr. NASH. That is right.

Senator LEVIN. And unless the beneficial owner, that terrorist organization, is listed, law enforcement is frustrated. Is that correct?

Mr. NASH. That is correct.

Senator LEVIN. Thank you. Thank you, Mr. Chairman.

Senator COLEMAN. Thank you very much, Senator Levin.

I will excuse this panel. I want to thank you for your testimony.

If I could paraphrase a movie, "Houston, we have a problem." I am not sure that we have arrived at the solutions today but clear-

ly, particularly given the last line of questioning, Senator Levin, we clearly have a problem that needs to be better addressed.

I want to thank the panel.

Senator LEVIN. And if our witnesses could let us know when those recommendations would be forthcoming, we would very much appreciate it.

And Mr. El-Hindi, if you would let us know whether or not your organization is going to be issuing a regulation next year. Do we expect that?

Mr. EL-HINDI. I will follow-up with you on that. Something like that is certainly a possibility but it is one of many possibilities in terms of how we approach this.

Senator LEVIN. Can you fill us in for the record as to whether that is going to be forthcoming?

Mr. EL-HINDI. Yes, sir.

Senator LEVIN. Thank you, Mr. Chairman.

Senator COLEMAN. Thank you.

I would now like to welcome our second and final panel of witnesses to today's hearing. Richard J. Geisenberger, the Assistant Secretary of State for Delaware; Scott Anderson, Deputy Secretary of State for Commercial Recordings of the office of the Secretary of State for the State of Nevada; and finally Laurie Flynn, the Chief Legal Counsel for the Office of the Secretary of the Commonwealth for the Commonwealth of Massachusetts.

I would welcome each of you to today's hearing and look forward to your testimony.

As you are aware, pursuant to Rule 6, all witnesses who testify before this Subcommittee are required to be sworn. At this time I would ask you to all stand and raise your right hand.

Do you swear the testimony you are about to give before this Subcommittee is the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. ANDERSON. I do.

Mr. GEISENBERGER. I do.

Ms. FLYNN. I do.

Senator COLEMAN. We have a timing system. I think we have the new boxes there, by the way.

Senator LEVIN. What are they, Mr. Chairman?

Senator COLEMAN. I do not think you have to press a button for the sound to go on now. I think it is perhaps a little more automated there. High tech. We are getting very high tech, Senator Levin.

I believe that one minute before the red light comes on you will see the light change from green to yellow. So at that point please summarize your, testimony. Your written testimony will be printed into the record in its entirety.

We will start with you, Mr. Geisenberger, then go to you, Mr. Anderson. And finally we will conclude with you, Ms. Flynn, and then we will proceed with our questions.

Mr. Geisenberger, you may proceed.

TESTIMONY OF RICHARD J. GEISENBERGER,[1] ASSISTANT SECRETARY OF STATE, STATE OF DELAWARE, DOVER, DELAWARE

Mr. GEISENBERGER. Mr. Chairman, Members of the Subcommittee, thank you for this opportunity to testify on this important subject.

Delaware is the legal home to more than half of all publicly traded companies in the United States and 61 percent of the Fortune 500 companies. The reasons to incorporate in Delaware are compelling, as mentioned by Senator Carper, modern and flexible corporate laws, a highly regarded judiciary to name just a few.

More than 750,000 business entities representing every sector of our Nation's economy are registered in Delaware, from small mom-and-pop businesses, private investment vehicles, religious and charitable organizations, to large well-capitalized companies, from publicly held General Motors to privately held Cargill. Many Delaware legal entities are affiliated with such large firms and are created to facilitate the financings, alliances and investment vehicles in which those large businesses engage.

We commend the GAO for a generally balanced and factually accurate report highlighting the challenges involved in collecting beneficial ownership information and the role of third parties in the company formation process.

Unfortunately, it is our view that the money-laundering threat assessment and the FATF reports present a far less-balanced view. We take strong exception to the FATF's conclusion that Delaware encourages secrecy and its State policies are driven by "a powerful lobby" of company formation agents. Indeed, as shown in the GAO reports, no State does verification and no States collected true beneficial ownership information reaching down to the actual individuals that own equity and exert control.

To the contrary, Delaware's laws promote the efficient flow of capital by allowing businesses to order their affairs in ways that meet ever changing business conditions. Our laws reflect the input of corporate attorneys across the United States and are driven by a balancing of interests among companies, investors, law-enforcement, and others.

With respect to the role of company formation agencies and registered agents, for over a decade Delaware has applied standards of conduct to its online agents. The State has also led the Nation, enacting a new statute this year that sets enhanced qualifications for Commercial Registered Agents and creates procedures to put rogue registered agents out of business.

As for beneficial ownership disclosure, it is the view of Delaware that: One, a reporting system that includes public companies would be a logistical and costly nightmare for corporate America; two, that even a self-reporting system that exempted public companies and their affiliates would have immense verification costs and several definitional problems; and three, such a system would impose costs on legitimate private businesses that seem vast in relation to the benefits that are, at best, uncertain.

[1] The prepared statement of Mr. Geisenberger appears in the Appendix on page 115.

Indeed, FinCEN's recent report acknowledges that a system of self-disclosure of managers and members is easily thwarted because money-launderers will falsify identities and most U.S. investment strategies rely extensively on the use of other business entities as equity holders.

But perhaps the single greatest concern we have is the likelihood that the role of Delaware, and indeed the United States, would shift from that of providing an attractive investment environment for domestic and international capital, one that values privacy, efficiency and the ease of capital formation, to being replaced by one of having regulatory and investigative oversight of the equity holders of the millions of legitimate enterprises in the United States.

Indeed, we believe that reforms are best focused on enhancing the ability of government officials to follow the money through the financial services system and providing resources needed to investigate and deter illicit activities. Delaware's recent amendments are a step in the right direction and deserve consideration in other jurisdictions. We also recommend that the Federal Government study whether existing Federal laws should be augmented.

For example, to create the level playing field mentioned by Senator Coleman, the Federal Government could study the costs and benefits of gathering additional beneficial ownership information through the Federal Tax ID application process.

Delaware is merely one stakeholder in this issue. We recommend that any discussion of these issues have input from the countless large and small companies and investors that would be most affected by a beneficial ownership disclosure requirement. It is critically important to hear their voices on the relative costs and benefits of such a system.

On behalf of the State of Delaware, I thank you for this opportunity to share these oral comments and our written testimony and look forward to answering any questions.

Senator COLEMAN. Thank you, Mr. Geisenberger. Mr. Anderson.

TESTIMONY OF SCOTT W. ANDERSON,[1] DEPUTY SECRETARY OF STATE FOR COMMERCIAL RECORDINGS, OFFICE OF THE SECRETARY OF STATE, STATE OF NEVADA, CARSON CITY, NEVADA

Mr. ANDERSON. Thank you, Mr. Chairman.

Good afternoon, Mr. Chairman, Mr. Levin, and Subcommittee Members. My name is Scott W. Anderson. I am Deputy Secretary of State for Commercial Recordings for Nevada Secretary of State, Dean Heller.

It is an honor to be here before you today and I thank you very much for the opportunity to participate in this hearing.

My comments today will be a brief summary of the information included in my written presentation that was submitted earlier to the Subcommittee. To begin, I would like to qualify my written statement, included in your materials, regarding the GAO report "The U.S. Money-Laundering Threat Assessment and the FATF Report." My comments were strictly from a Nevada filing officer's

[1] The prepared statement of Mr. Anderson with an attachment appears in the Appendix on page 133.

standpoint and do not reflect the standpoint of others on issues outside the processes of the filing office.

The Commercial Recordings Division of the Nevada Secretary of State's Office is responsible for the processing and filing of the organizational and amendatory documents of entities organized pursuant to Title 7 of the Nevada Revised Statutes. Nevada's business friendly statutes, tax structure, liability protections, and commitment to service, and an active resident agent and service provider industry have all helped make Nevada a leader in the business entity formation.

Historically, the Commercial Recordings Division of the Secretary of State has been strictly a filing office with no regulatory authority over the entities on file. Documents are reviewed for statutory requirements for filing and if those requirements are present, the documents must be filed. Minimal filing requirements allow for ease of filing. No beneficial ownership information is or has been required for entities filing in our office.

Additionally, the information contained in the filings submitted is not verified.

In fiscal year 2006, the Commercial Recordings Division processed over 85,000 new entities and over 300,000 initial, amended and annual lists. Over 40,000 each of corporations and limited liability companies were formed last year.

The Secretary of State's Office provides electronic services for the e-filing of initial and amended annual lists which is available on our website. There are plans to develop online services for the filing of articles of incorporation and other filing processes.

The Secretary of State does not actively promote the advantages of organizing in the State of Nevada. The resident agents and service companies actively promote the State of Nevada. It is estimated that 60 percent of the filings received in our offices are submitted through use of a resident agent. The Secretary of State does not regulate the resident agents that do business with our office. It is my understanding that portions of the Model Resident Agents Act, as proposed by the National Conference Committee on Uniform State Laws, will be introduced during the 2007 session of the Nevada Legislature.

In regards to beneficial ownership, beneficial ownership information is not required for filing in the Office of the Secretary of State and therefore is not maintained by the State or by resident agents. Resident agents are required to maintain a copy of the stock ledger or a statement as to the location of the ledger and our Nevada Department of Taxation may have some beneficial ownership information from the annual business license filings it receives.

As noted in the reports, some beneficial ownership information may be present on the public record from the information required for filing and that is provided by those filing in our office. We have received no specific requests for beneficial ownership information from law enforcement agencies, and additionally we have received no complaints from law enforcement other than what was stated in the reports and the meetings preliminary to the report, such as the GAO report, that a lack of beneficial ownership information has impeded any investigation.

Nevada has been working on several of the issues that have been brought forth in the different reports. Proposed legislation for the prohibition of bearer shares and a limitation on the use of nominee officers, as well as the provisions of the Model Resident Agents Act, are expected to be introduced during the 2007 Nevada legislature. Additionally, in the 2005 legislative session, provisions making it a Category C felony to knowingly offer fraudulent documents in the Office of the Secretary of State, and requiring beneficial ownership information on certain transactions were passed.

Currently the Secretary of State is attempting to facilitate a meeting with the Resident Agent Association in the State of Nevada, the State Bar Association and State legislators to fully discuss the collection of beneficial ownership information.

The entire issue is of great interest to our office and we recognize the importance of being involved in assisting this Subcommittee in its work.

Thank you again for this opportunity to participate today and I would be happy to answer any of your questions.

Senator COLEMAN. Thank you, Mr. Anderson. Ms. Flynn.

TESTIMONY OF LAURIE FLYNN,[1] CHIEF LEGAL COUNSEL, OFFICE OF THE SECRETARY OF THE COMMONWEALTH OF MASSACHUSETTS, BOSTON, MASSACHUSETTS

Ms. FLYNN. Good afternoon. Thank you, Mr. Chairman, Senator Levin, and Subcommittee Members. My name is Laurie Flynn. I am Chief Legal Counsel to the Secretary of the Commonwealth.

I applaud the Subcommittee's efforts for providing a national forum to discuss the adequacy of public disclosure in the business entity formation process. I hope that Massachusetts' recent deliberations and resulting resolutions in this area will assist the Subcommittee in its effort to balance the need for beneficial ownership information with the privacy concerns of legitimate business interests.

By way of background, Massachusetts recently adopted a new corporation law, Chapter 156D of the General Laws. The act was the first comprehensive revision of the corporate laws in Massachusetts in over 100 years and was prepared by a joint task force of the Boston Bar Association and the Massachusetts Bar Association, aptly named the Task Force on the Revision of the Massachusetts Business Corporation Law.

The task force consisted of over 50 experienced corporate practitioners, members of the legislature and representatives of the Office of the State Secretary. The task force chose the American Bar Association's Model Business Corporation Act as the basis for its corporate statute because the act had been adopted in a substantial majority of States.

However, Massachusetts deviated from the Model Act in a number of relevant areas, including the role of the Secretary of State in the entity formation process and the type of information disclosed in business organization documents. Such differences reflect a carefully crafted balance between public interest in adequate disclosure and the privacy concerns of the business community.

[1] The prepared statement of Ms. Flynn appears in the Appendix on page 140.

With regard to the role of the Secretary of State, Massachusetts retained the authority of the Secretary of State to review documents for compliance with law. Such provision is the basis for the Secretary's ability to hold administrative hearings if information provided in organizing documents is inaccurate or otherwise fails to comply with law. The Model Business Corporation Act relegates State authority in this area to a ministerial function. So essentially, if anything is provided, you have to take it.

Second, the new act authorizes the Secretary to require more information in the formation process than is collected in a Model Act State. In Massachusetts, the articles of organization contain a supplemental information that includes a description of the business activity, the name and address of the president, treasurer, secretary, and each of the directors, the name and address of the registered agent, the location of the corporation's principal office, and the location of the office in the Commonwealth where certain records required to be maintained by the act will be kept. One of the required records is indeed a list of the names and addresses of all shareholders, in alphabetical order, by class of shares, showing the number and class of shares held by each.

The new act does not authorize the issuance of bearer shares nor does it permit the use of nominee directors and/or officers. With regard to nominee shareholders, though, Massachusetts corporate law recognizes registered and beneficial holders. Nevertheless, the statute contemplates that standard bylaws will contain explicit statements to the effect that the corporation will only recognize the registered holder for purposes of voting, dividend distribution and other shareholder actions and entitlements. The exception that proves the rule are the appraisal provisions of 156D, under which beneficial holders may assert statutory appraisal rights only if the registered holder has filed a nominee certificate with the corporation.

The Massachusetts Limited Liability Company Act, Chapter 156C, and the Massachusetts Revised Uniform Limited Partnership Act, contain similar provisions. Each requires the Secretary to review documents for compliance with law and requires the disclosure of managers or authorized principals and general partners. Each also requires the entity keep a list of members or limited partners in the State at the statutorily required office.

Furthermore, the limited partnership statute requires that such lists be made available to the State Secretary within five business days of receipt of a written request by the Secretary stating that said information is required in connection with an investigation or an enforcement proceeding.

These provisions, the ability to review for compliance with law, the identification on the public record of officers, directors, managers or principals—and not nominees—and the requirement that shareholder, member, or partnership lists be maintained in the Commonwealth accessible to the State Secretary, reflect Massachusetts' attempt to balance public interest in disclosure with the anonymity demanded by the institutional and individual investors in today's capital markets.

As I have not yet received any complaints from law-enforcement or from the business community and very few complaints from the public, I assume we have been successful.

I will just highlight, in response to your questions, a number of provisions that I think are helpful. Massachusetts has about 232,169 non-publicly traded corporations and 67,493 limited liability companies. The process for each of those in forming them would be for a document to be submitted with the appropriate information. That information would then be reviewed. If it was found to comply with law it would be filed. Once it is filed, it is scanned into our system, summary information is data entered, and it is available on the web, immediately by 7 o'clock that night.

The fees for forming a corporation are $275 if submitted in person or by mail and $250 if filed online. All documents are reviewed by both a clerk and an attorney. The fees for forming a limited liability company are somewhat higher, they are $500.

Again, Massachusetts does not collect beneficial ownership information during or subsequent to the incorporation process. That has been since 1951. Prior to 1951, we did collect that information.

We do, however, require that that information be maintained in the Commonwealth and accessible to law enforcement and the Secretary.

Massachusetts does not provide for third-party agents. We have only registered agents whose only role is to accept service of process on behalf of corporations.

We do not permit the use of nominee officers or directors. We do allow for nominee shareholders. We do not allow for bearer shares.

Massachusetts has not received any requests from law enforcement for beneficial ownership information in the last 5 years, and that may be because they can get that information directly.

One of the things that we have been determined to do as a result of these ongoing discussions with the Subcommittee and with the GAO is that the Secretary will file legislation in this upcoming session that will require limited liability companies and corporations to disclose members and shareholders to the State Secretary if, in his judgment, the public interest requires such disclosure. And we will require that disclosure must be made within 48 hours. Failure to provide such information will result in involuntary dissolution of the entity and the imposition of fines and penalties.

Last, I would like to say Massachusetts, after September 11, was notified that there were two nonprofit corporations that were suspected of funneling money to terrorist organizations and we promptly revoked their charters. We gave them notice, opportunity to be heard, and revoked their charters. So we have been somewhat more proactive in this area. Thank you.

Chairman COLEMAN. Thank you, Ms. Flynn.

I think it is fair to say that some of the things you are talking about are certainly movement in the right direction and we appreciate it.

Is it fair to say, by the way, across the board, Mr. Geisenberger, in Delaware you do not have bearer shares? That is not something that you allow in Delaware.

Mr. GEISENBERGER. Delaware law has never permitted bearer shares. We made it explicit in our statute in 2002, in response to the FATF report.

Senator COLEMAN. In Nevada, you are moving in that direction.

Mr. ANDERSON. We are moving in that direction.

Senator COLEMAN. Is there any question that bearer shares are problematic and should be prohibited?

Mr. ANDERSON. According to the Bar Association, in my discussions with the Bar Association, there has not been a large problem with bearer shares. However, because there is no prohibition of bearer shares in State law, there is this belief that there is wide use of bearer shares. So with that, they are proposing changes to legislation to prohibit the use of bearer shares in the State of Nevada.

Senator COLEMAN. I would question the accuracy of your statement that it has not been a problem. And I think everything that we have seen and we have heard confirms that the potential for abuse is great. But, again, I understand you are moving in that direction.

I am trying to find some common ground that everyone says we know this is a problem. Limitations of use of nominee officers, how is that handled in Delaware, Mr. Geisenberger?

Mr. GEISENBERGER. With respect to corporations, officers have to be natural persons and directors have to be natural persons. Shareholders can be nominees, and obviously in publicly traded companies they are almost exclusively nominees. With respect to limited liability companies, the managers and the members can be other business entities. And that is really the issue we are talking about here. Most investment vehicles in the United States, that is how they are structured. It is a business owning a business owning a business before you get to the actual human being that has the beneficial interest in the asset. And reaching down to that level raises lots of issues about costs and certainly questions about privacy and the legitimate anonymity of being able to—for everyone not to know exactly what you are invested in.

Senator COLEMAN. Ms. Flynn, in the Commonwealth of Massachusetts, do you have any limitations on the use of nominee officers?

Ms. FLYNN. Massachusetts does not permit the use of nominee officers or directors.

Senator COLEMAN. Mr. Anderson.

Mr. ANDERSON. It is common practice in the State of Nevada that there be nominee officers. However, the Nevada Resident Agents Association is looking at legislation in the 2007 session of the Nevada legislature to limit that use, and I do not know what that limitation would be? However, we are moving away from that.

Senator COLEMAN. Mr. Geisenberger, you indicated it would be important as we move forward, to bring in a broad array of stakeholders in this discussion. I agree with you on that. I do think we have to strive for the balance, but again understand that there is a problem today and one that exposes us, as we heard from the other panel, to risks—that you could have terrorist organizations and our ability to deal with those is an ID system. We know that this is a terrorist organization. And they literally can move in and

take over existing corporations without any risk of exposure. And I think that is problematic. To me it just seems like we have a big gaping loophole there.

A question, if I can, about Delaware law. You did mention that Delaware is doing some things dealing with registered agents. My question on that, and just from my information, please correct me if I am wrong, that the Delaware law dealing with registered agents which would require more stringent qualifications applies to—I have information that it applies to 237 out of 32,000 registered agents. Is my information incorrect?

Mr. GEISENBERGER. That is correct. There are 32,000 registered agents in Delaware. I would imagine they have very large numbers in other States, as well, because a company can form itself. Most registered agents in the State of Delaware, indeed the vast majority, represent three or fewer entities. Ninety-six percent of our 32,000 agents maybe just represent a civic association or a not-for-profit. They could be the company themselves, a small mom-and-pop business.

Senator COLEMAN. Your testimony indicated the new statute for registered agents would put rogue registered agents out of business. My only question is does this new statute apply to more than 237 out of the 32,000 registered agents?

Mr. GEISENBERGER. The new statute establishing additional qualifications, like having a business license, applies only to the 237. However, the statute allowing the Court of Chancery to enjoin a registered agent from doing business for not meeting certain qualifications about having an address, not meeting certain qualifications about retaining customer information, applies to all 32,000 registered agents in the State.

Senator COLEMAN. My time is up. I am going to come back to one other line of questioning but I will turn to my colleague, Senator Levin.

Senator LEVIN. Thank you.

Ms. Flynn, you said near the end of your testimony that the reason that there is not a request from law enforcement to your agency for the list of beneficial owners is that they can get that information directly?

Ms. FLYNN. That is correct. Massachusetts entities are required to maintain lists of shareholders, lists of limited partners in an LLC's instance, list of members at their principal office or statutorily required office in the Commonwealth.

Senator LEVIN. Is that true in Delaware?

Mr. GEISENBERGER. No, there is no requirement to maintain that list in the State of Delaware.

Senator LEVIN. So in one State law enforcement has access, in another State it does not have access to the beneficial owners. Why is that such a huge burden in Massachusetts? Obviously, it is not a huge burden, they are able to do it. So why do you think it is such a huge burden in Delaware?

Mr. GEISENBERGER. Massachusetts, to put it in perspective, I believe you form 25,000 new entities a year. We form about 135,000 new entities a year. The types of entities that we are forming in Delaware tend to be everything from large publicly traded companies to their affiliates. As I mentioned earlier, it may be possible

to create a requirement for director and officer, or even manager and member information.

I think it is important to recognize the distinction between manager and member information, director and officer information, and true beneficial ownership—an actual natural person who owns the business. So were you to go down that path and require that in Delaware, which is something that certainly could be examined, you would still end up with a list of other business entities being the beneficial owners or being the registered holders of these other businesses.

Senator LEVIN. Of course, but that allows law enforcement to track those other business owners.

Mr. GEISENBERGER. That is correct.

Senator LEVIN. It is important that we have that capability. And you do not seem to recognize the importance of that. You talk about the cost of it but you have another State and that did not turn out to be a very burdensome cost.

Mr. GEISENBERGER. I think it needs to be, as I mentioned in my testimony, balanced against the interests of privacy and efficiency.

Senator LEVIN. Don't they have those interests in Massachusetts?

Mr. GEISENBERGER. I do not have.

Senator LEVIN. Let me tell you they do. They care just as much about their privacy and efficiency as people in Delaware or all over the world that use Delaware or Nevada or anyone else. There is no difference in terms of human beings wanting anonymity or privacy, but they just do not allow it in Massachusetts. They say you can get to those owners by going to the companies that have registered agents.

So I do not know why you say that your privacy interest is any greater than any other States' concern for privacy.

Mr. GEISENBERGER. Our concern, and this is not unique to Delaware, I think it is a concern that we have generally from a national perspective, which is that if we create a requirement that says that the beneficial ownership of every business entity in the United States is a matter of public record or is easily accessible, that it creates a number of issues ranging from identity theft to not the technical publicly-traded securities definition of insider trading, but the possible use that information by the people who are collecting it, the resident agent community and others.

Senator LEVIN. That is not what anybody is proposing, it is a straw man. Just go to what Massachusetts does, try that. You say that could be done. That is helpful. Law enforcement finds that helpful. Why doesn't Delaware do it?

Mr. GEISENBERGER. Delaware does not do it because we have a concern—the reason the Secretary of State does not do it is because it is not part of our statute.

Senator LEVIN. Why do you resist?

Mr. GEISENBERGER. The reason we do not advocate it is a concern——

Senator LEVIN. Why do you resist it?

Mr. GEISENBERGER. We have resisted because we believe that there are legitimate business transactions and that the vast—as you mentioned, I believe, earlier in your discussion, there are 15

million business entities in the United States. If 0.1 percent of them are engaged in illegitimate practices and the other 99.9 are in legitimate enterprises, we have concerns about how that information put on the public record could be misused.

Senator LEVIN. Thank you.

Mr. Anderson, if you could take a look at Exhibit 1,[1] this is formacompanyoffshore.com that talks about Nevada company formations. It is one of those first four pages. I am not sure which of the first four it is but it is—we are going to put the board up there. I think you may be able to read it there.

It talks about Nevada. No IRS information sharing. Stockholders are not on public record, allowing complete anonymity. Do you see that that could create a problem for law-enforcement? That is advertised as why go to Nevada.

Mr. ANDERSON. The reason Nevada does not have an IRS sharing agreement is because Nevada does not have a personal or corporate income tax, and therefore we do not have information to share with the Internal Revenue Service.

Now all the information that we do require for filing is available to the Internal Revenue Service, just as it is available to any other person wishing to look at the public record.

Senator LEVIN. In terms of the ownership, stockholders are not on public record, allowing complete anonymity. That is one of the selling points for Nevada, as it is for Delaware and other States.

Mr. ANDERSON. I could see this as being a potential problem. However, resident agents are required to hold the stock ledger or a statement of where the stock ledger is located, so that law enforcement officers should be able to get that information.

Senator LEVIN. The actual owners?

Mr. ANDERSON. It is a list of the stockholders, the stock ledger that is part of Nevada revised statutes.

Senator LEVIN. Which could be nominees and other corporations; is that correct?

Mr. ANDERSON. Potentially, yes.

Senator LEVIN. If you would take a look at Exhibit 9,[2] perhaps both of you, representing both Delaware here and Nevada. This is a country comparison chart. This is people who are telling folks all over the world, "Hey, incorporate in these States and you will have no taxes and you will have anonymity."

Take a look at what it says here. Incorporate in Delaware and Nevada for top-notch privacy.

Can you see the problem for law-enforcement when that is peddled as the reason to incorporate in your States?

Mr. GEISENBERGER. I can tell you, Senator, that when we put together our statute this year, looking at the question of what should be the reasons that would allow our Court of Chancery to enjoin a registered agent from doing business, we looked at this issue because obviously it is this kind of—we certainly do not advocate this sort of promotion of Delaware. It is not how we promote Delaware.

Senator LEVIN. Are you troubled when Delaware is promoted this way?

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[1] See Exhibit 1 which appears in the Appendix on page 144.
[2] See Exhibit 9 which appears in the Appendix on page 352.

Mr. GEISENBERGER. I am very troubled that Delaware is promoted this way. Unfortunately, we could not come to consensus on a statutory remedy that would limit the free speech of these types of businesses. They are not prohibited.

Senator LEVIN [presiding].7 Try the Massachusetts approach.

My time is up. Senator Carper.

Senator CARPER. Thanks, Mr. Chairman.

Let me just say, by way of introduction, let me ask Mr. Geisenberger a question. Have you always worked in the Division of Corporations, Department of State?

Mr. GEISENBERGER. No, I have not.

Senator CARPER. Did you ever have a previous stint in State government?

Mr. GEISENBERGER. Yes, I had a wonderful stint in State government as the economic policy advisor for Governor Thomas Carper.

Senator CARPER. I knew I had seen you before. [Laughter.]

Senator LEVIN. I was distracted. Is there some kind of a conflict that I missed here?

Senator CARPER. I hope not.

It is great to see you. Thank you very much for your service to the people of Delaware. And thanks very much for being here today and joined by your colleagues, Mr. Anderson and Ms. Flynn.

Go back again and just take another minute and explain to us the changes that were made in Delaware law earlier this year. Why the State made those, why you think that is a good thing, and whether or not other States might want to consider doing something similar to that.

Mr. GEISENBERGER. I think to the points that were made earlier that outreach is important, and we have been doing a lot of work over the last 6 years, and we have had FinCEN and OFAC come to Delaware, meet with our registered agent community, educate them on what their responsibilities are. We have had discussions with the FATF, with the U.S. Department of Treasury and others about what kinds of things we could and should be doing.

In response to that, we decided to look at our existing registered agent statute and see what we could do. One of our biggest concerns, and we think it was a legitimate concern, was when law-enforcement said what happens if you have a bad registered agent? How do you get rid of them? And the answer was we had no mechanism within which to do that.

So we adopted a statute that said there are these qualifications. If you are in the business of being a registered agent there is certain information you need to provide the Secretary of State so that we know exactly who you are, so that we know who the people are who are doing business in Delaware. Again, those companies representing 50 or more entities.

We established a requirement that they have a Delaware business license which means they have to fill out certain tax forms in Delaware which give us more information about who they are. We established a requirement that every Delaware registered agent or that every company and every LLC and the State is required to keep with their registered agent the name of a natural person who is the communications contact for that business entity. So that when a law enforcement agency goes to a registered agent, the reg-

istered agent is not a dead end in the investigatory process. The registered agent has to have on file the name of the communications contact for that business entity so that law enforcement can continue down that trail.

And then we said if an agent is failing to do that, failing to retain this information, failing to have a business license, failing to have an office open for business during normal business hours, the Secretary of State can go to the Court of Chancery and get them enjoined from doing business in the State or their officers and directors.

This act takes effect January 1, 2007 and we look forward to enforcing it. There may be some registered agents in Delaware that may not be in Delaware anymore after we take certain actions.

Senator CARPER. Are there other changes? Delaware corporate law is dynamic and it changes from time to time and updated by the legislature and governor. Are there other changes that you foresee that might be considered along these lines?

Mr. GEISENBERGER. I think the question of whether Delaware would eventually require that a manager be part of the public filing is something that the State may consider, taking the input of corporate attorneys and others in the law-enforcement community. I think our biggest concern is requiring that every business entity in Delaware and in the United States then track that ownership down to the level of a natural person because in so many legitimate business transactions the managers and members are other business entities.

Senator CARPER. As Ms. Flynn reviewed the law in the Commonwealth, one of the questions I had, and I again direct it to Mr. Anderson and Mr. Geisenberger, did you hear anything there that she described and said that might make sense for us?

Mr. ANDERSON. Yes, Senator Carper. While it may make sense, it is something that I would definitely take back and discuss with our resident agents and with our business law section of the State Bar Association. The Secretary of State generally does not make the substantive changes to the commercial law and I would definitely have to defer to the business law section of the State Bar and the resident agents in regards to this.

However, in hearing some of the ideas brought forth from the State of Massachusetts and from Delaware, this is information that I can take back to them as part of our discussion.

Senator CARPER. Mr. Geisenberger, before you respond, Ms. Flynn as you heard your fellow witnesses from Nevada and Delaware testify with respect to what we do in our State and what they do in Nevada, does anything pop up for you that says they may want to do that differently and we have some ideas that might apply?

Ms. FLYNN. There are two things that I think I would suggest they do differently, and the first would be to change the way in which they review documents. I think presently both Nevada and Delaware, the review of documents submitted is a ministerial review, which does not give them room to determine that documents comply with law. So if there is something that appears unlawful on their face, they have no ability to take action. So I would suggest

that is the more appropriate standard for a corporate formation agency.

And second, I think that there are a number of things that they can do with regard to beneficial ownership. I understand the concerns that maybe investors do not want beneficial ownership on the public record, because everything in our office is immediately accessible online and there are some very strong privacy concerns. But I think that those concerns can be——

Senator CARPER. Could you give an example or two of one of those privacy concerns?

Ms. FLYNN. I will give you an example. Jerry Lewis was an officer and director of the Jerry Lewis Telethon. And at one point, under Massachusetts law he had to provide his residential address on filings with our office. That was fine when those documents were just microfilmed. But when those documents were now scanned and put out on the web for anyone to see, his home address became accessible to anyone who had the ability to do a little bit of searching and therefore his security was jeopardized.

Senator CARPER. Where does he live?

Ms. FLYNN. He has since moved.

And there are concerns of others, law-enforcement personnel and that type of thing, those types of people who necessarily do not want their home address on the public record, people who have been involved in peacekeeping in other countries who now return home where they do not want their addresses on the public record.

So one of the things that we did was to change from residential addresses to business addresses.

And with regard to beneficial owners, that list is not maintained in the Secretary of State's office where it would be public record but it is maintained in the Commonwealth and is accessible to law enforcement upon request and to the Secretary.

Senator CARPER. Mr. Chairman, if I could just bounce it back to Mr. Geisenberger, and if you have any response to the points that Ms. Flynn made and some areas that we might want to take under advisement in Delaware.

Mr. GEISENBERGER. First, I need to say that the review that Delaware officials take of documents is not a ministerial function.

Senator CARPER. How would you describe it?

Mr. GEISENBERGER. If there is something that does not follow the law, we reject the document or suspend the document until such time as the document comes into compliance with the law.

We get dozens of requests every single day in Delaware for beneficial ownership information. The typical phone call that I get is from somebody with a small-town newspaper in wherever it might be, North Dakota, saying we want to know who owns ABC LLC, a Delaware corporation. We will frequently ask why because we are kind of interested. And they will say well, they are trying to build a development and people want to oppose that development and we need to know who really owns it.

My concern about making this kind of information on the public record is that if that is the kind of thing—I think that could have tremendous economic impact on the United States. If we put information on the public record that will actually prevent legitimate businesses from assembling parcels of real estate, investing in var-

ious investment vehicles, if it creates situations where an investor wishes to invest in multiple funds that maybe compete with each other, and then everybody knows oh, that guy is invested in my competitor, which creates a lot of issues for the types of businesses that form in Delaware.

Keeping the record with the registered office is certainly something, as you know we have a Corporation Law Council, it is really something they can be reviewed by that Corporation Law Council. I think it raises a lot of issues because, as we said, one of the things we want to make sure of is that we are not inhibiting the free flow of capital and the ease of capital formation.

Frequently shares of corporations, certainly publicly traded companies, but even privately held companies, those shares freely flow to different owners every single day of the year. Even on an intraday basis. So the lists you are likely to have at the time that law enforcement makes a request, I think it would be very difficult for those types of business entities that have thousands of beneficial owners, or in some cases millions of beneficial owners, to be able to keep track of that in their registered office on a daily basis or an intraday basis.

Senator CARPER. My thanks to each of you and we appreciate your testimony and we appreciate your responses to our questions. Thanks so much.

Senator LEVIN. In Delaware now there is a communication contact. Is that what is required by law?

Mr. GEISENBERGER. That is correct. Every business entity must provide a communications contact to their registered agent.

Senator LEVIN. Does that person have knowledge of the beneficial owners?

Mr. GEISENBERGER. They may or they may not.

Senator LEVIN. They are not required to?

Mr. GEISENBERGER. They are not required to.

Senator LEVIN. Is there any reason not to require them to have the beneficial owners?

Mr. GEISENBERGER. I think it raises the same question I just mentioned to Senator Carper, which is that the beneficial owners frequently are changing on a regular basis, on a daily basis, and even an intraday basis for both corporations and for LLCs.

Senator LEVIN. Is that not true in Massachusetts?

Mr. GEISENBERGER. I believe it is. I do not know how many public traded or large companies——

Senator LEVIN. We are not talking publicly traded.

Mr. GEISENBERGER. Even large privately held companies.

Senator LEVIN. It is true in all the States, I assume? We all incorporate. Delaware may have more than others, but we all incorporate.

Mr. GEISENBERGER. It may well be true that the same situation exists in those other States.

Senator LEVIN. But if they are able to keep track of it, why cannot your communications person keep track of it in a non-public corporation?

Mr. GEISENBERGER. I will use an example. I mentioned Cargill, which is one of the largest privately held companies in the country. They have 2.7 billion authorized shares. They are not publicly trad-

ed. Those 2.7 billion shares are owned by thousands of individuals. I do not know how those shares trade on a daily basis or do not trade on a daily basis or get transferred to other individuals on a daily basis.

I think it would be difficult to keep that in the State of Delaware and to say to a resident agent "from now on you are the recorder of who are the owners of this entity at any given moment."

Senator LEVIN. Does anybody keep track of the beneficial owner?

Mr. GEISENBERGER. I would assume that Cargill keeps a shareholder registry of their own.

Senator LEVIN. Could not the communications person say go to Cargill?

Mr. GEISENBERGER. That would be the holder of record, not necessarily the actual beneficial owner.

Senator LEVIN. Does anybody keep a record of all of those beneficial owners, do you think?

Mr. GEISENBERGER. Certainly these large companies do not know the actual beneficial holders of trusts, LLCs and others that are the beneficial holders of shares in privately held institutions.

Senator LEVIN. Do most States require annual reports?

Mr. GEISENBERGER. Most States require an annual report of directors and some officers for corporations. Many States do not require an annual report for limited liability companies.

Senator LEVIN. So what you are saying is that when it comes to beneficial ownership in non-publicly traded corporations that there is no central place where those lists are kept inside the company? That is what you are saying?

Mr. GEISENBERGER. I am saying that the actual natural person that is the beneficial owner, no, there is no requirement.

Senator LEVIN. I am not saying requirement. There is no place inside that company where those owners are named and listed? That is the ordinary course of business, that inside a non-publicly traded company——

Mr. GEISENBERGER. There is no requirement to do so.

Senator LEVIN. I am not saying a requirement. I am saying that when a company is formed, a corporation is formed, that is not a publicly traded corporation, you are saying as a matter of common practice that there is no place where the owners of that company are listed?

Mr. GEISENBERGER. Typically an LLC, certainly one with one or two members, would have, in their own office, a record of who are the owners of that entity.

Senator LEVIN. Who would ordinarily keep the list of the owners of a non-publicly traded company? Would they not almost ordinarily have a——

Mr. GEISENBERGER. With respect to an LLC, it would probably be the manager of the LLC, which could be another business entity.

Senator LEVIN. Would the manager of a non-publicly owned company ordinarily keep a list of the owners of that company?

Mr. GEISENBERGER. They would keep a list of the owners or business entities that are the owners, yes.

Senator LEVIN. So is there any reason why your communications person could not let the law enforcement person know who the manager is that keeps that list?

Mr. GEISENBERGER. You mean require that the communications contact be the person that maintains that list?

Senator LEVIN. No, that they cooperate with law enforcement to identify who that owner is, who that manager is?

Mr. GEISENBERGER. It is certainly something to consider. I think it could be a requirement, that the communications contact is aware of the—is able to communicate with the manager that is tracking the holders of record. It is worthy of consideration, sir.

Senator LEVIN. That would be very helpful. Somehow or another we are going to have to crack this nut. It is not acceptable that we just simply say that we are not going to be able to identify the owners of companies and we are going to allow them to be anonymous and therefore do whatever nefarious action they might be engaged in. We are going to have to find ways and if the States cannot do it, it seems to me the Federal Government is going to have to have some kind of a minimal requirement to do it.

That is not a particularly onerous requirement, to say since there is a communications connection to a corporation that that person be able to identify the manager who keeps a list of the beneficial owners. There is no great problem in terms of an unfunded mandate in that regard.

Hopefully the States are going to do this on their own and recognize the importance to all of our security and all of our well-being that we know who these folks are who own these companies.

I do not think the purpose of a corporation ever was to provide anonymity. I used to study corporation law about 50 years ago, so maybe my memory is a little off. But we have checked with more current—with people who teach corporation law and that is not the purpose of a corporation, to provide anonymity to shareholders. It is to provide limited liability, it is to provide easy ability to transfer stocks, but it is not to provide anonymity.

We have people who file assumed name certificates who form companies, who form partnerships. Those are listed in our Secretary of State's offices and in our local clerks' offices. It is done all the time and should be done.

I agree and I understand the sensitivity about home addresses. I am 100 percent with Jerry Lewis, both in his telethon and in protecting his home address. Those addresses should be and are protected.

But in terms of the identity as to who the owners are of companies, I just do not think that we can argue that the owners of companies can incorporate, thereby protecting themselves from being identified from law-enforcement. The stakes are too high, it seems to me, in terms of law enforcement for us to accept that as the rule.

I would hope that all of the States, I include Delaware, I include Nevada, all of the States would really be concerned when they see the way incorporating in their States are being peddled around the world. When you look at these websites, it is not that you have a great judiciary or wonderful corporation law that is selling Delaware on these websites. It is that owners' names are not disclosed. It is that we have top notch privacy restrictions. It is that you can

use a lawyer, I think in the case of Wyoming, they claim that you can have a lawyer to be your incorporator. And that lawyer can assert a lawyer-client privilege to stop law enforcement from getting access to information, which I do not believe is right. But nonetheless, that is what they claim.

I think there is a shared responsibility that we all have. Corporations serve obviously a very important function. We all acknowledge that. We also have to bring those disclosures into the real world that we have to deal with, which is a world where there is money laundering, where there is fraud, where there is misuse of the corporate entity, where now globally you are able to incorporate in some island in the Caribbean or some guy in some country can incorporate in one of our States on a computer in 10 minutes and thereby gain the kind of anonymity which then allows that corporation to be the person or entity that is shipping and laundering money coming into the United States.

Everyone talks about globalization. We need our corporate citizens—and you are citizens—to meet these needs.

In the meantime, the problem has existed apparently since 1977, we were told earlier today, more immediately and with greater immediacy, with the recent changes in our laws, including the PATRIOT Act. And so we are going to have to ask our States to seriously consider what law enforcement needs are. But in the meantime we have to do what we did earlier today, I believe, which is to ask law enforcement to tell Congress what it is they need to know and how are we going to require access to that information, hoping that it will not be necessary to pass Federal requirements. But if it is, hopefully they will be minimal, non-obtrusive, non-expensive, but at least require information to be maintained which would be accessible. If not verified, at least maintained so that our law enforcement people would have an opportunity then to track the names that are needed.

We extended an invitation to the Financial Action Task Force's Executive Secretary to appear at today's hearing. Due to prior commitments he was unable to attend. He did submit a written statement. This statement will be included in the printed hearing record as an exhibit.[1]

Senator CARPER. I am all done.

Senator LEVIN. I want to thank you, as always, for your contributions. I will not interject too partisan a note here, but I think every Member of this body, Democratic or Republican, is thrilled with the decision of the people of Delaware to return our dear colleague, Tom Carper, to the Senate. And I do not think if there were Republicans sitting over here, there would be any disagreement on that.

Thank you for your coming here today to this panel and we will stand adjourned.

[Whereupon, at 5:02 p.m., the Subcommittee was adjourned.]

[1] The prepared statement from Financial Action Task Force appears in the Appendix as Exhibit 3 on page 225.

APPENDIX

STATEMENT

OF

STUART NASH
ASSOCIATE DEPUTY ATTORNEY GENERAL
UNITED STATES DEPARTMENT OF JUSTICE

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

CONCERNING

"FAILURE TO IDENTIFY COMPANY OWNERS IMPEDES LAW ENFORCEMENT"

PRESENTED ON

NOVEMBER 14, 2006

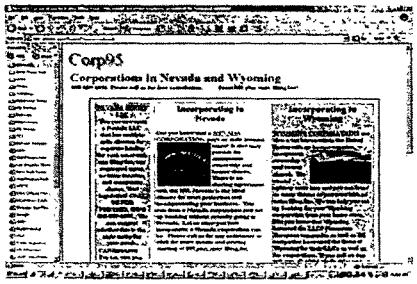
Testimony of Stuart Nash

Associate Deputy Attorney General
United States Department of Justice
November 14, 2006

Before the Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate

Chairman Coleman, Ranking Minority Member Levin, Members of the Subcommittee, I am pleased and honored to appear before the Permanent Subcommittee on Investigations to discuss the important topic of company formation in this country, especially in the context of the highly informative report this Subcommittee commissioned from the Government Accountability Office (GAO) earlier this year.

The words "shell corporation" often trigger the image of offshore financial centers and money laundering havens. Many people are surprised to learn that an Internet search on the words "shell corporation" will bring up dozens of domestic websites touting the anonymity, speed, and ease of using their services to incorporate in various states. For example, when we recently searched "shell corporation," the first website returned was one advertising corporations in Nevada and Wyoming. (See http://www.corp95.com/?source=adwords).



This website advertises that a Nevada corporation "may provide for anonymous and

bearer shares," and that, "There is no sharing agreement with the IRS." With respect to Wyoming, the website promotes anonymous ownership and bearer shares. Such corporations can be opened for $69, plus state filing fees. If you would like to purchase a "Shelf Corporation" that has a history, the website offers such aged corporations for an extra fee, and notes that, "You can have these complete companies by TOMORROW MORNING!"

In my testimony this morning, I would like to discuss with you some of the difficulties that we in the law enforcement community encounter both in our domestic investigations and in our ability to assist our foreign law enforcement counterparts in investigating their cases, as a consequence of the exponential increase in the formation of such domestic shell corporations. I would point out, however, that in this day and age, except for the most local of cases, the categories of "domestic" or "foreign" law enforcement cases are almost archaic. Virtually every major "domestic" investigation involving an organized criminal group has an international dimension, and many major "foreign" cases, if nothing else, involve the transfer of funds through the U.S. financial system. Whether the case involves narcotics trafficking, fraud, or terrorism financing, the funds involved in these cases circle the globe and have an impact on several continents. So, while it is helpful in some respects to discuss the impact of the corporate formation process in terms of the impact on our domestic cases and on our ability to assist our foreign colleagues, in the end, there is little distinction. United States law enforcement and our foreign counterparts are joined in a global offensive against organized crime and terrorism, and we must consider this problem in that broad context.

In addition, beyond the law enforcement context, I will also discuss the impact of our corporate formation policies on our standing and reputation in the global community. As I will discuss in more detail later in my testimony, the Financial Action Task Force (FATF),

the pre-eminent and highly respected multilateral group that focuses on combating money laundering and terrorist financing, identified shortcomings in our corporate formation process as an area of vulnerability in its recent evaluation of the United States' anti-money laundering regime.

Background

Corporate vehicles play a complex, varied, and essential role in modern economies. Legal entities, including corporations, trusts, foundations, and partnerships with limited liability characteristics, conduct a wide variety of commercial activities and support a broad range of entrepreneurial activities in market-based economies. However, despite the important and legitimate roles these entities play in the global economy, they may, under certain conditions, be used for illicit purposes, including money laundering, bribery and corruption, improper insider dealings, tax fraud, financing of terrorist activities, and other forms of illegal activities.

In order to move money obtained through criminal activity, or intended to promote or facilitate criminal activity, criminals must have access to accounts at financial institutions. Of course, criminals could simply open up such accounts in their own names, but as we know, criminals do not like to do business in their own names, nor do they like to identify themselves or provide any identifying information. One way to conceal their identities is to form a legal entity and open a bank account in the name of the legal entity.

In order to form a corporation, a company principal or someone acting on the company's behalf submits formation documents to the appropriate state office. Documents may be submitted in person, by mail, or, increasingly, online, and "the process can take anywhere from 5 minutes to 60 days." *Company Formations: Minimal Ownership Information is Collected and Available* (GAO-06-376) (*GAO Report*). The *GAO Report*

notes that, "A minimal amount of basic information generally is required to form a company." *(GAO Report*, p.7) Typically, the documents must give the company's name, an address where official notices can be sent to the company, share information for corporations, and the names and signatures of the persons handling the incorporation process.

As the *GAO Report* indicates, "Most states do not require ownership information at the time a company is formed," and only a few states require ownership information on annual or biennial reports in those states that require such periodic reports. (*GAO Report,* p.13) While all states require corporations to prepare a list of shareholders and maintain the list at the corporation's principal or registered office, this information is not always accurate or up to date. *(GAO Report*, p.43) The list could include nominee shareholders (*i.e.*, the shareholder on record may not be the beneficial owner), and a few states (according to the *GAO Report*, Nevada and Wyoming) allow "bearer shares" where the names of the shareholders are not on the stock certificates because ownership passes to whoever is physically holding the stock certificates.

While most states reviewed incorporation filings for the required information and fees, and checked to see if the proposed corporate name was available, none of the states reported verifying the identities of incorporators or company officials. (*GAO Report,* p.21) Not one state reported that it used federal criminal records or watch lists to screen the names of the incorporators. In sum, a person from within or outside of the United States, without any verification of identification, can submit the appropriate paperwork to form a corporation, and establish a corporation within as little as five minutes. The corporation is then a legal entity that can engage in business and open a bank account. Yet, some of the most important information about the corporation – its ownership – is nowhere recorded. If that corporation were to engage in fraudulent or negligent activity, it would be very difficult, or even

impossible, to identify its beneficial owners. If a subpoena were to be issued to the state office that keeps the register of corporate information, that office would not have any information about the beneficial owners of the corporation. If the incorporation process was handled by a third-party agent, that agent would probably not have any information concerning the identity of the beneficial owners. Domestic or foreign law enforcement agents would be stymied in their attempts to conduct an investigation because they would be unable to find out who is behind the illegal activity.

Abuse of Shell Corporations

As the discussion above indicates, shell corporations provide an opportunity for criminals or terrorists to engage in criminal activity while concealing the identities of the persons involved in the illegal activity. When business or financial transactions are conducted under the guise of a shell corporation, the identities of the persons actually conducting and benefiting from the transactions are concealed and may be difficult or impossible to identify. As the case examples below will illustrate, the use of shell corporations to facilitate criminal schemes has evolved over time. Initially, criminals used to open shell corporations and trusts in offshore jurisdictions to conceal their ownership of assets They would then open bank accounts in the names of these corporations or trusts. As banks began to scrutinize offshore shell corporations more closely, criminals realized that they could obtain some of the same benefits of offshore corporations from U.S. domestic shell corporations, with the added benefit that the U.S. corporations would not receive the same level of scrutiny.

However, after the enhanced customer identification requirements that resulted from the USA PATRIOT Act, U.S. banks began to require more information about domestic corporations that opened accounts at their institutions. This additional scrutiny resulted in the

most recent phenomenon whereby criminals – domestic and foreign – are opening shell corporations in the United States and then opening bank accounts in the names of these corporations in foreign countries where U.S.-based corporations have an aura of legitimacy. As we know, and as the examples below demonstrate, criminals are always quick to adapt to changes in the regulatory and law enforcement environment.

"Daisy Chain" Schemes

The practice of using U.S. shell companies to hamper criminal investigations is not new to U.S. law enforcement authorities. In the late 1980s and early 1990s, Russian and Italian organized crime groups, often working in concert with one another, developed elaborate schemes using U.S. shell companies to defraud the federal government, as well as several state governments, of hundreds of millions of dollars of motor fuel excise taxes due and owing on the sale of gasoline and diesel fuel. These schemes, commonly known as "daisy chain" schemes, were designed to give the appearance that fuel was sold through a series of distributors prior to reaching the end-user, making it difficult for federal and state revenue authorities to assess and collect the taxes, and to trace the proceeds of the scheme. *See e.g., United States v. Macchia*, 35 F.3d 662, 665 (2d Cir. 1994); *United States v. Morelli,* 169 F.3d 798, 801 (3d Cir. 1999*); Enright v. United States*, 347 F. Supp. 2d 159 (D.N.J. 2004).

Several of the distributors making up a "daisy chain" were merely shell companies, or front companies, that never took possession of, or title to, the fuel, but were inserted in the distribution chain solely to generate false invoices and to conceal the identities of the individuals and entities who were actually buying and selling bootleg fuel – that is, fuel on which the excise taxes had not been paid. The fuel was ultimately sold to unwary retailers for an amount which included the cost of the tax, but instead of properly paying the tax to the

government, the conspirators kept the funds for their personal enrichment.

The daisy chain schemes were structured so that the relevant excise tax liability appeared to be incurred by one of the shell companies, which usually consisted of little more than a mail drop, a telephone and a fax machine. When IRS agents and state revenue examiners attempted to assess and collect the taxes, they were typically frustrated because the company had essentially disappeared, and only listed nominees as the officers and directors. Likewise, bank accounts held in the names of these shell companies were used to launder the proceeds of the schemes, which were often wired to offshore accounts. The operation of these schemes was most prevalent in the northeastern United States. Many of these shell companies were incorporated in Delaware and Pennsylvania.

United States v. Semion Mogilevich

Semion Mogilevich and his co-conspirators are presently wanted in the Eastern District of Pennsylvania to stand trial for racketeering, fraud and money laundering, in connection with a multi-million dollar scheme responsible for defrauding thousands of investors in the United States, Canada and abroad in the stock of YBM Magnex International, Inc. ("YBM"), a public company headquartered in the United States.

The Indictment, filed on February 26, 2003, alleges that Semion Mogilevich funded and controlled the "Mogilevich Enterprise," which consisted of a network of individuals and companies throughout the world. Between 1993 and September 1998, these defendants conspired to defraud investors of over $150 million through a sophisticated scheme designed to create an illusion that YBM was a highly profitable international business, engaged primarily in the magnet industry. YBM operated in over twenty different countries including the United States, Canada, England, Hungary, Russia, the Ukraine, and Israel. The scheme ultimately collapsed in May 1998 with the execution of federal search warrants in

Pennsylvania and the suspension of the trading of YBM stock by the Ontario Securities Exchange.

The scheme made extensive use of shell companies to conceal the involvement of Mogilevich and his associates as the beneficial owners of YBM, to fraudulently inflate the value of YBM stock, to create false financial books and records, to control ownership of the stock, and to launder proceeds from the scheme. For example, approximately ten U.S shell companies incorporated in New York and Delaware appeared on the false books and records of YBM as buyers of YBM products, or as vendors of raw materials needed to manufacture magnets. The actual ownership and operation of the companies were located in Eastern Europe. However, these shells (with U.S. addresses) allowed YBM to misrepresent to securities regulators, auditors and the investing public that YBM was a lucrative investment opportunity with substantial sales in stable North American markets. This served to raise the value of the YBM stock. In reality, the conspirators were only using the shell companies as conduits to launder the proceeds from the sales of artificially inflated stock.

Securities Fraud Cases

Shell corporations have proved to be a popular mechanism to facilitate other securities fraud schemes as well. For example, in an FBI undercover operation labeled "Operation Uptick," 120 defendants, including members of all five New York City Mafia crime families, were indicted for participating in a securities fraud scheme that cost investors $50 million. Charges included racketeering, securities fraud, pension fund fraud, bribery, extortion, money laundering and witness tampering. The investigation involved the sale of fraudulent private placement offerings to the investing public. The subjects marketed the private placements to investors as an opportunity for investors to get in early on new growth companies. In reality, these domestic shell companies were often fronts designed to give the impression of

legitimate companies. The investors' proceeds were stolen by the principals of the sham companies. In addition to the stolen funds, brokers were paid cash kickbacks to push these offerings on unwitting clients. The kickbacks were paid by promoters and insiders of the thinly-traded stocks so that they could take advantage of the falsely-inflated price and sell off their shares before the price crashed. Payments of kickbacks to brokers on these stocks were made through numerous shell companies. As a result of the investigation, 157 individuals were convicted and $153 million was seized for forfeiture.

Tax Cases

Michael Hogan Case

Shell corporations are frequently used in income tax evasion schemes to hide money from the Internal Revenue Service (IRS). While our IRS colleagues are also testifying today, I would like to highlight two cases that demonstrate how domestic shell corporations have been used in tax evasion schemes. The first such case involved two brothers named Michael and Terrence Hogan, who were indicted in Ohio in 1998. Michael Hogan operated various airline-related businesses. At some point in his life, Michael Hogan decided that he was no longer going to file income tax returns. According to the indictment, in the early 1990s, Hogan began setting up front companies in Nevada and Delaware, and he transferred airplanes and other assets into the names of those corporations. He then purported to lease the airplanes to his company, Miami Valley Aviation (MVA), thereby creating false lease payable deductions for MVA and a mechanism by which he could siphon funds from MVA. Hogan opened bank accounts in the names of the front companies to stash his money. He opened numerous accounts in Ohio, Nevada, and Georgia, and later opened accounts in offshore jurisdictions including the Cayman Islands, Costa Rica, and the British Virgin Islands. Between 1991 and 1995, MVA evaded paying taxes on $3.8 million of income.

Hogan and his brother pled guilty to tax evasion charges in 1999. Hogan received a 36-month sentence.

The use of the domestic shell corporations in this case made it difficult to prove that the funds deposited in the shell corporation's bank accounts and the assets purchased in the names of the shell corporations were actually income and assets that belonged to Michael Hogan. The government was required to prove that, despite the cloak of the corporations and their nominees, Michael Hogan owned and controlled the funds and the assets. This proof required extensive use of subpoenas for documents and testimony, and made the investigation much longer and more difficult, especially if one compares how much easier it would have been to meet our burden of proof if either (1) the corporations were in Michael Hogan's business's name, or (2) the corporate records explicitly identified him as the beneficial owner.

Terry Neal Case

The second tax fraud case involves a defendant named Terry Neal, who was convicted of tax-related offenses in the District of Oregon. On April 23, 2003, a grand jury returned a thirteen-count indictment against Terry Neal and others. The indictment alleged that, since at least 1995, the defendants conspired to hide assets, income and expenditures from the IRS, for themselves and their clients. The defendants established foreign and domestic shell corporations for themselves and their clients, and then established domestic and foreign bank and securities accounts for the corporations, and devised a variety of ways they and their co-conspirators could use the funds in the United States without making the funds easily traceable to the true owner or paying taxes on them. These methods included "income stripping," the use of "warehouse banks," offshore credit or debit cards, false mortgage loans, false insurance policies, and offshore brokerage accounts.

The "income stripping" scheme involved setting up a Nevada corporation, which then billed the client's legitimate business for fictitious consulting or other services. The legitimate business would fraudulently deduct the payments as a business expense on its tax return. A "warehouse bank" account is a bank account at a regular commercial bank in which all clients' funds are commingled or pooled, for the purpose of concealing the clients' respective ownership interests of the funds. Clients would send instructions to Neal or his co-conspirators, who would conduct the transactions at their direction. Similarly, offshore bank accounts were used to conceal a client's funds, with credit or debit cards issued by an offshore bank used as one means for repatriating monies as needed.

The defendants also advised clients to purchase an "insurance policy" from a fictitious foreign insurance company. The client's legitimate business would deduct the insurance premium as a business expense on its tax return. The money would be sent offshore to the defendants, who kept six to nine percent as their fee. After a year, the balance of the funds would be deposited to one of the client's foreign bank accounts and would again be available to the client for withdrawal by debit card or other means.

In order to further conceal the scheme, the defendants prepared false, fictitious, and fraudulent documents to create a veneer of legitimacy to their clients' tax evasion. These documents included alleged false invoices for "consulting" or "services," promissory notes, consulting agreements, and insurance policies. They also prepared and filed false tax returns for the clients' Nevada corporations. These tax returns usually showed little or no tax due. When clients were contacted by the IRS, the defendants advised the clients to lie about their connection to the Nevada and offshore corporations and to destroy documents. The defendants charged substantial fees for their services.

Neal was sentenced in March 2006 to 60 months in prison and three years of

supervised release for his role in the operation of an offshore tax fraud scheme. At least fourteen clients of this fraudulent tax scheme have pled guilty in connection with their involvement. According to the Government's Supplemental Sentencing Memorandum, "Defendant (Neal) is directly responsible for defrauding the United States out of millions of dollars in taxes. His tax fraud was, quite simply, massive and on a scale rarely seen in this district. . ." The government's calculation of the tax loss was over $22 million.

Russian Money Laundering Schemes

In the cases discussed above, the criminal activity was primarily directed against the United States. However, over the past several years, we have seen numerous cases where domestic shell corporations have been established to facilitate foreign criminal activity. Several of these cases have involved activity designed to move money outside of Russia, either to evade Russian taxes or else to facilitate organized crime schemes.

Bank of New York

The Bank of New York (BNY) case was an early example of such a scheme. The BNY investigation in the Southern District of New York focused on misconduct related to the opening in 1996 of accounts at a retail branch of BNY in the names of Benex International Co., Inc. ("Benex") and BECS International LLC ("BECS"), two shell corporations that had no real legitimate business. These corporations were formed offshore. The bank accounts were opened by Peter Berlin, a Russian émigré, with the assistance of his wife, Lucy Edwards, also a Russian émigré, who was a BNY vice president. During the next three and one-half years, approximately $7 billion originating in Russia flowed through the Benex and BECS accounts to third-party transferees around the world.

The Benex and BECS accounts were part of an underground money transfer business that was operated by a bank located in Moscow and a company located in Queens, New

York. From a small single-room office in Queens, company employees executed hundreds of wire transfers per day from the Benex and BECS accounts, using electronic banking software provided by BNY to carry out wire transfer instructions provided by the Moscow bank. Despite the obvious money laundering risks associated with such an operation, BNY failed to conduct adequate due diligence or make "know your customer" inquiries with regard to Berlin or the Benex and BECS accounts. BNY also failed to monitor adequately the activity in the Benex and BECS accounts, which were the highest fee-producing accounts in the One Wall Street Branch where they were located.

These compliance lapses resulted in BNY entering into a non-prosecution agreement with the United States Attorneys' Offices for the Southern and Eastern Districts of New York in November 2005 to resolve two separate criminal investigations. BNY admitted its criminal conduct, agreed to forfeit $26 million to the United States, and to pay $12 million in restitution to victims of a fraud scheme in the Eastern District case. The bank also agreed to make sweeping internal reforms to ensure compliance with its antifraud and money-laundering obligations, and to be subject to monitoring by an independent examiner.

United States v. Garri Grigorian

A more recent case that followed the pattern of the scheme in the BNY case but utilized domestic shell corporations is the case of Garri Grigorian. On August 8, 2005, Garri Grigorian, a 43-year old Russian national living in Sandy, Utah, was sentenced to 51 months imprisonment and ordered to pay $17.42 million in restitution to the Russian government for his role in laundering over $130 million on behalf of Moscow-based Intellect Bank and its customers through bank accounts located in Sandy, Utah.

The criminal charges arose out of a relationship between Grigorian and Intellect Bank that began in 1998. In order to carry out the scheme, Grigorian, his co-conspirators, and an

associate established three U.S. shell companies and then opened bank accounts at banks in New York and Utah in the names of these shell companies. The shell companies never did any actual business. They formed two Limited Liability Corporations (LLCs) in Utah and one corporation in New York. These companies were acquired so that bank accounts could be established in their names, and thus make it appear as though wire transfers to and from those bank accounts were in furtherance of legitimate foreign trade with a U.S. company.

Grigorian and his co-conspirators opened bank accounts in business names, at local bank branches in Utah, to enable Intellect Bank to conduct U.S. dollar wire transfers on behalf of its customers. Intellect Bank regularly transferred large amounts of funds to the business bank accounts on behalf of Intellect Bank's customers. Intellect Bank would transmit instructions to Grigorian and his co-conspirators in Utah, directing where to wire transfer the funds deposited in the business accounts. Deposits were then made to the business accounts in bulk amounts on a daily basis. Then, Grigorian admitted, he and his co-conspirators transferred the funds out of the accounts to a large number of third-party transferees located around the world. Typically, there were numerous wire transfers in a single day to and from the business accounts. The investigation disclosed that there were more than 5,000 wire transfers to and from the business accounts in Utah from in or about October 1998, up to and including in or about January 2001, totaling more than $130 million.

Records from the Utah state agency provided limited details of the owners of the shell companies. Documents for the first company formed provided only the names of a registered agent and two managers of the company. Documents for the second company formed provided the name of a registered agent and a manager of the company. While a name was provided for the owner of the company, no address other than Moscow, Russia was listed. It was only through the verification of bank records that investigators were able to determine

that the actual owners of the companies were two individuals listed on the documents as a manager and an officer. Thus, the name provided on the state agency documents as the owner was merely a nominee name used in an effort to conceal and disguise the true owners. It was only because the true owners established bank accounts in the names of the shell companies and the fact that the bank maintained information that was not accessible from the state agency, that the true perpetrators of the scheme were revealed.

However, while the investigators could get to the owners of the Utah shell companies, the money flowing through the account was linked to numerous other U.S. shell companies. The fact that we could not determine the owners of those companies made it difficult to charge Grigorian with money laundering because we were unable to determine the source of the funds. Had we been able to ascertain the owners of those companies, our investigation could have proceeded further. We attempted to get details on the beneficial owners of the accounts from the banks, but most of the money went through correspondent accounts of foreign banks so that was a dead end. We had allegations of corrupt foreign officials using these shell accounts to launder money, but were unable -- due to lack of identifying information in the corporate records -- to fully investigate this area.

Recent Developments in Domestic Law Enforcement Cases

Criminals have learned from the Bank of New York and Grigorian prosecutions, and devised a more complicated version of the same scheme to evade law enforcement. Criminals who establish shell corporations in the United States are now increasingly opening bank accounts for those corporations in offshore jurisdictions where customer identification requirements may be less rigorous. However, these corporations are still able to gain access to the U.S. financial system if the foreign bank has a correspondent account at a U.S. financial institution. As the *GAO Report* noted:

> Customer Identification Program (CIP) requirements implemented by the USA PATRIOT ACT in 2001 establish minimum standards for financial institutions to follow when verifying the identity of their customers in connection with the opening of an account. Under these standards, financial institutions must collect the name of the company, its physical address (for instance, its principal place of business), and an ID number, such as the tax identification number. . . . One representative said that his institution also checked names against the OFAC [Office of Foreign Assets Control] list and requested photo identification from all signers on the account.

GAO Report, p.44.[1]

Thus, now the criminals establish U.S. shell companies in the names of nominees and through intermediaries. The criminals then establish bank accounts in the name of the U.S. shell companies in foreign jurisdictions. Latvia remains a popular jurisdiction for opening such bank accounts, but other jurisdictions are used, as well. Because the customer is a U.S. corporation, the customer has a certain aura of legitimacy. The foreign bank, in turn, has a correspondent account with a U.S. money-center bank in New York. The criminals then run the same scheme, described above, through the foreign bank, using the U.S. correspondent account to facilitate transactions.

On the surface, it appears as though wire transfers are being made to further foreign trade with a U.S. company that has a bank account in New York. In actuality, the criminals are running an underground banking channel in which it is nearly impossible to determine the source, nature, or destination of the money moving through it (which by all estimations amounts to billions of dollars). U.S. law enforcement agencies cannot determine who is

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1 With respect to beneficial ownership of the corporation, representatives of the financial community told the GAO investigators that, although they are not required to obtain ownership information in all cases, as a result of our "risk-based approach" to customer identification requirements, financial institutions routinely investigate high-risk applicants in order to uncover the ultimate beneficial owners. They further said that conducting the necessary due diligence on a company can be expensive and time-consuming because "institutions must sometimes peel back layers of corporations or hire private investigators to find the actual beneficial owner or owners of a company." *(GAO Report*, p.45) The result is that financial institutions, through their due diligence obligations, end up having to compensate for the fact that little or no due diligence is conducted when a corporation is established by a state agency.

perpetrating the scheme by reviewing the records maintained by the state where the U.S. shell company was formed because the criminals use nominees on the paperwork and purchase the shell company via an intermediary. Law enforcement also cannot determine who is perpetrating the scheme by reviewing the U.S. bank account records. The U.S. bank account records only identify the account holder of the correspondent account (*i.e.*, the foreign bank, itself). The records do not identify who controls the accounts within the foreign bank. U.S. law enforcement must get this information from the foreign country.

Getting such information from foreign countries is time consuming at best and often very difficult for a variety of reasons, including the prerequisites for Mutual Legal Assistance Treaty (MLAT) requests and lack of cooperation from some foreign countries. Even under the best of circumstances, the MLAT process is time-consuming. In some cases, following the money trail requires MLAT requests or other formal outgoing requests to multiple countries to obtain the necessary evidence. The combination of using domestic shell companies, where little or no useful information is available, with foreign financial institutions, where information can be difficult or time-consuming to obtain, makes these cases very difficult for us to investigate and prosecute.

Incoming Mutual Legal Assistance Requests

The use of domestic shell corporations in criminal schemes not only frustrates our domestic law enforcement efforts, but also frustrates the efforts of our foreign law enforcement counterparts. When the perpetrators use U.S. shell corporations to open bank accounts in foreign countries to launder money or otherwise facilitate criminal activities in those countries, foreign law enforcement will go to the foreign bank to obtain information about the owners of the accounts. If the bank account is in the name of a U.S. corporation, foreign law enforcement will have to request information on the beneficial owners of the

corporation from the United States. This is most commonly done through an incoming request pursuant to an MLAT with the United States if one is in effect, or else through the more cumbersome Letters Rogatory process.

The Office of International Affairs (OIA) in the Criminal Division of the Department of Justice is the central authority for handling incoming requests for assistance from foreign countries. When OIA receives a request for assistance, it will usually transmit the request to the U.S. Attorney's Office in the district in which the evidence is located unless it appears that all the evidence sought in the request in that district could be obtained without a subpoena. Requests for corporate records are transmitted to the FBI because the information is generally available without a subpoena. However, depending on what other assistance is sought in the request, the request may be transmitted to the U.S. Attorney's Office to execute in coordination with the FBI field office. In Delaware, because of the volume of requests, OIA relies upon the U.S. Attorney's Office for the District of Delaware to execute all of these requests. However, because of the lack of adequate disclosure or reporting requirements at the state level, the corporate records filed with the state agency -- either the articles of incorporation or the periodic reporting records -- will not identify the beneficial owners of the corporation. Moreover, it is not uncommon for the corporations to be inactive, so any information may be out of date. Consequently, the foreign investigation may be stymied at this point.

While the Department of Justice does not maintain statistics based on legal assistance requests specifically related to shell corporations, OIA, as the central authority for executing requests for international evidence, gains intelligence which both corroborates and illuminates the scope of the U.S. shell corporation problem. A review of MLAT requests received during 2004 and 2005 disclosed that, over the past several years, OIA has received

an increasing number of incoming legal assistance requests which, in the course of being executed, are revealed to involve U.S. shell corporations. This survey indicated that in 2004, OIA received 198 legal assistance requests from Eastern European countries, and that 122 of these requests involved U.S. shell corporations. In 2005, those figures increased to 281 requests received from Eastern European countries, with 143 of those requests involving information involving U.S. shell corporations. The majority of those requests came from Russia and the Ukraine. In most of those cases, OIA had to respond by saying that information about the beneficial owners of the corporation is not available. At a time when we are trying to foster good relationships with our law enforcement counterparts and encourage international cooperation, such responses are counterproductive and damaging to our credibility.

Company Formation Agents

Another factor that contributes to the frustration of law enforcement when investigating shell corporations is the use of company formation agents. Company formation agents help individuals or companies form companies by filing formation documents and other paperwork with the appropriate state agencies. In some cases, these agents perform other services as well, such as serving as an agent for service of process, or even serving as a director of the newly-formed corporation. As the *GAO Report* points out, there is very little oversight of these agents by the states. The agents rarely collect information on ownership since the states do not require it. States generally do not require the agents to verify the information collected from clients. Some of the company formation agents open thousands of corporations and market these corporations around the world. In response to an incoming request for assistance in a foreign investigation, a registered agent told U.S. authorities that he estimated that he opened more than 8,000 companies for a foreign company broker over a

ten-year period, primarily in Delaware and Oregon, without meeting anyone personally or having any knowledge about the business purposes for these entities. These foreign brokers are then able to sell the U.S. corporate entities to anyone willing to pay the price for a U.S. corporation.

Our colleagues at the U.S. Immigration and Customs Enforcement (ICE) have advised us that their special agents have encountered several cases where third-party agents incorporate vast numbers of businesses in various states. When ICE encounters cases involving the use of shell corporations, it is usually incidental to other violations, such as money laundering or fraud.

In one such case, the investigation began with information (a Suspicious Activity Report or SAR) received from a bank that an individual received over $1 million in his account from various banks in Latvia, Russia, and Lithuania. The amount of money moving through the accounts seemed unusual because the individual listed his occupation as a self-employed construction worker. One of the financial transactions was conducted on behalf of a company registered in both Austria and Salem, Oregon. The registered agent for the company in Oregon was identified and interviewed for information in November 2003.

During that interview, the third-party agent outlined his involvement in registering companies. Basically, he advertises his status as a third-party agent on the Internet and responds to requests from overseas to register companies in the U.S. The agent receives $80 for every corporation he establishes. Over the course of several years in that business, the agent registered over 2,000 corporations, over 1,200 of which were still active companies at the time of the interview. The registrations took place mostly in Oregon, but also in Arkansas, Colorado, Idaho, Iowa, Kentucky, Montana, South Dakota, Washington, and West Virginia.

Most of the requests to the third-party agent for incorporating businesses in the USA involved "Eastern Europeans." According to the agent, Oregon maintains some of the lowest costs for forming corporations, and Oregon law requires very minimal information when forming corporations. Also, once he completes the paperwork and forwards the information to the requesting party, he no longer has a part in the business.

ICE ultimately closed this case because the main target of the original case had moved and could not be found. However, many investigations lead to a similar fate. Banks file numerous SARs disclosing suspicious movements of money by corporations, and investigations initiated on the basis of these SARs frequently lead to a dead end because the case involves a U.S. shell corporation that has opened an account at a foreign bank, and sufficient information concerning the purpose or the true nature of the transaction cannot be obtained.

The Financial Action Task Force

The FATF is the preeminent multilateral group that addresses money laundering issues. The United States is one of the founding members of FATF. Since its creation in 1989, the FATF has spearheaded the effort to adopt and implement measures designed to counter the use of the financial system by criminals. It established a series of 40 Recommendations in 1990 that set out the basic framework for anti-money laundering efforts and are intended to be of universal application. These Recommendations were revised in 1996 and in 2003 to ensure that they remain up to date and relevant to the evolving threat of money laundering,

In reviewing the rules and practices that impair the effectiveness of money laundering prevention and detection systems, the FATF found that:

Shell corporations and nominees are widely used mechanisms to launder the

> proceeds from crime, particularly bribery (*e.g.* to build up slush funds). The ability for competent authorities to obtain and share information regarding the identification of companies and their beneficial owner(s) is therefore essential for all the relevant authorities responsible for preventing and punishing money laundering.

See FATF Report on Misuse of Corporate Vehicles, p.5 (October 2006) (available at http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html).

Consequently, several of the 40 Recommendations address steps that nations should take with respect to shell corporations, most notably Recommendation 33:

> Countries should take measures to prevent the unlawful use of legal persons by money launderers. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares should take appropriate measures to ensure that they are not misused for money laundering and be able to demonstrate the adequacy of those measures. Countries could consider measures to facilitate access to beneficial ownership and control information to financial institutions undertaking the requirements set out in Recommendation 5.

Probably the most unique element of the FATF, and a major contributor to its success, is the process of peer review. The 40 Recommendations are exactly that – recommendations. The Recommendations are not binding on any member. However, compliance with the 40 Recommendations is encouraged by the process of peer review implemented through a program of mutual evaluations. Under the mutual evaluation program, each jurisdiction is periodically examined by a team of reviewers to assess each member's compliance with the 40 Recommendations. Jurisdictions are given a ranking of Fully Compliant (FC), Largely Compliant (LC), Partially Compliant (PC), or Non Compliant (NC) with respect to each Recommendation.

The United States has undergone three such evaluations, with the most recent one taking place earlier this year. The evaluation report was presented to the FATF Plenary in June 2006. While the overall evaluation of the United States was very positive and lauded

our efforts in terms of investigations, prosecutions, and seizures, the United States received four rankings of NC. Two of these four NC rankings were based on our laws and regulations relating to legal entities and beneficial ownership (Recommendations 33 and 34). The Report found that the United States is not compliant with respect to Recommendation 33 ("Transparency of Legal Persons and Arrangements") because:

> While the investigative powers are generally sound and widely used, there are no measures in place to ensure that there is adequate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities.

As a result of these NC rankings and the PC ranking the U.S. received on core Recommendation 5 regarding customer due diligence (of which identification of beneficial owners is a significant part), the United States must provide a succinct update to the FATF Plenary in June 2008 describing the corrective actions it has or is taking.

Of course, company formation processes within the United States have traditionally been within the province of the individual states. As FATF itself recognized, it is an over-simplification to simply label the "United States" as non-compliant in this area. Rather it is the company formation mechanisms within fifty individual states that are currently deficient in this respect.

However, it is important to recognize that, as the *GAO Report* points out, some jurisdictions that have had reputations as "money laundering havens" have enacted measures to regulate firms that provide services such as company formation. The United Kingdom Crown Dependencies of Jersey and the Isle of Man began regulating company service providers in 2001 and 2000, respectively. In those jurisdictions, company service providers now must be licensed, and are required to conduct due diligence to verify the identity of their clients and to obtain company ownership information to form a new company. By

implementing these measures, Jersey and the Isle of Man have taken a major step toward ensuring that information concerning the beneficial ownership of new corporations will be obtained. In order to address privacy concerns, the ownership information is not maintained in the public record, but is kept at the registry in Jersey and with company service providers in the Isle of Man, and is available only to law enforcement.

In fact, many jurisdictions in the Caribbean, once labeled as "money laundering havens," have taken similar measures. For example, the Cayman Islands has enacted legislation to regulate company service providers. They are now governed by the Companies Management Law (2003 Revision) and its accompanying regulations, and supervised by the Fiduciary Services Division of Cayman Islands Monetary Authority (CIMA). A large range of service providers falls within the ambit of the law — law firms; asset managers; those providing registered office, company secretary, and alternate director facilities; administering offices; and trust service providers. Allowance is also made for additional corporate services to be included. A corporate service license is required for those providing basic services such as company formation, and the filing of statutory returns. Service providers controlling assets or acting as secretary, authorized custodian, or other more substantive functions require a companies-management license. Trust companies are, however, licensed under the Banks and Trust Companies Law (2003 Revision), while insurance and fund managers are licensed under the insurance and securities investment business laws.

Compliance with the Cayman money laundering requirements is effected through CIMA's supervisory process. CIMA's Fiduciary Supervisory Division is responsible for supervising trust companies and company management service providers, and applies the same high standards during the licensing and "Know Your Customer" process as is applied in other industry sectors. An on-site inspection program has been implemented that reflects the

Offshore Group of Banking Supervisors' *Trust and Company Service Providers Statement of Best Practice*. Company managers must submit audited financial statements to CIMA. In addition, company manager directors must submit a certificate of compliance with the AML requirements on an annual basis. The Money Laundering Regulations require that Cayman Islands Financial Service Providers (FSPs) implement procedures regarding customer identification, suspicious transaction reporting, employee training, and record keeping. Laws protect those who make reports, and tipping-off (*i.e.,* notifying a customer that a suspicious transaction has been reported) is penalized. Additionally, any bearer shares issued by a corporation must be immobilized and held by a custodian outside of the corporation. The steps taken by other jurisdictions to address the problems presented by shell corporations demonstrate that the problem is not insurmountable.

Conclusion

I would like to conclude by expressing the gratitude of the Department of Justice for the continuing support that this Subcommittee has demonstrated for anti-money laundering enforcement, especially in the area of correspondent banking. The Department believes that we must continue to strengthen our anti-money laundering laws, not only to fight drug trafficking but also to fight terrorism, white collar crime and all forms of criminal activity that generate or utilize illegal proceeds. The downside of globalization is that it affords perpetrators of crime new outlets and vehicles for these crimes, and thus poses new threats to confront. We in the Department of Justice look forward to working alongside our Treasury and Homeland Security colleagues, with this Subcommittee and with your colleagues in the Senate and the House to address the issues identified in this hearing.

I would welcome any questions you may have at this time.

WRITTEN TESTIMONY OF K. STEVEN BURGESS
DIRECTOR, EXAMINATION
SMALL BUSINESS/SELF EMPLOYED DIVISION
INTERNAL REVENUE SERVICE
BEFORE
SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
COMPANY FORMATIONS: MINIMAL OWNERSHIP INFORMATION IS COLLECTED AND AVAILABLE

NOVEMBER 14, 2006

Good afternoon, Chairman Coleman, Ranking Member Levin, and other Members of the Permanent Subcommittee on Investigations. I am Steve Burgess, Director of Examination for the Small Business/Self Employed (SB/SE) division of the Internal Revenue Service. I am accompanied this morning by Robert A. Northcutt, the Acting Director of SB/SE's Abusive Transactions Office. He has first-hand knowledge of some of the issues that will be discussed this afternoon and he will join me in responding to your questions.

It is my pleasure to appear before you today to discuss a critical issue relating to our ability to enforce our nation's tax laws adequately --- the need for transparency of beneficial ownership of legal entities so that taxpayers cannot conceal such interests for the purpose of evading tax obligations or facilitating other financial fraud and money laundering.

In August, this Subcommittee held a hearing on offshore tax shelters and released a report that discussed the billions of dollars being lost to the United States Treasury by corporate and individual taxpayers seeking to hide income in foreign tax havens or shelter income by claiming it was earned in low tax jurisdictions.

At that hearing, Commissioner Everson commented that, by their very nature, offshore abusive tax avoidance transaction (ATAT) arrangements are designed to conceal the identity of the taxpayers and to shield their ownership of assets and income from detection.

That hearing received significant press coverage. As a result, many people may have been astonished to learn that corporate and individual taxpayers could so easily "go offshore" to avoid reporting and payment of their Federal taxes and exploit the financial secrecy laws deliberately created in certain foreign jurisdictions to attract foreign business.

As I will discuss today, and as this committee is already well aware, it is not just the secrecy laws in these foreign tax havens that can be exploited by persons to evade taxes or conceal criminal transactions. Within our own borders, the laws of some states regarding the formation of legal entities have significant transparency gaps which may even rival the

secrecy afforded in the most attractive tax havens. This domestic transparency gap is an impediment to both U.S. law enforcement and the enforcement of tax laws in other countries.

Need for Transparency

A key component of our ability to enforce tax laws in almost any area is the availability of information regarding the transaction in question. This is especially true in a global environment where the transaction in question may involve multiple corporate entities, both foreign and domestic.

Not only must information about the transaction itself be available, but relevant information about the parties to the transaction must be available, as well. A critical element in evaluating and understanding transactions is to identify the beneficial owners of the corporations in question. The "beneficial owner" is the person who ultimately owns or exercises effective control over the legal entity. This would include an individual, a foundation, or a group of individuals represented by an investment advisor or mutual fund, for example.

The lack of transparency possible in corporations, trusts, limited liability companies (LLCs), and other entities enables countless numbers of taxpayers to hide their noncompliance behind a legal entity. This noncompliance would include such things as the non-filing of proper returns and the hiding of taxable income.

A huge industry exists that uses the internet and other channels to promote "asset protection" over the internet and through other channels. While "asset protection" is a common and generally legitimate estate-planning strategy, the term has also become a buzz phrase that attracts individuals interested in facilitating tax fraud, non-compliance with tax and other laws, financial crimes, and even terrorist financing.

Privacy and protection against personal liability have long been important and necessary components for the formation of corporations and the operation of a successful market economy. However, once formed this same privacy and secrecy can be used to shield the owner's identity in such a manner that it will often impede a government investigation to the point where the investigation must be discontinued.

Corporate Formation

In accordance with our federal system of government, state laws govern the legal formation of business entities within their boundaries, as well as the informational and reporting requirements imposed on such entities. While requirements vary from state to state, in each instance a minimal amount of information is required in order to form the new entity. Generally, information concerning the beneficial ownership of the entity is not required.

According to a report from the Government Accountability Office (GAO) on company formations in April, 2006, only four states --- Alabama, Arizona, Connecticut, and New Hampshire --- request some ownership information. Even in these states, however, the requirement applies solely with respect to the formation of LLCs.

State officials and agents told the GAO that collecting company ownership information could be problematic. According to the report,

> "Some state officials and agents noted that collecting such information could increase the cost of company filings and the time needed to approve them. Some officials said that if they had additional requirements, companies would go to other states or jurisdictions. Finally, officials and agents expressed concerns about compromising individuals' privacy because owner information disclosed on company filings would be part of the public record, which has not historically been the case for private companies."

It is important to note that large, publicly traded companies whose securities are registered with the Securities and Exchange Commission (SEC) are already subject to federal disclosure requirements regarding beneficial ownership. New requirements imposed by states would likely have a greater impact on private companies and smaller companies that do not currently file with the SEC.

This competition among states for corporate registrations has created what some have characterized as a "race to the bottom" in terms of establishing minimal information and verification requirements in corporate formation and reporting. According to the Money Laundering Threat Assessment, issued jointly by several federal law enforcement agencies late last year, a handful of U.S. states offer company registrations with cloaking features --- such as minimal information requirements and limited oversight --- that rival those offered by offshore financial centers. The three states cited as the most accommodating for the organization of these legal entities are Delaware, Nevada, and Wyoming.

From an IRS perspective, non-compliant taxpayers, including non-filers, fraudulent taxpayers, abusive promoters and under-reporters, have taken advantage of certain state laws, particularly in Nevada. Nevada has laws that may be used to help hide the identity of the non-compliant taxpayers; these laws are perceived by some taxpayers as available to facilitate taxpayer non-cooperation with the IRS; and non-compliant taxpayers may take advantage of an established industry for forming and servicing corporate entities.

Wyoming has similar laws. In fact, Wyoming incorporators advertise that a Wyoming corporation can offer the same benefit of "asset protection" as Nevada but at a lower cost and without the perceived stigma of a Nevada corporation.

Bearer Shares and Nominee Officers

Bearer shares and nominee officers are particularly effective and popular in establishing an anonymously owned entity. Bearer shares are issued by the corporation upon formation

and actually deem ownership of the corporation to the holder of the share. To determine ownership, one must actually find who has physical possession of the shares. Nevada and Wyoming are the only states that permit bearer shares.

Nominee officers also make it easy for non-compliant taxpayers to establish a corporation and remain completely anonymous. While most states require that corporate officers have some meaningful relationship to the corporation, Nevada and Wyoming do not require this. An internet search of "Nominee Officer" will reveal hundreds of businesses offering Nevada and Wyoming entities, the owners of which are never reported to the state. A single nominee can serve as all of the officers for a Nevada or Wyoming corporation. The nominee officer is reported to the State, but is essentially just a name on a piece of paper. Corporate owners, who wish to remain anonymous, can hold the title of vice president, which is not reported to the State, and hire a nominee to hold the other offices. With relative ease, corporate owners can shift income to another, similarly formed entity, and the only available information regarding that entity will be the nominee and the nominee's address. These nominees are often resident agents (or abusive promoters) who primarily forward mail to a P.O. Box. If asked, many nominees claim they do not know the identity of the owner. If the entity had been established by another promoter, using bearer shares and nominee officers, they could be telling the truth.

IRS Investigations

There are approximately 250 resident agents in Nevada that each service 185 or more corporations. The largest of these serves nearly 30,000 entities. The IRS has authorized several investigations under Section 6700 of the Internal Revenue Code (IRC) into promoters of Nevada corporations and resident agents. These investigations have revealed widespread abuse, as well as problems in curtailing that abuse.

It should be noted that the promoters themselves are generally not engaged in overtly abusive activity subject to penalties under Section 6700. The activities they undertake on behalf of their clients are consistent with the state laws under which they operate. However, many of their clients are engaged in fraudulent activity in violation of tax, money laundering, and other laws.

For example, our office, as a result of several promoter investigations has obtained client lists that are being used as a source for potential non-filer audits. An initial sampling of the client lists showed that anywhere from 50 to 90 percent of those listed are currently, or have been previously, non-compliant with Federal tax laws. These included non-filers, under-reporters and those who exploit "Corporation Sole" statutes. Used as intended, Corporation Sole statutes enable religious leaders — typically bishops or parsons — to be incorporated for the purpose of insuring the continuation of ownership of property dedicated to the benefit of a legitimate religious organization. However, some promoters facilitate a particularly abusive scheme whereby they exploit legitimate laws to create sham, one-person, non-profit religious corporations.

We have also seen instances where a promoter advises its clients to place their stock ledger and bearer shares in an offshore entity, thereby further ensuring their anonymity and thwarting a Nevada requirement that the resident agents know the location of the stock ledger. If asked who owns a particular entity, the resident agent can say that all he/she knows is that it is owned by an entity in an offshore country.

While the non-compliance rates found in the client samples of the promoters we have investigated (50 to 90 percent) are probably not the norm across all Nevada corporations, even if non-compliance is a fraction of those numbers the potential loss to the Treasury is still considerable. There are over 650,000 active and inactive entities in Nevada.

It is important to remember that this is for only one state.

Moving Forward

We are looking at a number of strategies to target the widespread tax non-compliance by many of the shell companies represented by resident agents and promoters. One of the key elements of this is the establishment of an Issue Management Team (IMT) similar to teams we have formed in other significant areas of potential non-compliance. There are several things that the IMT might pursue.

First, the Service has authorized audits for a small number of taxpayers in Nevada who are non-filers. As part of this, we are contemplating mass audits of non-filers that would produce a list of non-filer and non-compliant participants. This list would be categorized from the most egregious (high income non-filers, corporation sole, fraud, etc.) to the least egregious taxpayers as a means to plan efficient and effective audits. This audit list would be compiled from promoter audits, the Nevada Secretary of State database, and possible John Doe summonses.

Second, we are also looking at additional promoter investigations. Even if the promoters themselves are not found to be in violation, accessing their client lists could provide valuable information. Criteria for selection of promoters for such investigations could include the size of the entity, the existence of corporation sole, the number of inactive corporations, the company's own compliance data, etc. Once authorized, the investigations could concentrate on securing a client list to determine levels of non-compliance and conducting audits to determine whether the promoter made any overt abusive statement in the formation and administration of the corporations.

Third, the Service will consider "John Doe summonses" to resident agents. The summonses would be similar to the ones issued to credit card companies related to the use of offshore credit cards. Nevada resident agents and incorporation companies provide a legitimate service to a group of unknown "Does" whom the Service has reason to believe are using these valid services to abuse the tax system. The John Doe summons could request the identity of individuals who are paying for resident agent services or who have paid for the formation of a Nevada corporation. This information should reveal ownership

of active and inactive Nevada Corporations which the Service suspects could include a large amount of non-filers and abusive schemes.

Fourth, we are coordinating our efforts with those of other Federal agencies. As indicated in the GAO report, the lack of corporate transparency is a problem for many governmental agencies including the FBI, the Financial Crimes Enforcement Network (FinCEN) in the Department of the Treasury, and the Department of Homeland Security.

Finally, we understand that Nevada may be changing its approach to these types of entities. The president of the Nevada Resident Agent Association may support legislation in the 2007 legislative session that outlaws nominee officer services. Some political leaders in the state have also indicated that they may address the nominee officer issue.

Information Sharing With Trading Partners

Foreign governments that are trying to enforce their own tax laws are often stymied by the use of shell corporations in the United States for which beneficial ownership information is difficult to obtain. Most of the tax treaty requests for exchange of information involving U.S. shell companies (LLCs and Corporations) are received from Eastern European countries and the Russian Federation. These U.S. shell companies, organized mainly in Delaware, Nevada, Arkansas, Oklahoma, and Oregon, are used extensively in Eastern Europe and the Russian Federation to commit Value Added Tax (VAT) fraud.

The IRS has received requests from other treaty countries relating to U.S. shell companies; however, the number of these cases has not been tracked in countries other than Eastern Europe and the Russian Federation due to the low volume. Of the 306 Eastern European and Russian requests relating to U.S. shell companies made in 2002, 40, 26, and 18 percent were from Russia, Lithuania, and Latvia, respectively. In 2003, 63 percent of the 440 requests were from Russia, and 14 and 13 percent were from Lithuania and Latvia, respectively. Of the 363 requests in 2004, 37, 23, 14, and 14 percent were from Russia, Latvia, Lithuania, and the Ukraine. In 2005, 77 percent of the 561 requests were made by Russia, 9 percent by the Ukraine. Of the 369 requests made in 2006, 64 percent were from Russia and 7 percent were from the Ukraine.

The IRS is generally unable to determine the "beneficial owner" of these U.S. shell companies. However, the IRS has pursued for its tax treaty partners all legal means available in the U.S. to obtain information on the broker and reseller of the U.S. shell companies. The IRS checks its internal records to determine whether the U.S. shell company has an Employer Identification Number and files U.S. tax returns, searches for information on a nationwide commercial service, and frequently obtains information from Secretary of State websites.

The IRS also requests information from the U.S. Company Formation Agents (Agents) by Information Document Requests and summonses. The Agent is usually able to supply a limited amount of information that reveals the client who commissioned the creation of the U.S. shell company along with contact names, addresses, billing information, emails, and

other information regarding the shell companies, brokers, and resellers. In most cases, the clients are foreign agents (foreign resellers) that pay for the formation of large numbers of U.S. shell companies for sale to other foreign persons.

While the IRS is often unable to provide its treaty partners with beneficial ownership information regarding U.S. shell companies, it encourages its treaty partners to pursue the leads that are provided by making exchange of information requests to the country where the foreign reseller is located. However, the country of the foreign reseller usually does not have an exchange of information program with the country attempting to verify the transaction and obtain beneficial ownership information.

Since Russia, Latvia, Lithuania, and the Ukraine are the main countries affected by this type of tax fraud, they continue to express their concern that the U.S. Limited Liability Company (LLC) regime is an offshore haven used to falsify VAT transactions.

Potential Solutions

I understand that the Subcommittee is interested in developing solutions to this problem, and, in discussions with the Subcommittee staff, several suggestions were advanced that may be worthy of consideration. Included among these is the development of model state laws that would make the ownership and control of all corporations more visible, at least for law enforcement.

It has also been suggested that perhaps the IRS could collect more information. Specifically, one idea is to add a line to the application (Form SS-4) that must be completed prior to the issuance of an Employee Identification Number (EIN). Currently, Form SS-4 requires the name and tax identification number (such as the Social Security number) of the principal officer if the business is a corporation, or general partner if it is a partnership, or owner if it is an entity that is disregarded as separate from its owner (disregarded entity), such as a single member LLC. The additional line would ask for the name of the beneficial owner(s) of the corporation seeking the EIN. This would apply to all corporations seeking an EIN. Since this information is already required of publicly traded companies, as stated above, this would likely increase the burden of reporting more significantly for private and smaller companies.

While this sounds like a relatively simple solution, it would not fully address the problem. Some companies do not request or need EINs. For example, a single member LLC with no employees would not need an EIN. In addition, some EINs become inactive after a certain period, dropping off the IRS database. For example, U.S. shell companies being used in foreign criminal activity are sometimes inactive in the United States. In addition, ownership information on LLCs owned by foreign individuals or entities would only be available if the LLC obtained an EIN for income that was subject to tax in the United States.

In addition, the IRS is not always notified when the ownership changes. In the instance of bearer shares, beneficial ownership changes each time the shares are passed from one person to another.

There is also an issue relating to the IRS' inability to share data with other Federal agencies. As part of the administration of federal tax laws, IRS investigators can use IRS data in their investigations of tax and related statutes, but access by other federal and state law enforcement is restricted by 26 U.S.C. § 6103. For example, in order for other federal law enforcement officials to access IRS information provided by taxpayers (or their representatives) a federal court must issue an ex parte order. The agency requesting the information must show that it is engaged in preparation for a judicial, administrative or grand jury proceeding to enforce a federal criminal statute or that the investigation may result in such a proceeding.

That said, there are several examples of tax information sharing currently authorized by the Internal Revenue Code. For example, there are additional provisions currently in the tax code providing for disclosure, in certain limited situations, of such information relating to criminal or terrorist activities or emergency circumstances. Additionally, state law enforcement officials can access IRS information for enforcement of state tax laws. Law enforcement officials can also obtain IRS information with the taxpayer's consent.

Summary

Mr. Chairman, the issue of disguised corporate ownership is a serious one for the IRS in terms of its ability to enforce the tax laws and in our efforts to reduce the tax gap. Our experience has shown us that the clearer the transaction and the identity and role of the parties to that transaction, the higher the rate of compliance with the tax laws and the anti-money laundering statutes.

Unfortunately, the lack of transparency caused by states not requiring sufficient beneficial ownership information upon the formation of a legal entity allows individuals who are intent on tax fraud, money laundering, and even terrorist activities to operate under a veil of secrecy that can frustrate the best efforts of law enforcement. We even see instances where we are unable to provide the full assistance requested by our tax treaty partners as they attempt to enforce the tax laws in their own countries.

The IRS has formed an Issue Management Team to address this matter. We will be going after both the promoters and their clients. We want to continue to work with FinCEN, the FBI, the Department of Homeland Security, and other Federal agencies. We also want to work with the states, both in sharing information and in making sure they recognize the risks of allowing the formation of corporations using techniques such as nominee officers and directors and bearer shares.

I appreciate the opportunity to be here this afternoon and Robert and I will be happy to respond to any questions.

United States Government Accountability Office

GAO

Testimony

Before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

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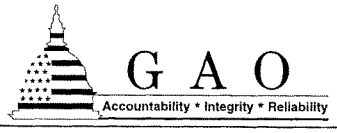
COMPANY FORMATIONS

Minimal Ownership Information Is Collected and Available

Statement of Yvonne D. Jones, Director
Financial Markets and Community Investment



GAO-07-196T

GAO
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Highlights

Highlights of GAO-07-196T, a testimony to Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

Companies, which are the basis of most commercial activities in market-based economies, may be used for illicit as well as legitimate purposes. Because companies can be used to hide activities such as money laundering, some states have been criticized for requiring too little information about companies when they are formed, especially concerning owners. This testimony draws on GAO's April 2006 report *Company Formations: Minimal Ownership Information Is Collected and Available* (GAO-06-376), which addressed (1) the information states and other parties collect on companies, (2) law enforcement concerns about the role of companies in illicit activities and the information available on owners, and (3) the implications of collecting more ownership information. GAO surveyed all 50 states and the District of Columbia, reviewed state laws, and interviewed a variety of industry, law enforcement, and other government officials.

What GAO Recommends

While not making recommendations, GAO observes that any requirement to collect company ownership information must take into consideration (1) the conflicting concerns of states, law enforcement agencies, and other parties about collecting such information and (2) the need to uniformly apply any requirement in all states.

www.gao.gov/cgi-bin/getrpt?GAO-07-196T.

To view the full product click on the link above. For more information, contact Yvonne Jones at (202) 512-8678 or jonesy@gao.gov.

November 14, 2006

COMPANY FORMATIONS

Minimal Ownership Information Is Collected and Available

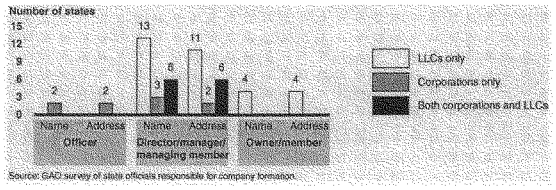
What GAO Found

Most states do not require ownership information at the time a company is formed or on the annual and biennial reports most corporations and limited liability companies (LLC) must file. Four of the 50 states and the District of Columbia require some information on members (owners) of LLCs (see figure). Some states require companies to list information on directors, officers, or managers, but these persons are not always owners. Nearly all states screen company filings for statutorily required information such as the company's name and an address where official notices can be sent, but no states verify the identities of company officials. Third-party agents may submit formation documents for a company but usually collect only billing and statutorily required information and rarely verify it.

Federal law enforcement officials are concerned that criminals are increasingly using U.S. "shell" companies—companies with generally no operations—to conceal their identities and illicit activities. Though the magnitude of the problem is hard to measure, officials said that such companies are increasingly involved in criminal investigations at home and abroad. The information states collect on companies has been helpful in some cases, as names on the documents can generate additional leads. But some officials said that available information was limited and that they had closed cases because the owners of a company under investigation could not be identified.

State officials and agents said that collecting company ownership information could be problematic. Some noted that collecting such information could increase the cost and time involved in approving company formations. A few states and agents said that they might lose business to other states, countries, or agents that had less stringent requirements. Finally, officials and agents were concerned about compromising individuals' privacy, as information on company filings that had historically been protected would become part of the public record.

Information Collected on Ownership and Management at Formation



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

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to participate in today's hearing on company formation practices among the states. My testimony, which is based on our April 2006 report to this subcommittee, will provide an overview of the information about the owners of nonpublicly traded companies that is routinely collected and made available by the 50 states and the District of Columbia.[1] As you know, the majority of companies in the United States are legitimate businesses that carry out an array of vital activities and are the backbone of our economy. However, companies can also be used for illicit purposes, such as laundering money or shielding assets from creditors. For example, government and international reports have said that "shell" companies—companies with generally no operations—have become popular tools for facilitating criminal activity because the persons controlling the company are not easily identifiable.[2] State statutes, which have historically governed the company formation process, generally provide for the privacy of the identities of company owners. This privacy may protect owners and their assets in the event of a lawsuit, but it can also be used to conceal the identity of the beneficial owners, or the persons who ultimately own and control a business entity.

In my statement today, I will address three main points. First, I will describe the ownership information that states collect on companies and their efforts to review and verify it. Next, I will discuss the concerns of law enforcement agencies about how companies can be used to hide illicit activity and how information on those companies, or the lack of it, can affect investigations. Finally, I will discuss the implications of requiring that states and others collect information on the owners of companies formed in each state. Our report, and this testimony, is based on extensive audit work that included a survey of officials from all of the states and the District of Columbia, a review of state statutes and company formation forms, and interviews with academics, third-party agents, law firms,

[1]GAO, *Company Formations: Minimal Information Is Collected and Available*, GAO-06-376 (Washington, D.C.: April 7, 2006).

[2]See U.S. Departments of Treasury, Justice, Homeland Security, et al, U.S. Money Laundering Threat Assessment Working Group, *U.S. Money Laundering Threat Assessment* (Washington, D.C.: December 2005); and Organization for Economic Co-operation and Development (OECD), *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (Paris: 2001).

financial institutions, law enforcement, and other state and federal officials.[3]

In summary:

- Most states do not require companies or third-party agents that represent them to provide ownership information at formation or in periodic reports. Similarly, states usually do not require information on company management, such as corporate officers and directors and limited liability company (LLC) managers, in the company formation documents, but most states require this information on periodic reports. Third-party agents that submit formation documents to the state on a company's behalf usually collect only information they need to bill the company for their services and statutorily required information. The information they collect generally does not include information on company owners. States and agents are generally not required to verify any information on company ownership or management or to screen names against criminal watch lists, although almost all state officials reported that they screen filings for the presence of statutorily required information such as the company name and an address where official notices can be sent. With rare exceptions, the agents we spoke with did not request additional information on company owners or verify clients' identity.

- Law enforcement officials we spoke with were concerned about the use of shell companies in the United States that enable individuals to conceal their identities and conduct criminal activity.[4] These officials said that they have also had difficulty investigating U.S. shell companies that were being used for illicit purposes because they could not identify the owners. Quantifying the magnitude of the criminal use of shell companies is difficult, but law enforcement officials told us about investigations, both domestic and international, that have involved such companies and the movement of billions of dollars. The law enforcement officials we interviewed said that they had obtained some company information from

[3]The survey and a complete tabulation of state-by-state and aggregated results can be viewed at http://www.gao.gov/cgi-bin/getrpt? GAO-06-377SP. Third-party agents include company formation agents who help individuals form companies and agents for service of process who receive legal and tax documents on behalf of a company. Agents can be individuals or companies operating in one state or nationally with only a few clients to thousands of clients.

[4]Creating a shell company is not a crime but rather can be a method for hiding criminal activity. When we refer to "shell companies" in this statement, we mean U.S. companies that do not conduct any legitimate activity.

company formation documents or periodic reports and occasionally from agents during investigations and that this information had generated additional leads. But some officials noted that the information available from the states often did not reveal who owned the company and that cases had been closed because owners could not be traced.

- State officials, agents, and others we interviewed said that collecting company ownership information could be problematic, for several reasons. For example, state officials told us that the costs and time involved in approving company formations could increase, potentially slowing down or derailing business dealings. In addition, a few states and agents said they might lose business to other jurisdictions with less stringent requirements. State officials and agents also expressed concerns about maintaining the privacy of the owners of legitimate businesses that historically had been protected from public scrutiny. State officials, agents, and other experts in the field suggested that internal company records, financial institutions, and the Internal Revenue Service (IRS) could be alternative sources of ownership information for law enforcement investigations, but we found that using these sources could also be problematic.

Background

The company formation process is governed and executed at the state level. Formation documents are generally filed with a secretary of state's office and are commonly called articles of incorporation (for corporations) or articles of organization (for LLCs). These documents, which set out the basic terms governing the company's existence, are matters of public record. According to our survey results, in 2004, 869,693 corporations and 1,068,989 LLCs were formed in the United States. See appendix I for information on the numbers of corporations and LLCs formed in each state. Appendix II includes information on states' company formation processing times and fees.

Although specific requirements vary, states require minimal information on formation documents. Generally, the formation documents, or articles, must give the company's name, an address where official notices can be sent, share information (for corporations), and the names and signatures of the persons incorporating. States may also ask for a statement on the purpose of the company and a principal office address on the articles. Most states also require companies to file periodic reports to remain active. These reports are generally filed either annually or biennially.

Although individuals may submit their own company filing documents, third-party agents may also play a role in the process. Third-party agents include both company formation agents, who file the required documents with a state on behalf of individuals or their representatives, and agents for service of process, who receive legal and tax documents on behalf of a company. Agents can be individuals or companies operating in one state or nationally. They may have only a few clients or thousands of clients. As a result, the incorporator or organizer listed on a company's formation documents may be the agent who is forming the company on behalf of the owners or an individual affiliated with the company being formed.

Businesses may be incorporated or unincorporated. A corporation is a legal entity that exists independently of its shareholders—that is, its owners or investors—and that limits their liability for business debts and obligations and protects their personal assets. Management may include officers—chief executive officers, secretaries, and treasurers—who help direct a corporation's day-to-day operations. LLCs are unincorporated businesses whose members are considered the owners, and either members acting as managers or outside managers hired by the company take responsibility for making decisions. Beneficial owners of corporations or LLCs are the individuals who ultimately own and control the business entity.

States and Agents Generally Do Not Collect or Verify Information on Company Ownership and Management

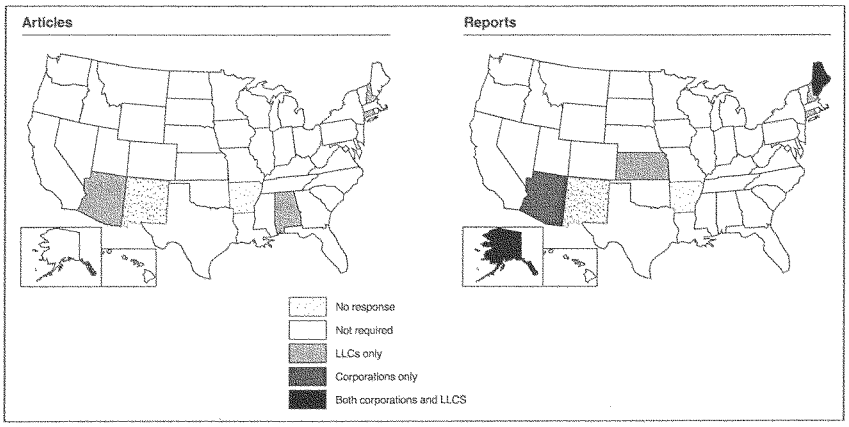
Our survey revealed that most states do not collect information on company ownership (see fig. 1). No state collects ownership information on formation documents for corporations, and only four—Alabama, Arizona, Connecticut, and New Hampshire—request some ownership information on LLCs.[5] Most states require corporations and LLCs to file periodic reports, but these reports generally do not include ownership information. Three states (Alaska, Arizona, and Maine) require in certain cases the name of at least one owner on periodic reports from corporations, and five states require companies to list at least one member on periodic reports from LLCs.[6] However, if an LLC has members that are

[5]In response to a question on requirements for LLC member information, a Connecticut official said that either a member's or a manager's name was required on the articles of incorporation. In New Hampshire, a member or manager is required to sign the articles of organization. One state did not respond to the survey question on providing names of owners of corporations, and two states did not respond to the question on the addresses of owners.

[6]The five states are Alaska, Connecticut, Kansas, Maine, and New Hampshire. One state did not respond to this survey question.

acting as managers of the company (managing members), ownership information may be available on the formation documents or periodic reports in states that require manager information to be listed.

Figure 1: States Requiring Ownership Information in Articles and Periodic Reports



Sources. GAO survey of state officials responsible for company formation (data); Art Explosion (map).

Note: Arkansas and New Mexico omitted responses to certain questions on our survey. Arkansas responded that LLC member information is not required on articles or reports. We found from our legal review that Arkansas does not require the address of a corporation's owner on articles or periodic reports. Our legal review also found that New Mexico does not require corporations to list the name or address of an owner on articles or periodic reports. For LLCs, we found that New Mexico does not require member names and addresses on formation documents or periodic reports.

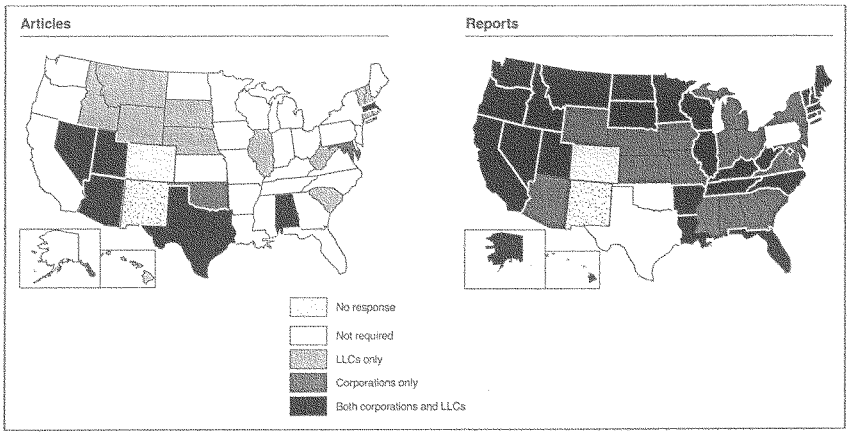
States usually do not require information on company management in the formation documents, but most states require this information on periodic reports (see fig. 2). Less than half of the states require the names and addresses of company management on company formation documents. Two states require some information on officers on company formation documents, and 10 require some information on directors. However, individuals named as directors may be nominee directors who act only as

instructed by the beneficial owner.[7] For LLCs, 19 states require some information on the managers or managing members on formation documents.[8] Most states require the names and addresses of corporate officers and directors and of managers of LLCs on periodic reports. For corporations, 47 states require some information about the corporate officers, and 38 states require some information on directors on periodic reports. For LLCs, 28 states require some information about managers or managing members on the periodic reports.

[7]A nominee director may be an individual who is located where the business was formed and may sign official documents for the business on behalf of the beneficial owner. Typically, the nominee director will have no knowledge of the business affairs or accounts, cannot control or influence the business, and will not act unless instructed to by the beneficial owner.

[8]One state did not respond to this survey question.

Figure 2: States Requiring Management Names or Addresses in Articles and Periodic Reports



Sources: GAO survey of state officials responsible for company formation (data); Art Explosion (map).

Note: New Mexico responded on our survey that information on corporate officers is required on reports and information on directors is required for both articles and reports, but did not respond to the questions about the names and addresses of LLC managers/managing members. We found in our legal review that New Mexico does not require this information on LLC filings.

In addition to states, third-party agents may also have an opportunity to collect ownership or management information when a company is formed. Third-party agents we spoke with generally said that beyond contact information for billing the company and for forwarding legal and tax documents, they collect only the information states require for company formation documents or periodic reports. Several agents told us that they rarely collected information on ownership because the states do not require it. Further, one agent said it was not necessary to doing the job. In general, agents said that they also collected only the management information that states required. However, if they were serving as the incorporator, agents would need to collect the names of managers in order to officially pass on the authority to conduct business to the new company principals. A few agents said that even when they collected information on company ownership and management, they might not keep records of it, in part because company documents filed with the state are part of the public

record. One agent said that he did not need to bear the additional cost of storing such information.

According to our survey, states do not verify the identities of the individuals listed on the formation documents or screen names using federal criminal records or watch lists. Nearly all of the states reported that they review filings for the required information, fees, and availability of the proposed company name. Many states also reported that they review filings to ensure compliance with state laws, and a few states reported that they direct staff to look for suspicious activity or fraud in company filings.[9] However, most states reported they did not have the investigative authority to take action if they identified suspicious information. For example, if something appeared especially unusual, two state officials said that they referred the issue to state or local law enforcement or the Department of Homeland Security. While states do not verify the identities of individuals listed on company formation documents, 10 states reported having the authority to assess penalties for providing false information on their company formation documents. One state official provided an example of a case in which state law enforcement officials charged two individuals with, among other things, perjury for providing false information about an agent on articles of incorporation.

In addition, our survey shows that states do not require agents to verify the information collected from their clients. Most states have basic requirements for agents for service of process, but overall states exercise limited oversight of agents. Most states indicated on our survey that agents for service of process must meet certain requirements, such as having a physical address in the state or being a state resident. However, a couple of states have registration requirements for agents operating within their boundaries. Under a law that was enacted after some agents gave false addresses for their offices, Wyoming requires agents serving more than five corporations to register with the state annually. California law requires any corporation serving as an agent for service of process to file a certificate with the Secretary of State's office and to list the California address where process can be served and the name of each employee authorized to accept process. Delaware has a contractual relationship with approximately 40 agents that allows them, for a fee and under set

[9]We do not have information on the extent of this legal review in all of the states that responded that they conduct such a review.

guidelines, access to the state's database to enter or find company information.

Agents we interviewed said that since states do not require them to, they generally do not verify or screen names against watch lists or require picture identification of company officials. One agent said that his firm generally relied on the information that it received and in general did not feel a need to question the information. However, we found a few exceptions. One agent collected a federal tax identification number (TIN), company ownership information, and individual identification and citizenship status from clients from unfamiliar countries. Another agent we interviewed required detailed information on company principals, certified copies of their passports, proof of address, and a reference letter from a bank from certain international clients. A few agents said that they used the Office of Foreign Assets Control (OFAC) list to screen names on formation documents or on other documents required for other services provided by their company.[10]

The agents said they took these additional steps for different reasons. One agent wanted to protect the agency, while other agents said that the Delaware Secretary of State encouraged using the OFAC list to screen names. One agent felt the additional requirements were not burdensome. However, some agents found the OFAC list difficult to use and saw using it as a potentially costly endeavor. OFAC officials told us that they had also heard similar concerns from agents.

[10]OFAC is an office within the U.S. Department of the Treasury that administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals, as well as a master list of "Specially Designated Nationals and Blocked Persons" (SDN) that includes numerous foreign agents and front organizations, terrorists, terrorist organizations, and narcotics traffickers. All U.S. persons, both individuals and entities, are responsible for ensuring they do not do business with a person or entity listed on the SDN list. Undertaking any type of business or financial transaction with a person or entity on this list is illegal under federal law.

Lack of Ownership Information Can Obstruct Law Enforcement Investigations

Law enforcement officials and others have indicated that shell companies have become popular tools for facilitating criminal activity, particularly laundering money. A December 2005 report issued by several federal agencies, including the Departments of Homeland Security, Justice, and the Treasury, analyzed the role shell companies may play in laundering money in the United States. Shell companies can aid criminals in conducting illegal activities by providing an appearance of legitimacy and may provide access to the U.S. financial system through correspondent bank accounts.[11] For example, the Financial Crimes Enforcement Network (FinCEN) found in a December 2005 enforcement action that the New York branch of ABM AMRO, a banking institution, did not have an adequate anti-money laundering program and had failed to monitor approximately 20,000 funds transfers—with an aggregate value of approximately $3.2 billion—involving the accounts of U.S. shell companies and institutions in Russia or other former republics of the Soviet Union. But determining the extent of the criminal use of U.S. shell companies is difficult. Shell companies are not tracked by law enforcement agencies because simply forming them is not a crime. However, law enforcement officials told us that information they had seen suggested that U.S. shell companies were increasingly being used for illicit activities. For example, FinCEN officials told us they had seen many suspicious activity reports (SAR) filed by financial institutions that potentially implicated U.S. shell companies. One report cited hundreds of SARs filed between April 1996 and January 2006 that involved shell companies and resulted in almost $4 billion in activity.[12]

During investigations of suspicious activity, law enforcement officials may obtain some company information from agents or states, either from state's Internet sites or by requesting copies of filings. According to some law enforcement officials we spoke with, information on the forms, such as the names and addresses of officers and directors, might provide productive leads, even without explicit ownership information. Law enforcement officials also sometimes obtain additional company information, such as contact addresses and methods of payment, from

[11]A correspondent account is an account that a foreign bank opens at a U.S. bank to gain access to the U.S. financial system and to avoid bearing the costs of licensing, staffing, and operating its own offices in the United States. Many of the largest international banks serve as correspondents for thousands of other banks.

[12]See U.S. Departments of Treasury, Justice, Homeland Security, et al, U.S. Money Laundering Threat Assessment Working Group, *U.S. Money Laundering Threat Assessment* (Washington, D.C.: December 2005).

agents, although one state law enforcement official said the agents might tell their clients about the investigation. In some cases, the actual owners may include their personal information on official documents. For example, in an IRS case a man in Texas used numerous identities and corporations formed in Delaware, Nevada, and Texas to sell or license a new software program to investment groups. He received about $12.5 million from investors but never delivered the product to any of the groups. The man used the corporations to hide his identity, provide a legitimate face to his fraudulent activities, and open bank accounts to launder the investors' money. IRS investigators found from state documents that he had incorporated the companies himself and often included his coconspirators as officers or directors. The man was sentenced to 40 years in prison.

In other cases, law enforcement officials may have evidence of a crime but may not be able to connect an individual to the criminal action without ownership information. For example, an Arizona law enforcement official who was helping to investigate an environmental spill that caused $800,000 in damage said that investigators could not prove who was responsible for the damage because the suspect had created a complicated corporate structure involving multiple company formations.[13] This case was not prosecuted because investigators could not identify critical ownership information. Most of the officials we interviewed said they had also worked on cases that reached dead ends because of the lack of ownership information.

[13]Dispersing assets among as many different types of entities and jurisdictions as possible is also a way to protect assets. The goal of this approach is to create complex structures that, in effect, provide multiple protective trenches around assets, making it challenging and burdensome to pursue. See GAO, *Environmental Liabilities: EPA Should Do More to Ensure That Liable Parties Meet Their Cleanup Obligations*, GAO-05-658 (Washington, D.C.: Aug. 17, 2005)

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

States and agents recognized the positive impacts of collecting ownership information when companies are formed. As previously noted, law enforcement investigations could benefit by knowing who owns and controls a company. In addition, a few state officials said that they could be more responsive to consumer demands for this information if it were on file. One agent suggested that requiring agents to collect more ownership information could discourage dishonest individuals from using agents and could reduce the number of unscrupulous individuals in the industry.

However, state officials and agents we surveyed and interviewed indicated that collecting and verifying ownership information could have negative effects. These could include:

- Increased time, costs, and workloads for state offices and agents: Many states reported that the time needed to review and approve company formations would increase and said that states would incur costs for modifying forms and data systems. Further, officials said that states did not have the resources and staff did not have the skills to verify the information submitted on formation documents.[14]

- Derailed business dealings: A few state and some private sector officials noted that an increase in the time and costs involved in forming a company might reduce the number of companies formed, particularly small businesses. One state official commented that such requirements would create a burden for honest business people but would not deter criminals.

- Lost state revenue: Some state officials and others we interviewed felt that if all state information requirements were not uniform, the states with the most stringent requirements could lose business to other states or even countries, reducing state revenues.

- Lost business for agents: Individuals might be more likely to form their own companies and serve as their own agents. Agents also indicated that it might be difficult to collect and verify information on company owners because they often were in contact only with law firms and not company officials during the formation process.

[14]State officials and others also noted that individuals could easily provide false names if ownership information were required without being verified.

In addition, some state officials noted that any change in requirements for obtaining or verifying information, or the fees charged for company formation, would require state legislatures to pass new legislation and grant company formation offices new authority. Further, state and private sector officials pointed out that ownership information collected at formation or on periodic reports might not be complete or up to date because it could change frequently. Finally, as noted, some states do not require periodic reports, and law enforcement officials noted that a shell company being used for illicit purposes might not file required periodic reports in any case.[15] Law enforcement officials told us that many companies under investigation for suspected criminal activities had been dissolved by the states in which they were formed for failing to submit periodic reports. In addition, since a company can be owned by another company, the name provided may not be that of an individual, but another company.

We also found that state officials, agents, and other industry experts felt that the need to access information on companies must be weighed against privacy issues. Company owners may want to maintain their privacy, in part because state statutes have traditionally permitted this privacy in part to avoid lawsuits against them in their personal capacity. Some business owners may also seek to protect personal assets through corporations and LLCs. One state law enforcement official also noted that if more information were easily available, criminals and con artists could take advantage of it and target companies for scams. Although business owners might be more willing to provide ownership information if it would not be disclosed in the public record, some state officials we interviewed said that since all information filed with their office is a matter of public record, keeping some information private would require new legislative authority. The officials added that storing new information would be a challenge because their data systems were not set up to maintain confidential information. However, a few states described procedures in which certain information could be redacted from the public record or from online databases.

[15]Our review of state statutes indicated that 14 states do not require periodic reports for LLCs and that 3 did not require them for corporations. In 3 states (Alabama, New Jersey, and Oklahoma), the annual report is submitted to a different office, such as the department of revenue, than the office that handles formation filings. In addition, biennial reports were required to be filed by corporations in 7 states and by LLCs in 5 states.

In our review, state officials, agents, and other experts in the field identified three other potential sources of company ownership information, but each of these sources also has drawbacks.

First, company ownership information may be available in internal company documents. According to our review of state statutes, internal company documents, such as lists of shareholders for corporations, are required in all states for corporations.[16] Also, according to industry experts, LLCs usually prepare and maintain operating agreements as well.[17] These documents are generally not public records, but law enforcement officials can subpoena them to obtain ownership information. However, accessing these lists may be problematic, and the documents themselves might not be accurate and might not reveal the true beneficial owners of a company. In some cases, the documents may not even exist. For example, law enforcement officials said that shell companies may not prepare these documents and that U.S. officials may not have access to them if the company is located in another country. In addition, the shareholder list could include nominee shareholders and may not reflect any changes in shareholders.[18] In states that allow bearer shares, companies may not even list the names of the shareholders.[19] Finally, law enforcement officials may not want to request these documents in order to avoid tipping off a company about an investigation.

Second, we were told that financial institutions may have ownership information on some companies. The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001 established minimum standards for financial institutions to follow when verifying the identity of

[16]Delaware, Kansas, and Oklahoma statutes do not expressly state that a corporation is required to maintain a list of shareholders, but shareholders must be able to extract information on shareholders from corporate documents maintained by the corporation.

[17]Some states may not require written operating agreements. If there is no operating agreement, the LLC follows default provisions of the LLC act of the state where the company was formed.

[18]With publicly traded shares, nominees (e.g., shares registered in the names of stockbrokers) are commonly and legitimately used to facilitate the clearance and settlement of trades. Nominee shareholders can also be used in privately held companies to shield beneficial ownership information.

[19]According to the U.S. Money Laundering Threat Assessment, Nevada and Wyoming allow the use of bearer shares, which accord ownership of a company to the person who possesses the share certificate.

their customers. For customers that are companies, this information includes the name of the company, its physical address (for instance, its principal place of business), and an identifying number such as the tax identification number.[20] In addition, financial institutions must also develop risk-based procedures for verifying the identity of each customer.[21] However, according to financial services industry representatives, conducting due diligence on a company absorbs time and resources, could be an added burden to an industry that is already subject to numerous regulations, and may result in losing a customer. Industry representatives also noted that ownership information might change after the account was opened and that not all companies open bank or brokerage accounts. Finally, correspondent accounts could create opportunities to hide the identities of the account holders from the banks themselves.

Finally, the Internal Revenue Service was mentioned as another potential source of company ownership information for law enforcement, but IRS officials pointed to several limitations with their agency's data. First, IRS may not have information on all companies formed. For example, not all companies are required to submit tax forms that include company ownership information. Second, IRS officials reported that the ownership information the agency collects might not be complete or up to date and the owner listed could be another company. Third, law enforcement officials could have difficulty accessing IRS taxpayer information, since access by federal and state law enforcement agencies outside of IRS investigations is restricted by law. IRS officials commented that collecting additional ownership and management information on IRS documents would provide IRS investigators with more detail, but their ability to collect and verify such information would depend on the availability of resources.

[20]Pub. L. No. 107-56, 115 Stat. 272 (Oct. 26, 2001). Section 326 of the USA PATRIOT ACT directs Treasury and the federal financial regulators to adopt customer identification program requirements for all "financial institutions," which is defined broadly to encompass a variety of entities, including, among others, (1) banks that are subject to regulation by one of the federal banking regulators, as well as credit unions that are not federally insured, private banks, and trust companies; (2) securities broker dealers; (3) futures commission merchants and introducing brokers; and (4) mutual funds. See 31 U.S.C. § 5312; 31 C.F.R. part 103.

[21]See GAO, *USA PATRIOT ACT: Additional Guidance Could Improve Implementation of Regulations Related to Customer Identification and Information Sharing Procedures*, GAO-05-412 (Washington, D.C.: May 6, 2005).

Concluding Remarks

In preparing our April 2006 report, we encountered a variety of legitimate concerns about the merits of collecting ownership information on companies formed in the United States. On the one hand, federal law enforcement agencies were concerned about the existing lack of information, because criminals can easily use shell companies to mask the identities of those engaged in illegal activities. From a law enforcement perspective, having more information on company ownership would make using shell companies for illicit activities harder, give investigators more information to use in pursuing the actual owners, and could improve the integrity of the company formation process in the United States. On the other hand, states and agents were concerned about increased costs, potential revenue losses, and owners' privacy if information requirements were increased. Collecting more information and approving applications would require more time and resources, possibly reducing the number of business startups and could be considered a threat to the current system, which values the protection of privacy and individuals' personal assets. Any requirement that states, agents, or both collect more ownership information would need to balance these conflicting concerns and be uniformly applied in all U.S. jurisdictions. Otherwise, those wanting to set up shell companies for illicit activities could simply move to the jurisdiction that presented the fewest obstacles, undermining the intent of the requirement.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or other members of the committee may have at this time.

Staff Contacts and Acknowledgments

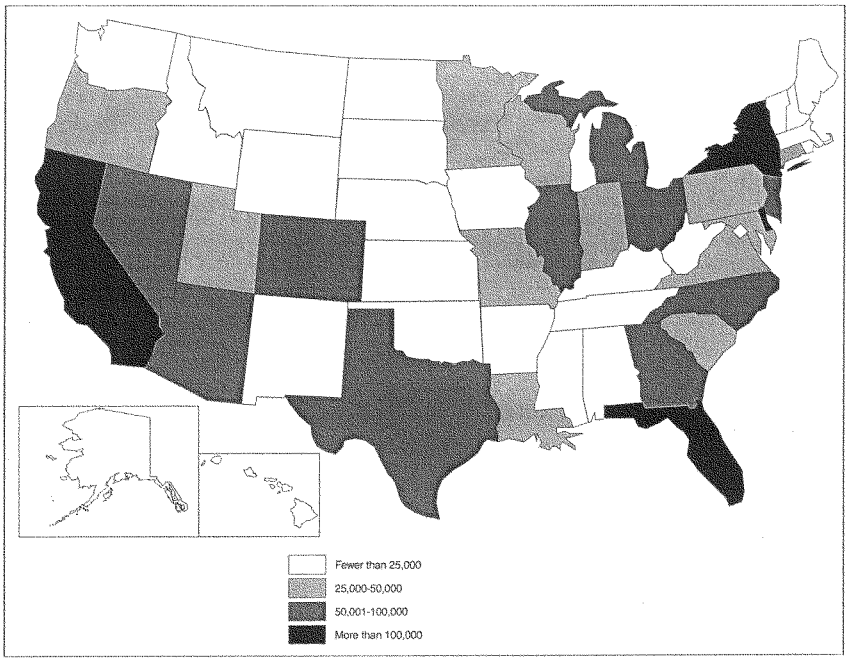
For further information regarding this testimony, please contact me at (202) 512-8678 or jonesy@gao.gov. Individuals making contributions to this testimony include Kay Kuhlman, Assistant Director; Emily Chalmers; Jennifer DuBord; Marc Molino; Jill Naamane; and Linda Rego.

Appendix I: The Number of Corporations and LLCs Formed in the United States

Historically, the corporation has been the dominant business form, but recently the limited liability company (LLC) has become increasingly popular. According to our survey, 8,908,519 corporations and 3,781,875 LLCs were on file nationwide in 2004. That same year, a total of 869,693 corporations and 1,068,989 LLCs were formed. Figure 3 shows the number of corporations and LLCs formed in each state in 2004. Five states—California, Delaware, Florida, New York, and Texas—were responsible for 415,011 (47.7 percent) of the corporations and 310,904 (29.1 percent) of the LLCs. Florida was the top formation state for both corporations (170,207 formed) and LLCs (100,070) in 2004. New York had the largest number of corporations on file in 2004 (862,647) and Delaware the largest number of LLCs (273,252). Data from the International Association of Commercial Administrators (IACA) show that from 2001 to 2004, the number of LLCs formed increased rapidly—by 92.3 percent—although the number of corporations formed increased only 3.6 percent.[1]

[1]IACA is a professional association for government administrators of business organization and secured transaction record systems at the state, provincial, and national level in any jurisdiction. The IACA data include domestic, foreign, and professional companies. Domestic companies are those doing business in the same state in which they are incorporated or formed. Foreign companies do business in a state, but they are incorporated or formed in another jurisdiction, either in another U.S. state or a foreign country. Professional corporations may include professional services, such as those performed by doctors, dentists and attorneys. Combining figures for these different types of companies overestimates the number of companies formed under the state statutes examined in this report, which covers only domestic companies. Some states did not report data to IACA.

Figure 3: Domestic Corporations and LLCs Formed in U.S. States in 2004



Sources: GAO survey of state officials responsible for company formation (data); Art Explosion (map)

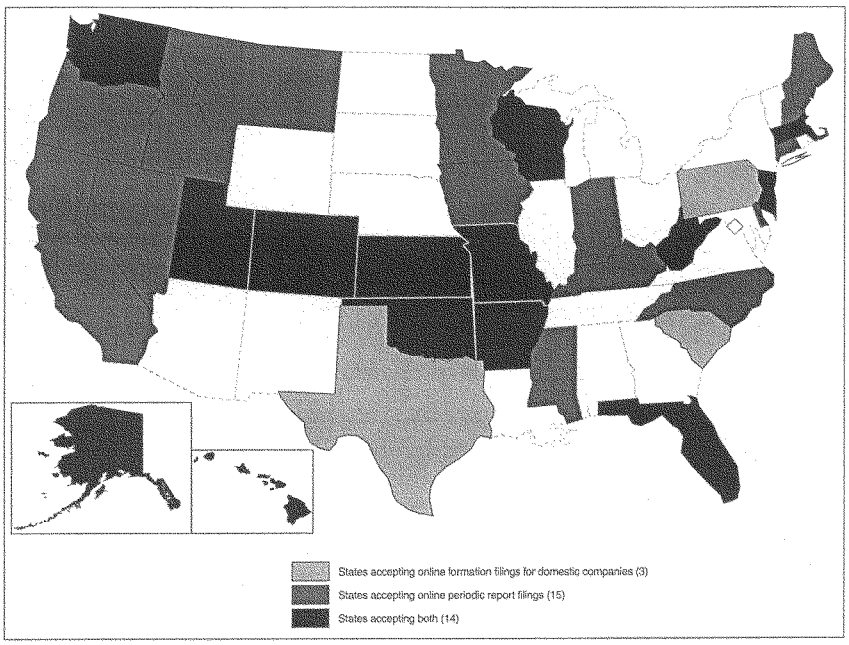
Appendix II: Company Formation and Reporting Documents Can Be Submitted in a Variety of Ways

Company formation and reporting documents can be submitted in person or by mail, and many states also accept filings by fax. Review and approval times can depend on how documents are submitted. For example, a District of Columbia official told us that a formation document submitted in person could be approved in 15 minutes, but a document that was mailed might not be approved for 10 to 15 days. Most states reported that documents submitted in person or by mail were approved within 1 to 5 business days, although a few reported that the process took more than 10 days. Officials in Arizona, for example, told us that it typically took the office 60 days to approve formation documents because of the volume of filings the office received.

In 36 states, company formation documents, reporting documents, or both can be submitted through electronic filing (fig. 4 shows the states that provide a Web site for filing formation documents or periodic reports).[1] In addition, some officials indicated that they would like or were planning to offer electronic filing in the future.

[1]Electronic filing includes the ability to file a document through a Web site, e-mail, or fax. Five states reported that they offer e-mail filing for company formation documents, and 4 states reported that they offer e-mail filing for periodic reports. In addition, 27 states reported that they accept formation or periodic report filings by fax.

Figure 4: States That Provide a Web Site for Filing Formation or Periodic Report Filings



Sources: GAO survey of state officials responsible for company formation (data), Art Explosion (map)

As shown in table 1, in many cases states charge the same or nearly the same fee for forming a corporation or an LLC. In others, such as Illinois, the fee is substantially different for the two business forms. We found that in two states, Nebraska and New Mexico, the fee for forming a corporation may fall into a range. In these cases, the actual fee charged depends on the number of shares the new corporation will have. The median company formation fee is $95, and fees for filing periodic reports range from $5 to $500.

Table 1: State Company Formation Fees as of November 2005

State	LLCs	Corporations
Alabama	$75	$40
Alaska	250	250
Arizona	50	60
Arkansas	50	50
California	70	100
Colorado	125	125
Connecticut	60	150
Delaware	90	50
District of Columbia	150	89
Florida	125	79
Georgia	100	100
Hawaii	50	50
Idaho	100	100
Illinois	500	150
Indiana	90	90
Iowa	50	50
Kansas	165	90
Kentucky	40	40
Louisiana	75	60
Maine	175	145
Maryland	100	100
Massachusetts	500	275
Michigan	50	60
Minnesota	135	135
Mississippi	50	50
Missouri	105	58
Montana	70	70
Nebraska	100	60-300
Nevada	75	75
New Hampshire	100	50
New Jersey	125	125
New Mexico	50	100-1,000
New York	200	125
North Carolina	125	125
North Dakota	125	80

State	LLCs	Corporations
Ohio	125	125
Oklahoma	100	50
Oregon	50	50
Pennsylvania	125	125
Rhode Island	150	230
South Carolina	110	135
South Dakota	125	125
Tennessee	300	100
Texas	200	300
Utah	52	52
Vermont	75	75
Virginia	100	25
Washington	175	175
West Virginia	100	50
Wisconsin	170	100
Wyoming	100	100

Source: GAO analysis of state Web sites.

Thirty states reported offering expedited service for an additional fee. Of those, most responded that with expedited service, filings were approved either the same day or the day after an application was filed. Two states reported having several expedited service options. Nevada offers 24-hour expedited service for an additional $125 above the normal filing fees, 2-hour service for an extra $500, and 1-hour, or "while you wait," service for an extra $1,000. Delaware offers same day service for $100, next-day service for $50, 2-hour service for $500, and 1-hour service for $1,000.

STATEMENT OF ASSOCIATE DIRECTOR
FOR REGULATORY POLICY AND PROGRAMS
JAMAL EL-HINDI
FINANCIAL CRIMES ENFORCEMENT NETWORK
UNITED STATES DEPARTMENT OF THE TREASURY

BEFORE THE
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

NOVEMBER 14, 2006

Chairman Coleman, Senator Levin, and distinguished Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the Financial Crimes Enforcement Network's (FinCEN) ongoing efforts to address money laundering and terrorist financing concerns associated with the lack of transparency in the ownership of certain legal entities. I appreciate the Subcommittee's interest in this important issue, and your continued support of our efforts to help prevent illicit financial activity.

I am also pleased to be testifying with my colleagues from the Department of Justice and Internal Revenue Service. Each of these agencies/offices plays an important role in the global fight against money laundering and terrorist financing, and our collaboration on these issues has greatly improved the effectiveness of our efforts.

FinCEN's mission is to safeguard the financial system from the abuses of financial crime, including terrorist financing, money laundering, and other illicit activity. FinCEN works to achieve its mission through a broad range of interrelated activities, including:

- Administering the Bank Secrecy Act (BSA);
- Supporting law enforcement, intelligence, and regulatory agencies through the sharing and analysis of financial intelligence; and
- Building global cooperation and technical expertise among financial intelligence units throughout the world.

FinCEN's main goal in administering the BSA is to increase the transparency of the U.S. financial system so that money laundering, terrorist financing and other economic crime can be detected, investigated, prosecuted and, ultimately, prevented. Our ability to work closely with our regulatory, law enforcement and international partners assists us to achieve consistency across our regulatory regime and, consequently, to better protect the U.S. financial system.

Shell Companies

Business entities, such as corporations, limited liability companies (LLCs), and trusts can be organized and established in all states with minimal public disclosure of information regarding controlling interests and ownership. We use the term "shell company" to refer to corporations, LLCs, and other business entities that typically have no physical presence (other than a mailing address) and generate little to no independent economic value.[1] Most legal entities are formed by individuals and businesses for legitimate purposes, such as to hold stock or intangible assets of another business entity[2] or to facilitate domestic and cross-border currency and asset transfers and corporate mergers. However, as noted in the 2005 U.S. Money Laundering Threat Assessment, shell companies have become common tools for money laundering and other financial crime, primarily because they are easy and inexpensive to form and operate, and because ownership and transactional information on these entities can be concealed from regulatory and law enforcement authorities.

According to a survey conducted by the U.S. Government Accountability Office, there were approximately 8.9 million corporations and 3.8 million LLCs registered nationwide in 2004. Although the corporation historically has been the dominant business structure, the LLC has become increasingly popular. More LLCs were formed nationwide in 2004 (1,068,989) than were corporations (869,693).[3]

Agents and Nominee Incorporation Services

Agents, also known as intermediaries, or nominee incorporation services (NIS) can play a central role in the creation and ongoing maintenance and support of shell companies. NIS firms are often used because they can legally and efficiently organize business entities in any state.

Agents and NIS firms advertise a wide range of services for shell companies, such as serving as in-state resident agents and providing mail forwarding services. Organizers of legal entities also may purchase corporate "service packages" to give the appearance of having an established physical local presence. These service packages can include a state business license, a local street address, an office that is staffed during business hours, a local telephone listing with a receptionist, and 24-hour personalized voicemail.

International NIS firms have entered into marketing and customer referral arrangements with U.S. banks to offer financial services such as Internet banking and funds transfer capabilities to shell companies and foreign citizens. U.S. banks that participate in these arrangements may be assuming increased levels of money laundering risk.

Some agents and NIS firms also provide individuals and businesses in the United States and abroad with a variety of nominee services that can be used to preserve a client's anonymity

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[1] U.S. Money Laundering Threat Assessment Working Group, *U.S. Money Laundering Threat Assessment* (December 2005), p. 47.

[2] Companies that hold significant assets (for example, subsidiary company shares) but that are not engaged in active business operations would not be considered shell companies as described herein (although they may in practice be referred to as "shell holding companies").

[3] U.S. Government Accountability Office, *Company Formations – Minimal Ownership Information is Collected and Available*, GAO-06-376 (April 7, 2006).

in connection with the formation and operation of legal entities. These services, although legal, may be attractive to those seeking to launder funds or finance terrorism, and can include:

- Nominee Officers and Directors: Incorporators provide the legal entity with nominees for all offices that appear in public records.

- Nominee Stockholders: A beneficial owner may use nominee stockholders to further ensure privacy and anonymity while maintaining control through an irrevocable proxy agreement with the nominee.

- Nominee Bank Signatory: A nominee appointed as the company fiduciary (such as a lawyer or accountant) can open bank accounts in the name of the legal entity. The nominee accepts instructions from the beneficial owners and forwards these instructions to the bank without needing to disclose the names of the beneficial owners.

Banks that serve as company formation agents remain subject to all BSA recordkeeping and reporting requirements, including customer identification program requirements and suspicious activity reporting.

FinCEN Study

As stated earlier in my testimony, FinCEN's main goal in administering the BSA is to increase transparency in the U.S. financial system. The lack of transparency in the legal entity formation process, the absence of ownership disclosure requirements and the ease of formation of legal entities make these corporate vehicles attractive to financial criminals to launder money or conduct illicit financial activity. This, in turn, poses vulnerabilities to the financial system, both domestically and internationally. That is why finding a way to address the misuse of legal entities in the context of the BSA has been and continues to be a priority for the U.S. Department of the Treasury and for FinCEN.

In response to concerns raised by law enforcement, regulators, and financial institutions regarding the lack of transparency associated with these business entities, FinCEN prepared an internal report in 2005 on the role of domestic shell companies (and particularly LLCs) in financial crime and money laundering. An updated version of this report was publicly released last week, along with an advisory to financial institutions reminding them of the importance of identifying, assessing and managing the potential risks associated with providing financial services to shell companies.

The report highlights several key findings that demonstrate the vulnerability of shell companies to abuse. They include the following:

- Domestic shell companies have legitimate and legal uses, but the ability to abuse such vehicles for illicit purposes must be continually monitored.

- Domestic shell companies can be and have been used as vehicles for common financial crime schemes such as credit card bust outs, purchasing fraud, and other fraudulent loans.

- The use of domestic shell companies as parties in international wire transfers allows for the movement of billions of dollars internationally by unknown beneficial owners. This could facilitate money laundering or terrorist financing.

- Agents and NIS firms play a central role in the creation and ongoing maintenance and support of domestic shell companies, some of which appear to be used for illicit purposes domestically and abroad.

- Based on our research, states do not appear to impose effective accountability safeguards on agents and NIS firms to ensure that the business entities they create, buy, sell, and support are used only for lawful and allowable purposes.[4]

- There is currently neither a requirement that the agents and NIS firms report suspicious activity involving the shell companies they create, buy, sell, or support, nor requirements or procedures to identify beneficial owners in certain jurisdictions if illicit activity is suspected.

- Certain domestic jurisdictions, especially when served by corrupt or unwitting agents or NIS firms, are particularly appealing for the creation of shell companies to be used for illicit purposes.

- LLCs, particularly when organized in states which do not require reporting of information on ownership,[5] provide an attractive vehicle for shell companies because they can be owned or managed anonymously, and are inherently vulnerable to abuse.

State Requirements

The report also examines the level of transparency among states with respect to the reporting of information on ownership of LLCs. All limited liability companies have "members." A "member" of an LLC is equivalent to a shareholder of a corporation. LLCs may also have "managers." A "manager" of an LLC is equivalent to an executive officer or a member of the board of directors. An LLC may lack managers – in which case the members themselves would manage the LLC. The members in this case would resemble partners in a general partnership.

Fourteen states[6] impose no requirement to identify – in documents filed with the states – either members or managers of limited liability companies.

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[4] A few states – most notably Delaware – impose "standards of conduct" on persons serving as "registered agents." For example, the Court of Chancery in Delaware can enjoin a person from serving as a "registered agent" if the person has engaged in criminal conduct or in conduct that is likely to deceive or defraud the public. Service as a "registered agent" forms only part of the services that company formation agents and similar service providers often offer their clients. Moreover, a business entity need not organize or conduct activities in Delaware or any other state that imposes "standards of conduct."

[5] Although some states require the reporting of ownership information, no state requires the reporting of information regarding *beneficial* ownership. An individual may own an LLC indirectly, through nominees and other business entities. The U.S. Securities and Exchange Commission (SEC) addresses this potentiality through the concept of beneficial ownership, which the SEC defines as holding the rights of ownership "directly or indirectly, through any contact, arrangement, understanding, relationship, or otherwise." The concept of beneficial ownership would require an LLC – when reporting information – to "look through" nominees and business entities.

Eight states and the District of Columbia[7] require limited liability companies to include information that identifies managers. If an LLC has one or more managers, the LLC may report the identities of managers only. In the absence of managers, the LLC must report the identities of members.

Twenty-four states[8] require the inclusion of information that identifies members or managers. If an LLC has one or more managers, the LLC may report the identities of managers only. In the absence of managers, the LLC must report the identities of members.

Only four states[9] require the inclusion of information that identifies members, even when an LLC has one or more managers.

The discussion of state law requirements in the report is based on FinCEN's preliminary understanding of each state's reporting requirements.

The report discusses other ways, consistent with the laws of the states, in which those involved in the operation of limited liability companies may obscure ownership. For example, the laws of many states permit corporations, general partnerships, trusts, and other business entities to own and manage LLCs. Layers of ownership can be devised which make it highly unlikely that relationships among various individuals and companies can be discerned, even if one or more of the owners is actually known, discovered, or reported.

This patchwork of state laws allows LLCs to tailor their structures and activities to avoid reporting ownership information.

Statistics

When comparing the number of new LLCs created from 2001-2005 in conjunction with the various levels of transparency among the states, our analysis revealed the following:

- The average increase in new LLCs from 2001-2005 for the states with the least transparency was 120.09%.
- The states that provide the next level of transparency averaged a 112% increase from 2001-2005.
- The states that require information on members only when an LLC lacks managers had an average increase of 146.68% (three of five states reporting).

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[6] Arkansas, Colorado, Delaware, Indiana, Iowa, Maryland, Michigan, Mississippi, Missouri, New York, Ohio, Oklahoma, Pennsylvania, and Virginia.
[7] Massachusetts, North Carolina, Rhode Island, South Carolina, South Dakota, Tennessee, Vermont, Wisconsin, and the District of Columbia.
[8] California, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Kentucky, Louisiana, Maine, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Dakota, Oregon, Texas, Utah, Washington, West Virginia, and Wyoming.
[9] Alabama, Alaska, Arizona, and Kansas.

- The four states that provide the greatest level of transparency averaged an increase of 138.75%.

- The average increase in number of LLCs (2001-2005) for all states reporting to the International Association of Commercial Administrators (IACA)[10] was 133.37%.

In terms of percentage increases in new LLC filings, there appears to be no definitive correlation between level of transparency and preference of a state for LLC formation. Indeed, states with more transparency have exhibited slightly higher growth on average than states with less transparency, but there is much variation within each category. Other factors appear to account for the relative popularity of certain states over others.

Of the four states often recognized as being particularly appealing for the formation of shell companies (Oregon, Wyoming, Nevada, and Delaware),[11] only Delaware falls in the group offering the least transparency. The other three states fall in the group offering a moderate level of transparency.

A preliminary conclusion based on the above information suggests that mandating that all states require LLCs to report the identities of members and managers would not significantly affect the number of LLCs formed or the relative balance among states. Therefore, it appears that the vulnerabilities of the states that allow less transparency could be reduced through requiring greater transparency without a major effect on revenue generated for those states. In contrast, the ensuing benefits to law enforcement and regulatory entities of greater transparency could prove significant.

Again, other factors may be at work in determining the preference of organizers for one state over another when setting up a shell company. These might include considerations of convenience as well as availability. The services and advice of particular agents and NIS firms may be another key factor when legal entities are being formed for illicit purposes.

Examples of Abuse

FinCEN identified 1,002 Suspicious Activity Reports (SARs) filed from 1996 through the beginning of 2005 that reference activity that appears to be related to shell companies. These SARs reveal a wide variety of domestic and offshore financial center activity. Suspected shell company locations range from the United States to the Cook Islands, Vanuatu, Bahamas, the United Kingdom, Panama, the Cayman Islands, Nigeria, and Antigua. Nine-hundred thirty-two SARs identify activity involving suspected U.S.-based shell companies. Sixty-seven SARs identify activity primarily involving shell companies in typical offshore financial centers with some connection to a U.S. entity or financial institution (38 of these SARs identify suspected shell banks in foreign locations such as Uruguay, the Cook Islands, St. Lucia, and St. Vincent/Grenadines.) The activities or location of the suspected shell companies referenced in the SARs have some nexus with the United States. Because SAR filers frequently do not or

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[10] The IACA is an organization that solicits annual reporting information from the states.

[11] *See, e.g.*, U.S. Money Laundering Threat Assessment Working Group, "*U.S. Money Laundering Threat Assessment*," (Dec. 2005) at pp.47-50; U.S. Government Accountability Office Report No. GAO-06-376 to the Permanent Subcommittee on Investigations, U.S. Senate, "*Company Formations –: Minimal Ownership Information is Collected and Available*, GAO-06-376" (April 2006).

cannot provide information regarding the location of suspected shell companies (business location, mailing address, address of registered agent), the actual number of U.S.-based shell companies cannot be accurately determined. Many of the SARs identify multiple companies as possible shell companies.

Of the SARs describing recent domestic shell company activity in the United States, there are examples of a suspected Ponzi scheme, pump-and-dump stock fraud, telephone "cramming" by organized crime, possible money laundering by politically exposed persons, and other suspected frauds and suspicious movements of money, particularly through wire transfers.

Many of the U.S.-based suspected shell companies were observed to maintain banking relationships with Eastern European financial institutions, particularly in Russia and Latvia. Of the 1,002 SARs identified, 768 involved suspicious international wire transfer activity involving domestic shell companies following recurring patterns and sharing common characteristics. These SARs identify what appear to be 1,361 different suspects, both individuals and business entities, including 329 U.S.-based LLCs.[12] In addition, 504 of the SARs identify Russia and 449 identify Latvia as locations of activity in the narrative. The aggregate suspected violation amount reported by these SARs is nearly $18 billion.[13]

Case data suggest that the misuse of U.S. legal entities is of concern throughout the international community. For instance, during the first half of 2005, 15% of research requests made to FinCEN from the Latvian Financial Intelligence Unit (FIU), 21% of research requests from the Bulgarian FIU, 25% of research requests from the Slovakian FIU, 33% of the research requests from the Russian FIU, and 55% of the research requests from the Ukrainian FIU identified a U.S. LLC as the primary subject of the request. Concerns about the misuse of U.S. legal entities have been specifically referred to by the Financial Stability Forum, the European Commission, the International Organization of Securities Commissions (IOSCO), and the Organization for Economic Cooperation and Development (OECD).[14] Moreover, the Financial Action Task Force (FATF) also acknowledges the potential for abuse within its Forty Recommendations on Money Laundering (in particular, Recommendations 33 and 34 relating to transparency of legal persons and arrangements).[15]

Steps Forward

FinCEN is undertaking three key initiatives to deal with and mitigate the risks associated with misuse of legal entities.

1. Concurrent with this report, FinCEN issued an advisory to financial institutions highlighting indicators of money laundering and other financial crime involving shell companies, and emphasizing the importance of identifying, assessing, and managing the potential risks associated with providing financial services to such entities. The advisory also describes identified abuses by criminals of domestic shell companies overseas. The

[12] The number of truly unique subjects is probably slightly less due to alternate spellings, misspellings, incomplete identification, etc.
[13] As with the other SARs in this sampling, the actual total is somewhat less.
[14] *See, e.g.,* Financial Action Task Force (FATF) Report, *"The Misuse of Corporate Vehicles, Including Trust and Company Service Providers"* (Oct. 2006) at pp1.
[15] http://www.fatf-gafi.org/document/28/0,2340,en_32250379_32236930_33658140_1_1_1_1,00.html#40recs

advisory is consistent with existing guidance and does not represent a change in regulatory approach. [16] The advisory does not encourage financial institutions to discontinue or to refuse particular accounts on behalf of these business entities.

2. FinCEN is continuing its outreach efforts and communication with state governments and trade groups for corporate service providers to discuss identified vulnerabilities, and to explore solutions that would address vulnerabilities in the state incorporation process, particularly the lack of public disclosure and transparency regarding beneficial ownership of shell companies and similar entities.

3. Lastly, FinCEN is continuing to collect information and studying how best to address the role of certain businesses specializing in the formation of business entities in its effort to reduce money laundering and related vulnerabilities in the financial system through the promotion of greater transparency.

Given their role in forming and supporting business entities, these service providers – which could include attorneys, trustees, and other intermediaries engaged in the business of providing services relating to the formation and support of business entities – are in a unique position to know and obtain information about beneficial owners, to determine whether these entities are to be used illicitly, and to recognize suspicious activity. They have information critical to law enforcement, regulatory authorities, and other financial institutions in combating the use of shell companies to promote illicit finance. Moreover, they are in the best position – in the first instance – to discourage abuses by reducing the ability of the beneficial owners of these entities to operate anonymously and, consequently, with relative impunity.

Conclusion

In conclusion, Mr. Chairman, we are grateful for your leadership and that of the other Members of this Subcommittee on this issue, and we stand ready to assist in your continuing efforts to ensure the safety and soundness of our financial system. Thank you for the opportunity to appear before you today. I look forward to any questions you have regarding my testimony.

[16] *See,* "Business Entities (Domestic and Foreign"), FFIEC BSA/AML Examination Manual (July 28, 2006).

Richard J. Geisenberger

Invited Testimony

United States Senate
Committee on Homeland Security and Governmental Affairs
Permanent Subcommittee on Investigations

The Honorable Norm Coleman, Chairman
The Honorable Carl Levin, Ranking Minority Member

November 14, 2006

Mr. Chairman and Members of the Subcommittee:

Thank you for this opportunity to address the Subcommittee and to provide testimony on behalf of the State of Delaware in response to the Subcommittee's letter of November 1, 2006 and to share our observations and comments on the Government Accountability Office (GAO) report entitled *Company Formations: Minimal Ownership Information Is Collected and Available* (the "GAO report") as well as Chapter 8 of the December 2005 *U.S. Money Laundering Threat Assessment* (the "MLTA report"), and Section 5.1 of the *Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America* (the "FATF report") (together the "Reports").

My name is Rick Geisenberger, and I am Delaware's Assistant Secretary of State as well as the Director of the Delaware Division of Corporations. I have served in this position for the past six years. I wish to thank the numerous corporate and alternative entity law attorneys in Delaware who have assisted the State in preparing this testimony.

Our testimony specifically responds to the eight matters raised in the Subcommittee's letter as follows:

(1) The approximate number of non-publicly traded corporations and limited liability corporations (hereinafter "corporations") formed in Delaware each year; the procedures typically used to form corporations in Delaware, including the role of on-line procedures and registered agents; the typical amount of time required by Delaware authorities to form a corporation; and the typical fees charged.

Under the federal system in the United States, each state and the District of Columbia has the authority to charter corporations and other business entities. As noted in the GAO report, along with Florida, California, and New York, Delaware is one of the largest filing offices in the United States. Just over half of all publicly traded companies in the United States are incorporated in Delaware including 61% of Fortune 500 companies. Last year, 119 initial public offerings (IPO's) or 73% of all IPO's on U.S. exchanges were incorporated in Delaware.

Delaware officials including our Governor and Congressional Delegation have traveled the world telling the Delaware story to corporate attorneys, venture capitalists, large institutional investors and others that advise businesses on where to incorporate. The Delaware story is a compelling one -- -- modern and flexible laws that are updated annually to enable businesses to structure their internal affairs in ways that meet changing business conditions, a highly regarded judiciary that has written much of the modern case law on fiduciary duties, a well-developed corporate and legal services industry in our State that is expert in the application of Delaware corporate law and active in its development, unparalleled service and responsiveness from the Delaware Division of Corporations which handles complex documents efficiently and effectively, and an elected leadership in Delaware with an enduring commitment to ensuring the continued success of our corporate laws.

Due to these strengths, in 2005, more than 133,000 new, non-publicly traded corporations, limited liability companies, limited partnerships, general partnerships and statutory trusts made Delaware their legal domicile. As of November 4, 2006 there were 753,684 active domestic business entities and 9,397 active foreign entities (that is, having their legal domicile in a jurisdiction other than Delaware) on the State's corporate record. The legal entities incorporated in Delaware and other States represent every segment of the nation's economy including the for-profit, religious, governmental and charitable sectors.

At one end of the spectrum are large, well-capitalized public and privately held companies. Delaware is the legal home of thousands of publicly traded companies such as General Motors, Google and the New York Stock Exchange. Delaware is also home to many large privately held firms. Some of these firms, such as Cargill and Cox Enterprises, have millions of authorized shares held by thousands of beneficial owners. Some of the largest closely held corporations in America such as Mars Incorporated are Delaware business entities. A significant percentage of the legal entities formed in Delaware are subsidiaries or affiliates of such large firms, and are created for the purpose of arranging the financings, asset-backed securitizations, mergers and acquisitions, roll-ups, investment vehicles and strategic alliances in which those large businesses engage.

At the other end of the spectrum are small Mom & Pop businesses, private investment and real estate vehicles as well as religious, charitable and civic organizations. Due to the wide diversity of types of businesses formed in Delaware and the importance of speed and efficiency to large multi-national corporations, the Delaware Division of Corporations has developed a variety of innovative services to meet the business needs of such companies. For example, while some documents filed via paper might take a week or more to be approved by the State, the typical document is processed within 24 hours of receipt. It is not uncommon for large corporations to pay for expedited service options enabling documents to be processed in under an hour. The typical formation fee paid to the State is $90 plus a $30 fee for a certified copy of the formation document. Expedited service fees range from $40 to $1,000 depending on the level of expedited service requested.

(2) The extent of beneficial ownership information typically obtained by Delaware authorities during the incorporation process, including initial incorporation and period reporting requirements; why corporations but not limited liability corporations are required to file annual reports in Delaware; and Delaware policy on establishing corporations that issue bearer shares.

As noted in the Reports, neither Delaware nor other states' filing offices obtain beneficial ownership information, either at the time of formation or through periodic reports. It should be noted that the purpose of a public filing by a company has never been to ascertain beneficial owners. Rather the purpose of the public filing is to create a public record of the existence of a legal entity, the state or country of its legal domicile, and its address for service of process.

Like many corporation laws in other states, the Delaware General Corporation Law ("DGCL") does require that corporations file with the Delaware Secretary of State an annual report that includes the names and addresses of all of the corporation's directors, one officer and the number and description of authorized shares of stock. For several reasons outlined below, these reporting requirements do not readily fit the legal structure of Delaware limited liability companies.

First, from its inception, the Delaware Limited Liability Company Act ("DLLCA") has been a contract-oriented statute, modeled largely on Delaware's successful partnership laws. It was not modeled on the DGCL and as a result, the DGCL's annual report requirement was not replicated in the DLLCA.

Second, while Delaware corporations have a predictable form of governance, there are limitless options available for managing a Delaware limited liability company. Except in the rarest of situations, Delaware corporations are managed by a board of directors, and the DGCL contains numerous provisions regarding the manner in which such boards function and govern the corporation. By contrast, the DLLCA does not require any particular form for the management of a Delaware limited liability company, but rather leaves that to determination of the parties ("members" in limited liability company parlance). The DLLCA does provide a default rule for management by the members in the event the contract among the members does not otherwise provide.

Third, the DGCL contemplates an annual election of directors and it often follows that there is a change in officers at the same time. The annual report provides a useful means of making such annual changes in the composition of the board of directors and senior management a matter of public record. Unlike the DGCL, there is no analogous mandate for periodic elections under the DLLCA. Indeed, in many instances, management does not change in a predictable timeframe and sometimes not at all during the life of a Delaware limited liability company. Because a limited liability company is a creature of contract, the parties are generally already aware of the identity of the party or parties managing the limited liability company. To the extent parties desire to provide for a

notice requirement similar to the information rights afforded by the annual report of a Delaware corporation, they may do so by way of the agreement among them.

Fourth, in contrast to the DGCL, the DLLCA reflects an almost completely contract-oriented approach to intra-entity relationships. Whereas the DGCL provides stockholders with access to information (e.g., the name and addresses of directors) by way of a statutory mandate, the DLLCA allows parties to the contract governing a Delaware limited liability company to provide similar information rights by way of that agreement, if desired. Thus, the absence of an annual report analogous to the requirement under the DGCL illustrates this principle that Delaware limited liability companies are creatures of contract.

With respect to bearer shares, the DGCL Section 158 was amended in 2002 to clarify what had previously been generally understood: "A corporation shall not have power to issue a certificate in bearer form." For limited liability companies, bearer shares, or bearer limited liability company interests, are neither specifically permitted nor specifically prohibited under the DLLCA. Based on the experiences of a number of leading Delaware lawyers who practice in the field, bearer limited liability company interests are not used. While theoretically it might be possible for the contract governing a limited liability company to be drafted to permit bearer shares, the DLLCA is not structured to facilitate this. On the contrary, the default rules of the DLLCA contemplate that all members of a limited liability company generally be known by the limited liability company, just like all partners of a partnership are generally known by the partnership.

(3) The role and legal responsibilities of third party agents paid to assist in the formation of Delaware corporations, including whether they are required to obtain and verify beneficial ownership information; and Delaware procedures for overseeing the actions of such company formation agents;

Businesses typically form legal entities with the assistance of a third party such as an attorney, an accountant or a company formation agent. Some companies submit formation documents without the assistance of a third party. Some company formation businesses in Delaware have requested and been granted "online access" to the Delaware Corporation Information System (DCIS) by the Division of Corporations. This access permits such businesses to view certain public information in the State's database and enables "imaging" agents to scan and automatically transmit images of corporate documents to State officials. This system dramatically improves the State's efficiency and timeliness in the processing of complex corporate filings.

In exchange for such access, each of the State's 54 authorized online agents sign a contract with the State agreeing to comply with a variety of policies set by the Division. The contract is broadly drafted to permit the State to deny, revoke, or suspend online access to an agent or its officers, directors, partners, owners or key employees that 1) do not satisfy the minimum statutory qualifications to serve as a registered agent in Delaware; 2) have a criminal background or are known to associate with persons of

nefarious backgrounds or disreputable characters; 3) demonstrate financial irresponsibility in dealings with the Secretary of State; 4) demonstrate a pattern of submitting documents which contain inaccuracies or false statements; 5) fail to be responsive in addressing questions and concerns of the Secretary of State; 6) fail to comply with the laws and regulations of federal, state or local governments; or 7) have information coming before the Secretary of State related to the agent's competency, financial capability, honesty, integrity, reputation, habits or associations. The State does deny online access to company formation agents that fail to meet these standards.

Many company formation businesses in the State also offer registered agent services to their customers. Every company in the State is required to have a registered agent in the State to accept service of process. The registered agent may be the company itself, an individual resident of the State, or another legal entity. Registered agents are required under Delaware law to maintain a business office in the State which is generally open, or if an individual, they are required to be generally present at a designated location in the State at sufficiently frequent times to accept service of process and forward State correspondence to the entities they represent. There are more than 32,000 registered agents in the State of Delaware. The vast majority of registered agents in Delaware (more than 96%) represent three or fewer business entities.

We, of course, share the concern of federal law enforcement officials that business entities ought not to be formed for illicit purposes. In June 2006, the State adopted legislation designed to ensure that law enforcement will have better access to information that identifies a person who is acting as a representative of a Delaware business entity. Under this new legislation that takes effect on January 1, 2007, every Delaware business entity will be required to provide to their registered agent and to update from time to time the name, business address and business telephone number of a natural person who is an officer, director, employee or designated agent of the business entity who is authorized to receive communications from the registered agent. Every registered agent will be required to retain such information in paper or electronic form for every entity they represent.

Delaware has also become the first state in the nation to adopt legislation responding to concerns expressed by law enforcement regarding illicit practices of registered agents. Delaware has approached this issue from two angles. First, Delaware is making a conscious effort to ensure that the State gathers more information on companies engaged in the registered agent business. Effective January 1, 2007, 237 registered agents in Delaware -- those representing directly or through affiliates 50 or more business entities -- will be required to meet additional qualifications as "Commercial Registered Agents". Commercial Registered Agents in Delaware will be required to maintain a Delaware business license, have generally present in their office an officer, director or managing agent, and provide to the State such information identifying and enabling communication with the Commercial Registered Agent as the Secretary of State shall require. For the first time, the Secretary of State will be explicitly authorized to refuse to file documents on behalf of any registered agent that fails to meet the qualifications for being a registered agent. In addition, the new legislation creates a mechanism allowing the

Delaware Court of Chancery to enjoin any person or entity from serving as a registered agent for failure to meet the qualifications to be a registered agent; for conviction of a felony or crimes involving dishonesty, fraud or moral turpitude; or, for being engaged in conduct in connection with acting as a registered agent that is intended or likely to deceive or defraud the public. We believe that these new provisions of Delaware law will have the desired deterrent effect while continuing to enable legitimate business entities to conduct their affairs quickly, at minimum cost and without deterring economic activity and business investment by impinging on privacy.

(4) The extent to which Delaware permits the use of nominee shareholders, directors, and officers for corporations formed in the United States, and the justifications for the use of such nominees in the United States.

Directors: DGCL Section 141(b) establishes that directors must be natural persons ("The board of directors of a corporation shall consist of 1 or more members, each of whom shall be a natural person").

By default rule under the DLLCA, the members of a Delaware limited liability company share authority to manage the affairs of the entity. By contractual arrangement, however, the DLLCA permits the use of other management structures, including ones where the parties with managerial control are acting in a representative capacity on behalf of the members or other interested parties. The flexibility in the DLLCA in this regard responds to the personal, tax and business needs of contracting parties and is consistent with the overall contractual nature of limited liability companies. A party acting in such a representative capacity (i.e., a "nominee") need not be a natural person and may be another entity. For example, an individual (e.g., a parent) acting as trustee on behalf of beneficiaries (e.g., her children) may in her trustee capacity legally become a member of a Delaware limited liability company and as such manage the Delaware limited liability company; an investor in a Delaware limited liability company may be entitled to nominate a firm (e.g., a financial services firm) to manage some aspect of the Delaware limited liability company's business (e.g., formulating and executing its investment strategy) and that "nominee" manager legally may do so. Contracting parties demand flexibility to achieve legitimate tax, business and other goals, and the foregoing are just several examples of the limitless options available in structuring the management of a limited liability company.

Officers: The DGCL no longer explicitly establishes that officers must be natural persons. Until 1998, however, the statute governing the selection of corporate officers (Section 142(b)) implicitly recognized that officers must be natural persons, providing that "[e]ach officer shall hold *his* office until *his* successor is elected and qualified or until *his* earlier resignation or removal." (emphasis added). In 1998, in the interest of removing gender distinctions throughout the DGCL, the words "his" were eliminated in favor of the term "such officer's." This amendment was not intended, however, to expand Section 142 to permit non-natural persons to serve as corporate officers. To our knowledge, moreover, it remains universal practice that officers of Delaware corporations are natural persons.

The DLLCA does not require that a Delaware limited liability company have any officers. By contractual arrangement, however, a Delaware limited liability company may have one or more "officers." Under the DLLCA, a person who is an officer of a Delaware limited liability company need not be a natural person and may be an entity. As discussed with respect to directors, the management of a Delaware limited liability company may be structured in a manner that such an officer is acting in a representative capacity. As noted above, the DLLCA's flexibility in these respects furthers legitimate interests.

Stockholders: Like the Model Business Corporation Act,[1] the DGCL and the DLLCA permit persons to hold formal or nominal title to shares or other equity interests in the name of other persons as beneficial owners. Taking advantage of that flexibility, the large majority of equity securities traded on the national securities exchanges and national securities markets are held in "street name," by depository nominees for the benefit of banks and brokers who, in turn, hold such securities for the benefit of clients as beneficial owners. The identities of the beneficial owners are largely unknown to the corporations or other entities that issue such securities. The Depository Trust Company, a principal securities clearinghouse, reports that it "retain[s] custody of almost 2.5 million securities issues worth about $28.3 trillion, including securities issued in the United States and more than 100 other countries."[2] It is therefore no understatement to say that without business entity laws permitting such nominee ownership, the equity capital markets in the United States would collapse as unmanageable.

In addition, flexibility as to the manner of ownership of stock and limited liability company interests fosters investment and capital formation (by securing for investors the limited liability that accompanies the use of a separate legal entity as the investment vehicle) and promotes efficiency (by enabling investment at the entity level). For example, an institutional investor (e.g., an insurance company or a pension plan) or a private investment firm may purchase interests in an investment fund created in the form of a Delaware limited liability company; two corporations may invest in a separate joint venture corporation or Delaware limited liability company in order to pursue a strategic alliance, and that investment vehicle in turn may make investments in other business entities for purposes of carrying out the strategic alliance; an individual (e.g., a parent) acting as trustee on behalf of beneficiaries (e.g., his children) legally may hold in his trustee capacity an economic interest in a Delaware limited liability company created to own real estate or other investment property.

(5) The approximate number of requests made over the last five years by law enforcement for beneficial ownership information related to Delaware shell corporations, and the extent to which the state was able to provide that information.

All documents filed with the Delaware Secretary of State are public information. The Secretary of State responds to hundreds of thousands of requests annually for copies of

[1] See Model Business Corporation Act §7.23 ("Shares Held by Nominees")
[2] http://www.dtcc.com/AboutUs/affiliates.htm?shell=false.

such documents and certificates of good standing. Delaware does not track the number of requests made for beneficial ownership information. We field daily requests for beneficial ownership information from citizens and/or members of the media that may, for example, be interested in researching the ownership of a particular privately-held investment or real estate venture. However, since federal, state and local law enforcement officials are already well aware that states do not track such information, we seldom receives such requests from law enforcement. We do, however, field frequent requests from law enforcement for annual reports, registered agent information and copies of company filings. Sometimes these requests come in the form of a subpoena although it is the position of the Division that requests for public information do not require a subpoena. The Division occasionally receives subpoenas requesting non-public information such as ad-hoc reports prepared by the State or information on depository accounts maintained at the State on behalf of customers of the Division. The State of Delaware fully cooperates with law enforcement and tax authorities in all such matters.

(6) Any information the state may have on the extent to which the lack of beneficial corporate ownership information in state records can impede or has impeded domestic and international law enforcement investigations.

The State has no specific knowledge of the extent to which the lack of beneficial ownership information by federal, state and local government records impedes or has impeded domestic and international law enforcement investigations.

(7) Delaware's views of: (a) the GAO report; (b) Chapter 8 of the December 2005 report, U.S. Money Laundering Threat Assessment, issued jointly by the Departments of Justice, Treasury, Homeland Security and others; and (c) section 5.1 of the 2006 Financial Action Task Force report, Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America, each of which addresses the issue that the United States does not obtain beneficial ownership information for shell corporations formed within U.S. borders.

The stated concern of the Reports is money-laundering, that is, the use of corporations and other business entities, the owners of which are anonymous, to facilitate illegal transactions. The ostensible solution offered by these Reports appears to be having each of the 51 jurisdictions in the United States impose a mandatory rule that would require companies to identify who their beneficial owners are, and then make that information available to the State and, perhaps, to the public.

In summary, it is the view of Delaware that (i) a beneficial ownership reporting system that included public companies would be a logistical and costly nightmare for corporations; (ii) even a self-reporting system that exempted public companies and their "affiliates" would have immense verification costs and definitional administrative problems;[3] and (iii) as applied to non-public companies, such a system would impose

[3] First, it will be difficult for the State to determine who would qualify as an "affiliate" under such an exemption. Second, since it is a self-reporting system, there is little doubt

costs on legitimate private businesses that seem vast in relation to benefits that are at best uncertain.

Part A of this portion of our testimony sets the stage for our comments on the GAO, MLTA and FATF reports by providing a brief summary of the concepts of record and beneficial ownership under Delaware law, as well as the current record-keeping requirements imposed on corporations governed by the DGCL. Part B of this portion of our testimony provides specific responses to the Delaware corporation law issues raised in the Reports.

A. Delaware State Law Concepts of Record and Beneficial Ownership

A "stockholder" under the Delaware General Corporation Law (the "DGCL") has historically been considered to be the "holder of record," and not the "beneficial owner" of a company's shares. The same is true in those states that have adopted the Model Business Corporation Act (the "Model Act").[4] In part, the law-- both in Delaware and elsewhere-- has developed this way for practical reasons. For example, Delaware corporations rely on a list of record holders in order to determine which of their stockholders are entitled to notice of a stockholder meeting. In contrast, corporations are not required to send notice of stockholder meetings to beneficial owners. This is because such a requirement would impose an unfair responsibility on the corporation to uncover all persons who hold a beneficial interest in its stock. Indeed, sorting through the various layers behind beneficial ownership would result in a logistical nightmare for the corporation (private companies included). It would also compromise the efficiency and certainty that reliance on a list of record holders provides to corporations.

Under the DGCL, record holders are considered the "stockholders" of a company. Delaware corporate law has traditionally limited the rights of stockholders to stockholders of record,[5] and has long recognized the "rule that a corporation may rely on its stock ledger in determining which stockholders are eligible to vote or exercise the important rights of a stockholder."[6] In fact, a corporation satisfies its obligations to its stockholders by communicating with record holders and is not required under Delaware

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that potential money-launderers will report that they are eligible affiliates of a public company and, the State, for all intents and purposes, could not easily determine their status.

[4] Model Business Corporation Act §7.23, Official Comment ("Traditionally, a corporation recognizes only the registered owner as the owner of shares.").

[5] For decades the Delaware Supreme court has consistently defined the term "stockholder" as a holder of record. *See In re Giant Portland Cement Co.*, 26 Del. Ch. 32 (Del. Ch. 1941); *Salt Dome Oil Corp. v. Schenck*, Del. Supr., 28 Del. Ch. 433, 41 A.2d 583, 589 (1945); *Carl M. Loeb, Rhoades & Co. v. Hilton Hotels Corp.*, Del. Supr., 43 Del. Ch. 206, 222 A.2d 789 (1966); *ENSTAR Corp. v. Senouf*, Del. Supr., 535 A.2d 1351, 1354 (1987); *Shaw v. Agri-Mark, Inc.*, 663 A.2d 464, 469 (Del. 1995); *Haft v. Dart Group Corp.*, 1997 Del. Ch. LEXIS 46 (Del. Ch. 1997).

[6] *See Shaw*, 663 A.2d at 469.

law to identify and disclose all of its beneficial owners. For example, Delaware law does not require corporations to send notice of stockholder meetings to beneficial owners or accept demand for appraisals from beneficial owners.[7]

This is so because corporations must have a practical means by which they can ascertain the names of the individuals with whom they need to communicate in regard to corporate transactions, or other significant corporate events.[8] Using the list of record holders provides "order and certainty," by allowing corporations to deal freely with the registered holders without having to investigate the beneficial ownership of its stock.[9] According to the Supreme Court of Delaware:

> The corporation ought not to be involved in possible misunderstandings or clashes of opinion between the non-registered and registered holder of shares. It may rightfully look to the corporate books as the sole evidence of membership.[10]

A contrary rule, such as the rule contemplated by the Reports, would amount to an unreasonable burden on corporations. It would also compromise the certainty and expediency that relying on a list of record holders provides to corporations. Corporations would be faced with the near impossible task of uncovering, on a continuous basis, all persons who hold an interest in their stock, whether through a business entity, trust, or some other form of ownership.

Indeed, to comply with such a rule, public corporations would have to sift through various levels of the holders of stock, including the brokerage houses, banks, depositories and other nominees, to discover the identity of their beneficial owners (who had chosen to have those entities register their respective shares). Such a task would be incredibly time-consuming and costly. This is especially true for large private companies that have a number of shareholders who spread out their ownership and hold shares in multiple trusts, or some other business entity.

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[7] *See Gilliland v. Motorola, Inc.*, 859 A.2d 80, 85 (Del. Ch. 2004) (holding that the corporation satisfies its notice obligation under section 262 by sending notice to the brokers or fiduciaries, and is not required to send notice to the beneficial owners.); *see also Edgerly v. Hechinger*, 1998 Del. Ch. LEXIS 177 (Del. Ch. 1998) (holding that only a holder of record can demand an appraisal); *Bandell v. TC/GP, Inc.*, 1996 Del. LEXIS 23, Del. Supr., No. 247, 1995, Berger, J. (Jan. 26, 1996) (ORDER) (holding that an appraisal action must be filed by the record owner).

[8] *See In re Northeastern Water Co.*, 28 Del. Ch. 139, 150-151 (Del. Ch. 1944) (holding that "failure to have shares registered so as to indicate an interest in others than the registered holder may reasonably be deemed a manifestation of intent that the corporation should deal freely with the registered holder as the true owner without investigating his authority.").

[9] *Salt Dome Oil Corp.*, at 441 A.2d at 589.

[10] *Id.*

Apart from concern about the impact on corporations, there are nearly countless situations in which disclosure of beneficial ownership information of privately held firms would run counter to legitimate personal or business interests of equity owners:

(1) An investment fund, sponsored by an investment management firm, may take the form of a Delaware limited liability company. A listing of the investors in that Delaware limited liability company might effectively constitute the client list of the sponsor, which clients have been identified and cultivated by the sponsor at considerable effort and expense. Disclosure of the investors' identities in that case would permit a competing investment management firm to obtain and potentially trade unfairly on the sponsor's proprietary client list. Indeed, because investment management firms commonly invest in each other's investment vehicles, there are compelling competitive reasons not to reveal to the limited liability company investment vehicle the information as to the beneficial ownership of its various investors.

(2) A joint venture between two large companies, created for the purpose of developing a new manufacturing process, may take the form of a Delaware corporation. The mere existence of this joint venture relationship may be a sensitive business matter. Disclosure of the alliance could unfairly advantage rival firms by providing insight into their competitors' business initiatives and strategies.

(3) A Delaware limited liability company may be used as a personal estate planning vehicle. Many non-public Delaware limited liability companies hold significant "family" investments or other family assets or serve as a private mutual fund permitting family members to participate in a controlled investment structure. Disclosure of the beneficial ownership of the Delaware limited liability company in that circumstance could intrude on a family's realistic expectation that such sensitive matters will remain private. Moreover, disclosure of the beneficial owners could expose the family members to harassment by persons seeking to invade the family assets or expose a family member to actual physical danger.

B. Responses To Delaware Corporation Law Issues Raised In The Reports.

1. The GAO Report - The GAO Report is generally balanced and factually accurate in describing the types of information collected by States, such as Delaware, in connection with the formation of corporations. However, because the GAO Report was completed in April, 2006, it does not take into account the changes Delaware made this summer to its statutes as described in Section 3 of this testimony.

The GAO Report is important in that it highlights some of the practical problems and administrative challenges that requiring collection of beneficial ownership information in connection with the formation and maintenance of corporations would create. For example, many states, including Delaware, do not have the physical capacity, either in

staffing or technology, to assemble and maintain this information themselves. Indeed, in Delaware, such a requirement would require legislative action to mandate the provision of such information to the State or to registered agents.

Even if such a system were imposed, verifying information about beneficial owners at formation would be difficult, if not impossible, given the reasons for and timing of the formation of corporations. For example, a law firm may be instructed to form an investment vehicle for a client before the ownership of the entity is even determined. In addition, beneficial ownership information may (and frequently does) change following formation, and it would not be practical to require Delaware or registered agents to enforce reporting requirements regarding such changes. Moreover, many persons forming new corporations are themselves entities, such as public corporations and investment professionals, who are taking advantage of the benefits of the corporate form for legitimate business reasons, such as limiting liability exposure or facilitating more affordable borrowing rates through the use of so-called "bankruptcy remote" entities.

Finally, we share the concern expressed in the GAO Report that the experience of other jurisdictions could be repeated in Delaware and other states if this type of inquiry is mandated. It is hard not to envision a drop in the number of entities formed in the United States and a corresponding flight of capital if the beneficial ownership reporting requirements contemplated by the GAO Report are imposed.

2. MLTA Report - Chapter 8 of the MLTA Report ("Shell Companies and Trusts") is flawed in several important respects.

First, the specific reference in Chapter 8 to a "handful of U.S. states," and its identification and study of Delaware, Nevada and Wyoming, create the incorrect impression that Delaware offers what the report describes as "cloaking features" that are distinct and more protective of privacy than what most if not all other states also offer. This is not the case. The Model Act – the template for the majority of corporate statutes outside of Delaware – allows for nominee ownership (see §13.03, "Assertion of Rights by Nominees and Beneficial Owners"); the Model Act vests in the board of directors the discretion to dispense with share certificates (§6.26); unlike the Delaware General Corporation Law as recently amended, the Model Act makes no provision for closing down commercial registered agents for fraud or the like (see Model Act §§5.01-5.04); like Delaware law, the Model Act contains no limitation on share ownership by a national of any jurisdiction, regardless of place of residence, and permits the corporation to operate worldwide (see, e.g., §3.02(10) (corporate power to "conduct its business … within or without this state"); and like Delaware law, the Model Act requires no annual reporting of assets (§16.21). It is misleading to single out Delaware as if it were unusually hospitable to business participants seeking privacy for illegitimate purposes.

Second, Chapter 8 is flawed by an incomplete and cursory assessment of the importance of legitimate uses of so-called "cloaking features." For example, it asserts that "allowance of nominee shareholders undermines the usefulness of the shareholder register … because the shareholder may not be the ultimate beneficial owner." The

suggestion is that this feature of Delaware corporate law is a "cloaking feature" conducive to money laundering, but there is no recognition that the ability to hold shares in nominee name is central to the operation of U.S. securities markets, among many other important legitimate business purposes. Likewise, as an example of a claimed "race to the bottom" that creates "a real money laundering threat," Chapter 8 notes that "a Delaware-registered company may be owned by a national of any jurisdiction, regardless of his or her place of residence," and that "the company can be operated and managed worldwide ...." What is missing is an acknowledgement that the ability to attract ownership from all over the world, and the ability to operate in any area of the world, is a necessary underpinning of all capital investment in U.S.-chartered entities, and is a necessary underpinning of the ability of such entities to conduct business overseas as well as domestically, to the great benefit of U.S. investors, taxing authorities and citizens generally.

To be fair, Chapter 8 does acknowledge that shell companies and trusts "are used globally for legitimate business purposes." On the other hand, while it acknowledges that shell companies legitimately "serve as a holding company for intellectual property rights," Chapter 8 omits a wide variety of other uses of shell companies in real estate and other legitimate investment transactions. Similarly, while Chapter 8 acknowledges that trusts "are useful when assets are given to minors or individuals who are incapacitated," it fails to acknowledge the important role of trusts as estate planning devices for families of even relatively modest means.

Third, the "Side by Side Comparison of Wyoming and Nevada and Delaware" at the end of Chapter 8 is factually and legally erroneous in quite a few respects. As previously noted, Delaware law, just like the Model Act, does allow nominee shareholders and permit corporations to dispense with share certificates. The "Side by Side Comparison" fails to note either of these points. Likewise, it fails to note that, like the Model Business Corporation Act (§§8.50-8.59), Delaware law provides for indemnification of directors and officers of corporations. What this has to do with money laundering threats is not disclosed in Chapter 8, but the matter is another in which the "Side by Side Comparison" is erroneous in an obvious way.

Finally, it should be noted that much of the content of Chapter 8 was not the independent work product of the team that compiled the Threat Assessment. For example, much of the text merely rehashes the content of a GAO report that dated from October 2000. The "Side by Side Comparison" was copied verbatim from the website of a company formation business in Wyoming with no attempt at independent verification. Had Delaware officials been consulted regarding this chart and Chapter 8 in general, we could have corrected any erroneous information. While we may not agree with the GAO and FATF reports in their entirely, both the GAO and FATF, to their credit, took the time and effort to visit Delaware and seek input and comment from knowledgeable officials. No such effort was made by the authors of the Threat Assessment. This failure of communication and consultation by the authors of the Threat Assessment might account for its many flaws. In sum, it is our view that Chapter 8 is too cursory, unbalanced and inaccurate to be taken as a reliable basis for regulatory judgment in the area it addresses.

3. FATF Report - The general premise of Section 5.1 of the FATF Report is correct -- Delaware does not require corporations to track beneficial ownership nor does it require Delaware corporations to report such information to the registered agent or the Secretary of State so that such information is a matter of public record. However, the FATF Report is incomplete in a number of respects, and fails to take into account the costs and logistical problems associated with a policy of beneficial ownership disclosure, as well as the limited benefits to be gained by such a reporting requirement.

First, the FATF Report makes a somewhat illusory statement when it claims that "there is no obligation to file the name of any shareholder or beneficial owner when establishing either a corporation or an LLC" in Delaware. The report fails to mention that corporations do not ordinarily have beneficial or record shareholders at the moment of incorporation. Specifically, pursuant to Delaware General Corporation Law, the following sequence of events occurs in forming a corporation:

(1) The certificate of incorporation is filed with the Secretary of State. (Section 101).
(2) The certificate of incorporation contains, among other things, the name and address of the incorporators or the initial directors. (Section 102)
(3) An organizational meeting is held where the corporation adopts bylaws and elects directors and officers. (Section 108)
(4) The directors issue stock in the corporation, and the recipients of the shares become stockholders of the company after payment for the stock.

Accordingly, at the formation stage when the certificate is filed, the company has not yet issued stock in the corporation. Therefore, it would be inapt to require corporations to disclose beneficial ownership at the moment of incorporation.

Moreover, even if detailed disclosure of stock ownership (once shares are issued) were required, it would not provide information about the individuals responsible for the daily controls of the corporation. Under Section 141 of Delaware law, the business and affairs of a corporation are managed under the direction of the board of directors. The stockholders of a corporation are generally not authorized to direct the business of the corporation. For example, in the case of a shell corporation with a single shareholder, the stockholder generally is not permitted to open bank accounts, sign contracts, or take any action to bind the company without specific authorization by the board of directors. Therefore, disclosing the identities of beneficial stock holders of such shell companies would not necessarily address the concerns of the FATF.

Second, the collection of beneficial ownership information contemplated by the FATF Report goes well beyond the current requirements imposed on Delaware corporations. As noted in the FATF Report, the DGCL requires a corporation to maintain information about the record ownership of its shares, but does not require corporations to maintain lists of its beneficial owners. As explained more fully in Part A of this section, *supra*, under Delaware law, the stockholders of record are recognized as the "official

stockholders" of a company. This is because the rights associated with being a stockholder of a company are, for the most part, granted to the stockholders of record. It is the stockholders of record that are required to provide the corporation with information concerning the transfer of stock ownership. In fact, if a stockholder transfers record ownership of its shares to another person or entity, and fails to inform the corporation of this transaction, the corporation may refuse to permit the transferee to vote the shares or otherwise exercise the rights associated with record ownership.

The proposal contemplated by the FATF Report, which would require corporations to disclose changes in beneficial ownership and report such changes to the Secretary of State on a continuous basis, would be unduly burdensome and costly, requiring corporations and the State to employ a significant amount of resources. Moreover, even if the resources were available, such a reporting system would depend on the cooperation of the beneficial stockholders. As a self-reporting system, the beneficial stockholders would have to be willing to disclose the information to the company and the State. Furthermore, even if the beneficial owner disclosed his or her identity, the company and the State would have to expend additional resources verifying whether the information submitted by beneficial owners was current and accurate.

Finally, the FATF report fails to consider that many beneficial owners choose to remain anonymous for legitimate reasons. For example, many start-up companies get financing from so-called "angel investors" who do not want to disclose their identity, because they may have other investments in competing businesses, they value the privacy of their investment strategy, or they recognize that there is a potential for misuse of this information. In addition, many private companies choose to be private because they do not want ownership information publicly disclosed. Take, for example, a private company with many employees and competitors. Assume that the company has been owned of record and beneficially by its founder from its formation. As its founder ages, the founder might, for planning purposes, want to transfer shares of the corporation to various family members or faithful employees. The founder would not want that information available to competitors (potential purchasers of the shares) or to its other employees.

In sum, the FATF Report unfairly characterizes the Delaware system as one that encourages "secrecy" in the formation and ownership of companies. The report fails to take into account that there are numerous lawful and practical reasons why anonymity is valued in the realm of investments and business dealings. Furthermore, the report's suggestion that Delaware's (and other state's) policies are driven by a "powerful lobby" of "company formation agents" who want to maintain the status quo is untrue. The laws enacted under the DGCL and the policies of the Secretary of State are the result of the combined efforts and input of local practitioners, practitioners across the United States, and Delaware's legislature, and reflect the balanced interests of companies, investors, law enforcement, practitioners, and various government agencies.

(8) Recent steps taken by Delaware to address this issue, any recommendations for additional reforms, and any comments on ways to solve this problem.

Delaware has taken a number of recent steps addressing these issues, specifically enactment of a statute in June 2006 that establishes minimum qualifications for Commercial Registered Agents, creates procedures for enjoining a "rogue" registered agent or its principals from doing business in the State, and requires all Delaware business entities to provide a communications contact to its registered agent. We recommend that other states adopt similar measures to ensure reasonable oversight of registered agents and to assure that basic customer contact information is being gathered and retained and is available to law enforcement officials through normal investigatory and judicial procedures.

We also recommend that the federal government study whether existing federal laws should be augmented to address the concerns identified in the Reports. It is our belief that the mere act of forming a business entity is never an act of money laundering. Rather, money laundering occurs when illicit funds are moved through the United States and international financial systems. The United States has in force a number of homeland security, tax and banking laws that require financial institutions to obtain information from their customers that could be augmented through stronger enforcement, new regulations or amendments.

To this end, the most comprehensive federal law is the USA PATRIOT ACT. Section 326 of the USA PATRIOT ACT requires the Secretary of the Treasury, jointly with other agencies, to prescribe regulations that require financial institutions to implement reasonable procedures to (i) verify the identity of any person seeking to open an account, (ii) maintain records used to verify such person's identity, including name, address and other identifying information, and (iii) determine whether any such person appears on any list of known or suspected terrorists or terrorist organizations provided to financial institutions by any government agency. Section 326 of the USA PATRIOT ACT applies to all "financial institutions," which is very broadly defined to include a large range of types of financial institutions, including, without limitation, banks, trust companies, thrifts, credit unions, investment companies, brokers and dealers in securities, futures commission merchants, insurance companies, travel agents, pawnbrokers, dealers in precious metals, other money service businesses, and casinos. Under the regulations implementing Section 326 of the USA PATRIOT ACT, financial institutions are required, at a minimum, to obtain the following information for a customer prior to opening an account: (i) name, (ii) date of birth, if an individual, (iii) an address, and (iv) an identification number. Based on a risk assessment, a financial institution may also obtain information with respect to the beneficial owners of an entity opening an account, or information with respect to any person with authority over an account.

As to the requirement relating to the tax identification number, for U.S. persons, this will be such person's tax identification number. If the customer is an individual, the individual's social security number will be used as the individual's tax identification number. If the customer is not an individual, but is an entity (such as a corporation, limited liability company, partnership or statutory trust), pursuant to IRC § 6109(c), the entity must file a Form SS-4 with the Internal Revenue Service in order to obtain a tax

identification number. The applicant is required to sign the form SS-4 under penalties of perjury. The tax identification number will be issued by the Internal Revenue Service if the information requested on the Form SS-4 is supplied. The information required to be supplied by the entity on the Form SS-4, includes among other things the name of the principal officer, general partner, owner, grantor or trustor of the entity and the taxpayer identification number of such principal officer, general partner, owner, grantor or trustor of the entity.

Although the information provided on Form SS-4 is confidential, pursuant to IRC Section 6103(d), (e), (f), (h) and (i), upon request the information can be disclosed to persons having a material interest, federal, state and local law enforcement agencies and committees of Congress. If necessary, Congress could choose to expand the information requested on Form SS-4 to include beneficial ownership information. However, in the same way that beneficial ownership disclosure at the State level would create a massive State bureaucracy, such a system of beneficial disclosure through federal tax forms would likely create a massive and costly federal bureaucracy. While Delaware does not advocate this approach, it certainly is an option for federal policymakers to consider and one that would avoid a patchwork quilt of 51 different requirements in the states and District of Columbia.

The Bank Secrecy Act also requires financial institutions to comply with recordkeeping and reporting requirements involving certain financial transactions, including certain funds transfer and currency transactions, as well as transactions that are suspicious in nature, and provides law enforcement agencies with the means to trace the flow of illegal funds through the financial system. In order to comply with these recordkeeping and reporting requirements, financial institutions must obtain and retain certain customer identifying information

Revisions to the above-mentioned federal banking or tax laws (or any similar federal laws) may offer the best means for addressing the concerns about illegal activities identified in the Reports.

If there were to be a mandate to collect beneficial ownership information at the state level, we are concerned about the increased cost of collecting and assembling such data. Forms would need to be modified, computer systems reprogrammed, fees adjusted to handle increased labor costs associated with reviewing documents for compliance, increased costs for storage and retention of documents and increased demand for information retrieval and reporting. If such information were required to be maintained by lawyers, accountants, company formation businesses and/or registered agents, the costs would simply be passed on to private industry which would recover the costs in the form of possibly substantially higher representation fees. Also, policy makers would have to consider whether such a mandate would need to be accompanied by a prohibition on self-representation – since it would be impossible to verify whether such beneficial ownership records were being maintained by self-represented entities.

We are also deeply concerned about privacy and disclosure issues. If such a mandate were to place personal identifying information of tens or perhaps hundreds of millions of equity holders on the public record, it would create a huge risk of identity theft. Similar security issues would be raised if such information were not on the public record, but required to be maintained in the files or databases held by lawyers, accountants and company formation agents. Traditionally the owners of private businesses engage in entrepreneurial and investment activity with the expectation of complete privacy. Even SEC regulations permit shareholders to accumulate positions in large publicly traded organizations without disclosure up to a certain percentage. If the ownership of every investment in the United States is entered into massive databases, it certainly presents countless public policy concerns and issues with respect to privacy, security, and insider trading to name a few.

But perhaps the single greatest concern for the State of Delaware is the likelihood that the role of Delaware and, indeed the United States, would shift from that of providing an attractive investment environment for domestic and international capital to one of having regulatory or investigative oversight of equity holders of legal entities. In light of the various challenges and tremendous costs – both financial and economic – that would be associated with attempting to track beneficial ownership of more than 15 million legal entities registered in the nation's 51 jurisdictions, it is unlikely that the State of Delaware would support legislation requiring full beneficial ownership disclosure.

Instead, we believe that any additional reforms at the federal or State level are best focused on enhancing the ability of federal and state officials to "follow the money" through the financial services system, providing law enforcement with the resources to investigate alleged illicit activities and seeking to deter such activity in the first place. This is why we believe Delaware's recent amendments establishing more demanding requirements for Commercial Registered Agents are a step in the right direction and deserve the consideration of other jurisdictions.

The State of Delaware is keenly aware that we are but one of many stakeholders in this issue. In fact, the persons most affected by any reforms are businesses both here and abroad. We believe that any discussion of beneficial ownership disclosure requires input and comment from the persons who will be most affected by such regulations – namely large, medium and small businesses and investors. Perhaps hundreds of millions of individuals in the United States are beneficial holders of public and privately held for-profit and charitable organizations and would be affected by beneficial ownership disclosure. It is critically important to ensure that their voices are heard regarding the costs and benefits of such a system.

On behalf of the State of Delaware, I thank you for this opportunity to share our comments and I look forward to responding to any questions you may have.

PREPARED STATEMENT OF SCOTT W. ANDERSON

DEAN HELLER
Secretary of State

KIM A. HUYS
Chief Deputy Secretary of State

PAMELA A. RUCKEL
Deputy Secretary for Southern Nevada

STATE OF NEVADA

OFFICE OF THE
SECRETARY OF STATE

CHARLES E. MOORE
Securities Administrator

SCOTT W. ANDERSON
Deputy Secretary for Commercial Recordings

ELLICK C. HSU
Deputy Secretary for Elections

STACY M. WOODBURY
Deputy Secretary for Operations

November 9, 2006

Honorable Norm Coleman, Chairman
Honorable Carl Levin, Ranking Minority Member
Permanent Subcommittee on Investigations
United States Senate

Dear Mr. Chairman and Committee Members,

Thank you for the invitation to participate in the November 14, 2006 hearing of the U.S. Senate Permanent Subcommittee on Investigations. I also appreciate the Committee and the GAO allowing us to participate in the surveys and discussions preceding this hearing. The following information is provided to assist you in understanding how certain information is filed and reported on corporations, limited liability companies and other entities formed in the state of Nevada.

The Nevada Secretary of State, Commercial Recordings Division is responsible for processing and filing the organizational and amendatory documents of entities organized pursuant to Title 7 of the Nevada Revised Statutes. These entities included for-profit and nonprofit corporations, limited partnerships, limited liability companies, limited liability partnerships, limited liability limited partnerships and business trusts.

Historically, the Commercial Recordings Division has been strictly a filing office, with little or no regulatory authority over the entities on file or the resident agents they have appointed. Documents are reviewed for the statutory requirements for filing. Documents that meet the statutory requirements must be filed and put on the public record. Documents are accepted at face value with no validation of the information submitted. The Secretary of State's office does not have the authority or the resources to verify the information on each of the 500,000 plus documents filed each year.

Since the 1991 rewrite of Nevada's business entity statutes, Nevada has grown into a leader for business formation. Nevada's business-friendly statutes, tax structure and commitment to superior service have made it attractive to those wishing to organize under these business friendly laws.

The following information is submitted in response to the specific matters raised in the November 3, 2006 invitation from the committee.

1. Entities filed in the Secretary of State's Office

Fiscal Year	Corporations	Limited Liability Companies	Other Entity Types	Total
2002	34,093	15,344	2,929	52,366
2003	31,940	18,307	3,162	53,409
2004	35,186	25,745	2,734	63,665
2005	39,052	36,414	3,050	78,516
2006	41,083	40,777	3,141	85,001

A majority of the corporations filed each year are non-publicly traded corporations. Until 2005, there was no requirement of corporations to identify whether or not they were publicly traded. Since 2005, only 333 have identified that they are publicly traded by disclosing their central Index Key Number (CIK.)

Minimal information is required to file new articles of incorporation or organization. For corporations, the name of the corporation, the name and street address of the resident agent the number of authorized shares and par value (total authorized capital,) names and addresses of the first board of directors (at least one required on form for filing,) name, address and signature of the incorporator and signature of resident agent accepting appointment as resident agent accompanied by the associated fee. I have included copies of the forms for filing Articles of Incorporation and Articles of Organization.

Currently, there are no electronic services available for the filing of new Articles of Incorporation. However, there have been discussions about the future development of these services.

The base fee for filing Articles of Incorporation or Organization is $75. Corporations with authorized capital of greater than $75,000 pay from $175 up to a maximum of $35,000 based on their capitalization; as capitalization increases, fee increases.

Corporations, Limited Liability Companies and other entities on file in the Secretary of State's Office are required to file an Initial List of Officers, Directors and Resident Agent on or before the last day of the 2nd month following filing and an Annual List, thereafter on or before the last day of the month on which the anniversary of the filing of the Articles of Incorporation occurs. This list contains the President, Secretary and Treasurer of the corporation (Manager or Managing Member for LLCs,) must include the signature of an officer and the declaration 'I declare, to the best of my knowledge under penalty of perjury, that the above mentioned entity has complied with the provisions of NRS 360.780 and acknowledge that pursuant to NRS 239.330 it is a category C felony to knowingly offer any false or forged instrument for filing in the Office of the Secretary of State." Failure to provide any of the above information is grounds for rejection of the document.

Initial, Amended and Annual Lists may be filed online through our website at www.secretaryofstate.biz, using a trust account (internal deposit account used by resident agents) or credit card for payment. Lists filed online are processed and the information made available immediately upon completion of the electronic process.

The base filing fee for an Initial, Amended or Annual List is $125. Corporations with authorized capital of greater than $75,000 pay from $175 up to a maximum $11,100 per year based upon its capitalization; as capital increases, fee increases.

The turnaround time for initial Articles of Incorporation or Organization filed on a regular basis currently ranges from 3 – 7 working days based upon filing volume. The turnaround time for Annual lists of Officers is 2 – 5 working days based upon filing volume. Filings may be expedited and filed within 1, 2 or 24 hours based upon the expedited service requested. Additional fees of $125 for 24-hour service, $500 for 2-hour service and $1,000 for 1-hour service are required in addition to the "regular" fees associated with the filing. Expedited service is available for all filings and services offered by the Commercial Recordings Division. Expedite fees do not apply to online filings.

2. Beneficial ownership information is not required of corporations or limited liability companies at the time of filing Articles of Incorporation or Organization, nor is it required with the annual filings. However, the information contained in those documents may reflect the beneficial ownership of the entity. Beneficial ownership information may not be available at the time of entity formation as Articles of Incorporation are normally filed prior to the issuance of stock and there may be significant time between the initial formation and the actual issuance of stock or ownership interest. Names, addresses and signatures of the incorporators are requirements of filing and are part of the public record.

There is no requirement of resident agents to collect beneficial ownership information. There is a Nevada requirement that corporations, limited liability companies or other entities doing certain business with state or local governments must provide beneficial ownership information in the local jurisdiction where that business will occur. There is also a requirement for Nevada corporations and business entities apply for an annual business license with the Nevada Department of Taxation. It is my understanding that this application may contain beneficial ownership information, but that this information is not considered public, requiring a court order for its release.

Nevada has neither prohibition nor provision authorizing the issuance of "bearer" shares. Nevada Revised Statutes require that the Articles of Incorporation set forth the series of stock, number of shares authorized in each series and the associated par value. The Secretary of State does not receive any information that would identify "bearer" shares. It is my understanding that there will be legislation proposed during the 2007 Session of the Nevada Legislature to prohibit the issuance of "bearer" shares.

3. All entities filed in the Office of the Secretary of State pursuant to Title 7 are required to maintain a resident agent who resides or is located in the state. Each resident agent must have a street address for the service of process. As such, the articles of incorporation or organization must include the name, street address in the state of Nevada and signature of the resident agent accepting appointment as such. Failure to provide this residents agent information is cause for rejection of the filing.

Pursuant to the Nevada Revise Statues the resident agent shall keep a certified copy of the Articles of Incorporation or Organization, a copy of the corporation's bylaws and amendments thereto, and a stock ledger or duplicate stock ledger. In lieu of the ledger, they may

keep a statement setting out the name of the custodian of the ledger and the present and complete mailing address where the stock ledger is kept (Nevada Revised Statutes 78.105.)

It is estimated that 60% or more of the filing received in our office are submitted by or through a commercial resident agent (resident agent company that specializes in resident agent and related services.)

Currently, there is no regulation of resident agents by the Secretary of State or otherwise. It is my understanding that legislation may be introduced during the 2007 Session of the Nevada Legislature that proposes adoption of at least part of the Model Resident Agent Act adopted by the National Conference Committee on Uniform State Laws (NCCUSL.)

4. There is neither specific authorization nor prohibition of nominee officers. It is common for a resident agent to act as one or all of the officers and directors, managers or managing members. The justification for nominee officers is for the privacy and protection of the officers and/or owners of the entity. It is my understanding that there will be legislation proposed during the 2007 Session of the Nevada Legislature to prohibit or limit the use of nominee officers.

5. Nevada receives 25 – 35 requests per month from Federal, State and local law enforcement and regulating agencies for records pertaining to investigations. These requests are not for beneficial ownership information, but for any and all information pertaining to certain persons that may be acting as an officer, director, manager or managing member, or resident agent of an entity or pertaining to specific entity. We provide the requesting agency all the public record information requested, usually the entire file. This service is expedited at no cost to the law enforcement or regulating entity. Information that is confidential, such as payment information that may include bank account or trust account numbers, may be obtained through subpoena or court order, but are generally not requested. The Secretary of State is not apprised of the nature of the investigation or the outcome of the investigation. The requests do not identify the entities in question as "shell" corporations.

6. There has been no communication from domestic or international law enforcement that the lack of beneficial ownership information has impeded or can impede investigations. The only information I have received to this effect was communicated through the meetings with the GAO, Department of Treasury and the FATF in preparation for surveys and reports. The press has reported, as have legislators, that the lack of beneficial ownership information has made it difficult to identify the parties involved with certain public land transactions. This led to the requirement that the entities involved in these transactions provide beneficial ownership information in the county where the transaction will occur.

7. The GAO report, the U.S. Money Laundering Threat Assessment and the Financial Action Task Force reports give a relatively accurate description, from a Nevada standpoint, of the filing processes and environment. I am unable to comment on any recommendations in the reports as I have been unable to fully discuss these with the Resident Agents Association, Nevada State Bar Association or state legislators.

8. The Nevada Legislature meets every two years. This issue has gained momentum since the 2005 Legislative Session. It is reported that legislation will be proposed during the 2007 Legislative Session addressing the issues of bearer shares, nominee officers and regulation of the resident agent industry. The Secretary of State is attempting to facilitate a December roundtable

meeting with the Resident Agents Association, State Bar Association and state legislators to fully discuss the collection of beneficial ownership information.

Thank you for the opportunity to participate in this hearing. Please feel free to contact me if I can be of further assistance.

Respectfully,
DEAN HELLER
Secretary of State

By:
Scott W. Anderson
Deputy Secretary for Commercial Recordings

DEAN HELLER
Secretary of State
206 North Carson Street
Carson City, Nevada 89701-4299
(775) 684 5708
Website: secretaryofstate.biz

Articles of Incorporation

(PURSUANT TO NRS 78)

ABOVE SPACE IS FOR OFFICE USE ONLY

1. ***Name of Corporation:***	
2. ***Resident Agent Name and Street Address:*** *(must be a Nevada address where process may be served)*	Name Street Address City Nevada Zip Code Optional Mailing Address City State Zip Code
3. ***Shares:*** *(number of shares corporation authorized to issue*	Number of shares with par value: Par value $ Number of shares without par value:
4. ***Names & Addresses, of Board of Directors/Trustees:*** *(attach additional page there is more than 3 directors/trustees)*	1. Name Street Address City State Zip Code 2. Name Street Address City State Zip Code 3. Name Street Address City State Zip Code
5. ***Purpose:*** *(optional-see instructions)*	The purpose of this Corporation shall be:
6. ***Names, Address and Signature of Incorporator.*** *(attach additional page there is more than 1 incorporator)*	Name Signature Address City State Zip Code
7. ***Certificate of Acceptance of Appointment of Resident Agent:***	I hereby accept appointment as Resident Agent for the above named corporation. Authorized Signature of R. A. or On Behalf of R. A. Company Date

This form must be accompanied by appropriate fees.

DEAN HELLER
Secretary of State
206 North Carson Street
Carson City, Nevada 89701-4299
(775) 684 5708
Website: secretaryofstate.biz

Articles Of Organization
Limited-Liability Company
(PURSUANT TO NRS 86)

ABOVE SPACE IS FOR OFFICE USE ONLY

1. Name of Limited-Liability Company	Check box if a Series Limited-Liability Company ☐
2. Resident Agent Name and Street Address: *(must be a Nevada address where process may be served)*	Name Physical Street Address — City — NEVADA — Zip Code Additional Mailing Address — City — State — Zip Code
3. Dissolution Date: *(OPTIONAL-see instructions)*	Latest date upon which the company is to dissolve (if existence is not perpetual):
4. Management: *(check one)*	Company shall be managed by ☐ Manager(s) **OR** ☐ Members
5. Names Addresses, of Manager(s) or Members: *(attach additional pages as necessary)*	Name Address — City — State — Zip Code Name Address — City — State — Zip Code Name Address — City — State — Zip Code
6. Names, Addresses and Signatures of Organizers *(if more than one organizer attach additional page)*	Name — Signature Address — City — State — Zip Code
7. Certificate of Acceptance of Appointment of Resident Agent:	I hereby accept appointment as Resident Agent for the above named limited-liability company. Authorized Signature of R.A. or On Behalf of R.A. Company — Date

This form must be accompanied by appropriate fees.

Reset

PREPARED STATEMENT OF LAURIE FLYNN

Honorable Norm Coleman, Chairman
Honorable Carl Lever, Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Government Affairs
United States Senate

November 14, 2006

Re: The Collection of Beneficial Ownership Information for Non-publicly Traded Corporations and Limited Liability Companies

Honorable Chairman and Committee Members:

Thank you for the opportunity to present information to you regarding the business formation process in Massachusetts. I applaud the committee for providing a national forum to discuss the adequacy of public disclosure in the business entity formation process. I am hopeful that Massachusetts' recent deliberations and resulting resolutions will assist the subcommittee in its effort to balance the need for beneficial ownership information with the privacy concerns of legitimate business interests.

By way of background, Massachusetts recently adopted a new business corporations law, Chapter 156D of the General Laws. The Act, the first comprehensive revision of the corporate laws in Massachusetts in over one hundred years, was prepared by a joint task force of the Boston Bar Association and the Massachusetts Bar Association, aptly named the Task Force on the Revisions of the Massachusetts Business Corporation Law. The Task Force consisted of over fifty (50) experienced corporate practitioners, members of the legislature and representatives of the Office of the State Secretary. The Task Force chose the American Bar Association's Model Business Corporation Act as the basis for its corporate statute because the Act had been adopted in a substantial majority of states. However, Massachusetts deviated from the Model Act in a number of relevant areas, including the role of the state secretary in the entity formation process and the information disclosed in business organization documents. Such differences reflect a carefully crafted balance between public interest in adequate disclosure and the privacy concerns of the business community.

With regard to the role of the secretary of state, Massachusetts retained the authority of the state secretary to review documents for compliance with law. Such provision is the basis for the secretary's ability to hold administrative hearings if the information provided in organizing documents is inaccurate or otherwise fails to comply with law. The Model Business Corporation Act relegates state authority in the business formation process to a ministerial function.

Second, the new Act authorizes the secretary to require more information in the formation process than is collected in model act states. In Massachusetts, the articles of organization contain supplemental information that includes a description of the business activity, the name and address of the president, treasurer, secretary and each of the directors, the name and address of the registered agent, the location of the corporation's principal office, and the location of the office in the commonwealth where the records required to be maintained by the Act are kept. Required records include a list of the names and addresses of all shareholders, in alphabetical order, by class of shares, showing the number and class of shares held by each.

The new Act does not authorize the issuance of bearer shares, nor does it permit the use of nominee directors and/or officers. With regard to nominee shareholders, though, Massachusetts' corporate law recognizes registered and beneficial holders. Nevertheless, the corporations statute contemplates that standard bylaws contain explicit statements to the effect that the corporation will only recognize the registered holder for purposes of voting, dividend distribution and other shareholder actions or entitlements. The exception that proves the rule are the appraisal provisions of Chapter 156D (section 13.01) under which beneficial holders may assert statutory appraisal rights if the registered holder has filed a nominee certificate with the corporation.

The Massachusetts Limited Liability Company Act (Chapter 156C) and the Massachusetts Revised Uniform Limited Partnership Act (Chapter 109) contain similar provisions. Each requires the secretary to review documents for compliance with law and requires the disclosure of managers or authorized principals and general partners. Each statute also requires the entity to keep a list of members or limited partners in the state at the statutorily required office. Further, the limited partnership statute requires that such list be made available to the state secretary within five business days of receipt of a written request by the secretary stating that such information is required in connection with an investigatory or enforcement proceeding.

These provisions, the ability to review for compliance with law, the identification on the public record of officers, directors, managers or principals, and the requirement that shareholder, member or partnership lists be maintained in the commonwealth accessible to the state secretary, reflect Massachusetts' attempt to balance the public interest in disclosure with the anonymity demanded by institutional and individual investors in today's capital markets. As I have not yet received any complaints from law

enforcement officials or the business community, and very few complaints from the public, I assume we have been successful.

Finally, I offer the additional information requested by the subcommittee in its letter dated November 3, 2006.

1. The number of non-publicly traded corporations and limited liability companies for the period requested is as follows:

	2004	2005
Number of non- publicly traded corporations formed in Massachusetts	11,484	10,953
Number of foreign corporations registered to do business in Massachusetts	3,095	3,087
TOTAL number of non-publicly traded corporations organized in or registered to do business in Massachusetts	219,252	232,169
Total number of limited liability companies formed in Massachusetts	10,980	12,446
Total number of foreign limited liability companies registered in Massachusetts	2,222	2,537
TOTAL number of limited liability companies organized in or registered to do business in Massachusetts	53,902	67,493

In order to form a corporation in Massachusetts, an incorporator submits articles of organization to the state secretary. The articles include the name of the corporation, the number of authorized shares, a description of the relative rights and preferences of each class if more than one class of shares was authorized, any restrictions on transfer of stock contained in the articles, any other lawful provisions, a description of the business activity, the name and address of the president, treasurer, secretary and director(s), the name and address of the registered agent, the location of the principal office, and the location in the commonwealth where records required to be maintained by the Act are kept. The incorporator(s) must sign the articles of organization. They may be submitted in person, by mail, facsimile or electronically. The minimum fee for incorporation is $275 if submitted in person or by mail. It is $250 if submitted by facsimile or electronically. A clerk examiner and an attorney review each document. If the document is found to comply with law, the document is filed. Documents received in proper order during regular business hours are filed the same day.

Limited liability companies are formed in the same manner except the fee for forming a limited liability company is five hundred dollars ($500).

2. Massachusetts does not collect beneficial ownership information during or subsequent to the incorporation. Massachusetts corporate law does not authorize the issuance of bearer shares.

3. Massachusetts law does not provide for "third party agents". The only role of a registered agent under Chapter 156D is to accept service of process in legal proceedings involving the entity. Consequently, the state secretary does not regulate such agents, nor are they required to obtain and verify beneficial ownership information.

4. Massachusetts common law and Chapter 156D permit the use of nominee shareholders as noted above. Neither common law, nor Chapter 156D, permits the use of nominee directors or officers.

5. Massachusetts has not received any requests from law enforcement for beneficial ownership information in the last five years.

6. Massachusetts does not have any information concerning the extent to which lack of beneficial ownership information in state records has impeded domestic and international law enforcement investigations apart from the material provided by the subcommittee.

7. Massachusetts defers to the expertise of the agencies involved with respect to the merits of (a) the GAO report; (b) Chapter 8 of the December 2005 report, U.S. Money Laundering Threat Assessment issued jointly by the Departments of Justice, Treasury, Homeland Security and others; and (c) Section 5.1 of the 2006 Financial Task Force Report, Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America.

8. The state secretary will file legislation before January 2007, which will require limited liability companies and corporations to disclose members and shareholders to the state secretary as in his judgment the public interest may require within forty-eight hours of written demand. Failure to provide such information may subject the entity to involuntary dissolution and/or the imposition of fines and penalties.

Respectfully submitted,

Laurie Flynn, Chief Legal Counsel
Director, Corporations Division
Office of the State Secretary
Commonwealth of Massachusetts

"formacompany-offshore.com"

Excerpt from website of a U.K. based corporate formation company

Nevada Company Formations

The Advantages of Nevada

- No Personal Income Tax
- No Corporate Income Tax
- No Corporation Franchise Tax
- No Corporation Succession Tax
- No Taxes on Corporate Shares
- No State Annual Franchise Tax
- No I.R.S. Information Sharing Agreement
- Nominal Annual Fees
- Minimal Reporting and Disclosure Requirements
- Stockholders are not on Public Record allowing complete anonymity
- Registered Office – Registered Agent service

http://formacompany-offshore.com/nevada.html

Emphasis Added

Permanent Subcommittee on Investigations
EXHIBIT #1

DELAWARE
AN OFFSHORE TAX HAVEN
FOR NON US RESIDENTS

LLC - LIMITED LIABILITY COMPANIES
OFFSHORE INCORPORATION

Non Resident General Business Company

ADVANTAGES
Any national, regardless of place of residence, may own a Delaware LLC company.
It may have one or more members.
Owners' names are not disclosed to the state. The company is not required to report any assets.
The company can be operated and managed worldwide.

TAXATION
No V.A.T. or sales tax in Delaware.
No income tax for companies operating outside of Delaware.
No income tax for non-resident members.

FEATURES

<u>"wyomingcompany.com"</u>
Excerpt from website of a Wyoming based corporate formation company

"ATTORNEY PRIVILEGE FULL TIME NOMINEE SERVICES

...[W]e provide an attorney who serves between the beneficial client (you) and the nominee. With the attorney in place, there is an attorney client privilege invoked, which still allows the client to communicate instructions via a password to the nominee, but all nominee connections are handled through the attorney. This allows the nominee to respond to questions by referring to the attorney and the attorney can then invoke the client privilege... There is no connection with you and the corporation. The attorney's name will appear on the public record as the director. ... Price per year $2500.00"

Source: Wyoming Corporate Services, Inc., website: http://www.wyomingcompany.com/

"nevadafirst.com"

Excerpts from website of a Nevada based corporate formation company

PROFESSIONAL DIRECTOR / MANAGER SERVICES

"If you desire to retain a higher level of anonymity, you may wish to utilize our director services. ...

Additionally, the Director will be utilized to obtain the tax identification number for your corporate entity."

OFFICE IDENTITY PROGRAM

"Rather than a mail drop or a PO Box service, NFH offers genuine office suite services that includes an address with a distinct suite number, individualized mail forwarding, corporate telephone number (shared) that includes reception service, routine copier and facsimile service and a full service conference room. ..."

SHELF ENTITIES

"[S]helf companies offer... unique opportunities. Perhaps the leading reason for acquiring an aged entity in general is credibility. An answer to the most common question, yes you may merge your history with an aged entity. ...

The fact that NFH's Shelf Entities have never or had [sic] limited operations, that all stock or member shares remain intact, gives intrinsic value to that entity. ...

The age and not the name of the Shelf Company should be of primary importance as a name change can be readily accomplished along with a 'Certificate of Good Standing' which is issued by the Secretary of State and includes the new name with the original date."

Source: Nevada First Holdings, Inc., Website http://www.nevadafirst.com

Jurisdictions That Obtain Company Ownership Information on Formation Documents

Australia	Yes
The Bahamas	Yes
Cayman Islands	Yes
India	Yes
Italy	Yes
Isle of Man	Yes
Jersey	Yes
United Kingdom	Yes
United States	No*

*No state collects ownership information on formation documents for corporations; Alabama and Arizona, Connecticut, and New Hampshire request some ownership information on LLCs.

United States Government Accountability Office

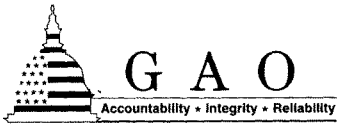
GAO

Report to the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

April 2006

COMPANY FORMATIONS

Minimal Ownership Information Is Collected and Available



GAO-06-376

Permanent Subcommittee on Investigations
EXHIBIT #2

April 2006

GAO
Accountability · Integrity · Reliability

Highlights

Highlights of GAO-06-376, a report to the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

COMPANY FORMATIONS

Minimal Ownership Information Is Collected and Available

Why GAO Did This Study

Companies form the basis of most commercial and entrepreneurial activities in market-based economies; however, "shell" companies, which have no operations, can be used for illicit purposes such as laundering money. Some states have been criticized for requiring minimal ownership information to form a U.S. company, raising concerns about the ease with which companies may be used for illicit purposes. In this report, GAO describes (1) the kinds of information each of the 50 states and the District of Columbia and third party agents collect on companies, (2) law enforcement concerns about the use of companies to hide illicit activity and how company information from states and agents helps or hinders investigations, and (3) implications of requiring states or agents to collect company ownership information.

What GAO Recommends

While not making recommendations, GAO observes that if a requirement to collect company ownership information is considered, it would be useful for policymakers to consider (1) options that balance the conflicting concerns among states, agents, and law enforcement agencies; and (2) uniformly applying any such requirement to all states or agents.

www.gao.gov/cgi-bin/getrpt?GAO-06-376.

To view the full product, including the scope and methodology, click on the link above. To view the results of GAO's survey of state officials responsible for company formations, click: www.gao.gov/cgi-bin/getrpt?GAO-06-377SP. For more information, contact Yvonne Jones at (202) 512-8678 or jonesy@gao.gov.

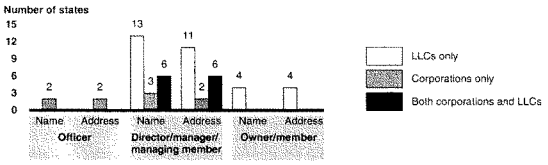
What GAO Found

Most states do not require ownership information at the time a company is formed, and while most states require corporations and limited liability companies (LLC) to file annual or biennial reports, few states require ownership information on these reports. With respect to the formation of LLCs, four states require some information on members, who are owners of the LLC. Some states require companies to list the names and addresses of directors, officers or managers on filings, but these persons may not own the company. Nearly all states screen company filings for statutorily required information, but none verify the identities of company officials. Third-party agents may submit formation documents to the state on a company's behalf, usually collecting only billing and statutorily required information for formations. These agents generally do not collect any information on owners of the companies they represent, and instances where agents told us they verified some information were rare.

Federal law enforcement officials are concerned that criminals are increasingly using U.S. shell companies to conceal their identity and illicit activities. Though the magnitude of the problem is difficult to measure, officials said U.S. shell companies are appearing in more investigations in the United States and other countries. Officials told us that the information states collect has been helpful in some cases because names on the documents, such as names of directors, generated additional leads. However, some officials said that the information was limited and that cases had been closed because the owners could not be identified.

State officials and agents said that collecting company ownership information could be problematic. Some state officials and agents noted that collecting such information could increase the cost of company filings and the time needed to approve them. Some officials said that if they had additional requirements, companies would go to other states or jurisdictions. Finally, officials and agents expressed concerns about compromising individuals' privacy because owner information disclosed on company filings would be part of the public record, which has not historically been the case for private companies.

Information Collected on Ownership and Management at Formation



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

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Abbreviations

CIP	Customer Identification Program
DEA	Drug Enforcement Agency
DHS	Department of Homeland Security
EIN	employer identification number
EOUSA	Executive Office of the U.S. Attorneys
EPA	Environmental Protection Agency
FATF	Financial Action Task Force on Money Laundering
FBI	Federal Bureau of Investigation
FinCEN	Financial Crimes Enforcement Network
IACA	International Association for Commercial Administrators
ICE	Immigration and Customs Enforcement
ID	identification
IRS	Internal Revenue Service
IRS/CI	Internal Revenue Service, Criminal Investigations
LLC	limited liability company
LLLP	limited liability limited partnership
LLP	limited liability partnership
NAICS	North American Industry Classification System
NCCUSL	National Conference of Commissioners on Uniform State Laws
OECD	Organization for Economic Cooperation and Development
OFAC	Office of Foreign Assets Control
SAR	suspicious activity report
SDN	Specially Designated Nationals
SEC	Security and Exchange Commission
SSA	Social Security Administration
TIN	taxpayer identification number

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United States Government Accountability Office
Washington, D.C. 20548

April 7, 2006

The Honorable Norm Coleman
Chairman
The Honorable Carl Levin
Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate

Companies—business entities that conduct a variety of commercial activities and hold a variety of assets—form the basis of most commercial and entrepreneurial activities in market-based economies. Companies in the United States play an essential and legitimate role in the country's economic system. They provide a wide variety of services that range from the provision of necessary utilities and investment services to retail sales of items such as clothing and furniture. Companies can also be set up that act as "shell" companies and conduct either no business or minimal business. Shell companies are used for legitimate purposes; for example, they may be formed to obtain financing prior to starting operations. However, government and international reports indicate that shell companies have become popular tools for facilitating criminal activity in the United States and internationally and can be involved in fraud and corruption or used for illicit purposes such as laundering money, financing terrorism, hiding and shielding assets from creditors, and engaging in questionable tax practices.[1,2] Such schemes can conceal money movements that range from a few thousand to many millions of dollars.

Using U.S. shell companies for such activities can be appealing because of the perceived legitimacy of U.S. companies in international commerce and the potential for concealing the identity of the beneficial owners behind the legal entity. The beneficial owners are the persons who ultimately own and

[1]See U.S. Departments of the Treasury, Justice, Homeland Security, et al, U.S. Money Laundering Threat Assessment Working Group, *U.S. Money Laundering Threat Assessment* (Washington, D.C., December 2005); and Organization for Economic Co-operation and Development (OECD), *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (Paris, 2001).

[2]Companies used to hide or facilitate illegal activity are sometimes also referred to as "front" companies and can sometimes conduct legitimate activity in addition to illegal activity. When we refer to "shell companies" in this report, we mean U.S. companies that do not conduct any legitimate activity.

control a company.[3] For example, a shareholder of a corporation could be a beneficial owner. State statutes have traditionally provided for the privacy of the identities of company owners and limited liability, which protects them against lawsuits and protects their personal assets. However, shell companies can provide beneficial owners with the means to conduct illegal activities while hiding the owners' identity and involvement. Also, company formation agents who help individuals form companies may facilitate the formation of these shell companies, further shielding the identity of the individuals controlling the company. Law enforcement agencies investigating cases in which such companies may have been used for illicit purposes often need to know who the owners are in order to determine responsibility for criminal actions.

In a previous investigation of foreign individuals laundering money through U.S. corporations formed in Delaware, we found that the state required very limited information when a company is formed.[4] The potential paucity of the information required when forming a company in the United States has raised concerns about the ease with which companies may be used for illicit purposes, particularly since the September 11, 2001, terrorist attacks. Given these concerns, you asked us to determine what types of information are routinely obtained and made available regarding the ownership of nonpublicly traded companies formed in each state.[5] Specifically, this report will describe

1. the kinds of information—including ownership information—that the 50 states and the District of Columbia collect during company formation and the states' efforts to review and verify the information;

[3]While definitions of beneficial ownership vary, this is the definition we developed for the purposes of this report.

[4]See GAO, *Suspicious Banking Activities: Possible Money Laundering by U.S. Corporations Formed for Russian Entities*, GAO-01-120 (Washington, D.C.: Oct. 31, 2000).

[5]Our focus is on the collection and availability of ownership information of nonpublicly traded companies whose securities are not registered with the Securities and Exchange Commission (SEC) pursuant to Section 12 of the Securities Exchange Act of 1934 (SEC Act) (codified at 15 U.S.C. § 78l), because significant shareholders of publicly traded companies are subject to certain federal regulatory requirements. For instance, every beneficial owner of more than 10 percent of any class of security registered with the SEC under Section 12 must file certain disclosure statements under Section 16(a) of the SEC Act (codified at 15 U.S.C. § 78p(a)) regarding the nature of such ownership.

2. the roles of third-party agents, such as company formation agents, and the kinds of information they collect on company ownership;

3. the role of shell companies in facilitating criminal activity, the availability of company ownership information to law enforcement, and the usefulness of such information in investigating shell companies; and

4. the potential effects of requiring states, agents, or both to collect company ownership information.

Individuals can choose a variety of business structures when forming a company. The scope of this report covers corporations and limited liability companies (LLC) because corporations have historically been the dominant business form and LLCs have recently grown in popularity. We refer to corporations and LLCs collectively as "companies" unless otherwise specified.

To address the objectives, we conducted a survey of officials from all of the states and the District of Columbia on their company formation and periodic reporting practices and cross-checked the responses against our review of state statutes, company formation forms, and state Web sites. Each of the 50 states and the District of Columbia responded to our survey. We also called and visited selected states to obtain further information about certain practices. In addition, we interviewed academics who have done research in the area, companies that provide filing and related services for businesses, law firms, financial institutions, state and industry associations, and state law enforcement agencies. Furthermore, we talked with officials from two jurisdictions outside of the United States that have recently implemented regulations for company formation agents.[6] We also spoke with officials from federal agencies in the Department of Homeland Security (DHS), including Immigration and Customs Enforcement (ICE); Department of Justice (Justice), including the Criminal Division, Drug Enforcement Agency (DEA), Federal Bureau of Investigation (FBI), and a U.S. Attorneys office and the Executive Office of the U.S. Attorneys (EOUSA); and Department of the Treasury (Treasury), including the

[6]We chose to interview officials from Jersey and Isle of Man, two United Kingdom crown dependencies, because these jurisdictions have implemented regulations for companies that provide filing and related services to businesses.

Financial Crimes Enforcement Network (FinCEN), Internal Revenue Service (IRS), and Office of Foreign Assets Control (OFAC).

We conducted our work from May 2005 through March 2006 in Arizona, Delaware, Florida, Maryland, Nevada, New York, Oregon, Virginia, and Washington, D.C., in accordance with generally accepted government auditing standards. A more extensive discussion of our scope and methodology appears in appendix I. The report also includes a glossary of terms. The survey and a more complete tabulation of state-by-state and aggregated results can be viewed at http://www.gao.gov/cgi-bin/getrpt?GAO-06-377SP. We provided a draft of this report to DHS, Justice, and Treasury. Justice and Treasury provided technical comments on the report that were incorporated, as appropriate.

Results in Brief

Most states do not require companies to provide ownership information at formation or in periodic reports. Similarly, states usually do not require information on other individuals who manage a company, including corporate officers and directors and LLC managers, on company formation documents, but most states require this information on periodic reports. However, these individuals may not be the owners of the company. States typically require basic information on company formation documents, such as the name of the company and the name and address of a contact where tax and other legal notices for the company should be sent. However, some may require other types of information, such as the company's principal office address or a statement of purpose. Almost all state officials reported that they screen filings for the presence of statutorily required information, but none reported screening names against criminal watch lists or verifying the identities of company officials provided in company formation or periodic report filings. Some officials said they do not take these steps because they do not have the legal authority or means to perform them.

Third-party agents may submit formation and other documents on behalf of a company, but the agents seldom collect ownership information or verify the information they collect. Individuals may also submit their own company filing documents. Company formation agents file required documents with a state for individuals or their representatives, while agents for service of process receive legal and tax documents on behalf of a

company.[7] Although these agents provide different services, one company may serve in both capacities. Some state statutes have basic requirements regulating agents for service of process, such as state residency, but otherwise there is little oversight of either type of agent and no verification of the information they provide. For example, some states may require the agent for service of process to have a local address but do not check to see whether the address is valid. Wyoming is the one state we found that requires agents for service of process to register yearly to discourage agents from providing false information and to have the information available if the agent is under investigation. Agents generally collect billing information and the information required by state statute for company formation but generally do not collect any additional information on ownership or management of the companies they represent. Agents are generally not required to verify information from clients, although some agents we spoke with may request additional information or verify the identity of international clients by requiring copies of passports. In some circumstances, a legal firm may be the contact for a company, and the agent may not interact with anyone affiliated with the company being formed.

Law enforcement officials are concerned about the use of shell companies in the United States that enable individuals to conceal their identities and conduct criminal activity and have encountered difficulties in investigating these shell companies because they cannot determine the owners of the companies. Quantifying the magnitude of the use of shell companies used in crimes is difficult because creating a shell company is not a crime but rather can be a method for hiding criminal activity. However, law enforcement officials told us they are seeing many investigations within the United States and in other countries where individuals have used U.S. shell companies to facilitate illicit activity involving billions of dollars. Most of the law enforcement officials we interviewed said that when they need company information, they obtain some information from state Web sites and company filings, and some said they also requested information from agents. Some law enforcement officials noted that the information available from states had proven helpful because names on the documents generated additional leads. However, some officials said that the information states collected was limited in revealing who owned and

[7]Agents for service of process may be known as registered agents, resident agents, statutory agents, or clerks in different states. Agents can be individuals or companies operating in one state or nationally with only a few clients to thousands of clients.

controlled the company and that cases had been closed because of insufficient information. For example, an Immigration and Customs Enforcement (ICE) official provided an example of a Nevada-based corporation that received 3,774 suspicious wire transfers totaling $81 million over a period of approximately 2 years. However, the case was not prosecuted because ICE could not identify the beneficial owner of the corporation.

Although law enforcement officials noted that information on owners was useful in some cases, state officials, agents, and others we interviewed said that collecting company ownership information could be problematic. For instance, if states or agents collected such information, the cost of filings and the time needed to approve them could increase, potentially slowing down business dealings or even derailing them. A few states and some agents also said they might lose business to other states, countries, or agents that had less stringent requirements, a consequence two foreign jurisdictions experienced after regulating agents and requiring collection of ownership information. Further, state officials and agents pointed out the difficulties of collecting information when companies are being formed or on periodic reports since ownership can change frequently. In addition, state officials and agents expressed concerns about maintaining privacy when making public information about legitimate businesses that historically has been protected. State officials, agents, and other experts in the field suggested internal company records, financial institutions, and the IRS as alternative sources of ownership information for law enforcement investigations. However, collecting information from these sources could present many of the same difficulties.

Background

States historically have had jurisdiction over the way business entities within their boundaries are formed and over reporting requirements for these entities. Statutes and requirements vary from state to state. In general, however, forming a company involves certain steps. Initially, a company principal or someone acting on the company's behalf submits formation documents to the appropriate state office—usually a division of the secretary of state's office—but in some cases to a different state

agency.[8] All formation documents filed with the state are matters of public record and are available to anyone. Documents may be submitted in person, by mail or, increasingly, online. A minimal amount of basic information generally is required to form a company, although these requirements also vary from state to state. Generally, the documents must give the company's name, an address where official notices can be sent to the company, share information for corporations, and the names and signatures of the persons incorporating (see fig. 1). State officials generally check to see that the documents supply the information required by statute. Fees vary by state from $25 to $1,000, and the process can take anywhere from 5 minutes to 60 days.[9] See appendix II for more information on how formation documents are submitted and on the company formation fees in each state. Expedited services, available in some states, decrease processing times but may require an additional fee. Most states also require companies to file annual or biennial reports in order to stay in good standing, for a fee ranging from $5 to $500.[10]

[8]Formation documents may be called articles of incorporation, certificates of incorporation (for corporations), or articles of organization or certificates of formation (for LLCs) in different states. In Alabama, formation documents are submitted to the probate judges at the county level. After a judge reviews and approves the documents, they are forwarded to the Secretary of State's office for review and filing.

[9]In Nebraska, the fees for filing articles of incorporation are based on the value of capital stock and can range from $60 to over $300. In New Mexico, the fees can range from $100 to $1,000, depending on the total amount of the authorized shares for the corporation.

[10]A certificate of existence or good standing shows that a company is in existence or authorized to transact business; that all fees, taxes, and penalties owed the state have been paid; that its most recent annual report has been filed; and that articles of dissolution have not been filed. States, cities, or counties may impose taxes or requirements for obtaining licenses or permits on businesses. We did not review the application or reporting requirements that businesses may have to submit to other state or local agencies in order to conduct business.

Figure 1: How Companies Are Typically Formed

Submission of company formation documents to state			Document processing		
Who may submit	**How to submit**	**What is typically required**	**Who is responsible**	**What steps are taken**	**Possible outcomes**
Company principal Attorney, or individual acting on behalf of the company Other agent (e.g., company formation agent)	In person Mail Fax Online or e-mail	Company name Name and address of agent for service of process Number or type of shares[a] Names, addresses, or signatures of incorporators or organizers Median fee: $95[b]	State agency Division of secretary of state's office or a division of tax/revenue agency, or other agency	Check for availability of desired company name Check for presence of all required information Process payment	ACCEPT: States accept company formation if information is complete. States provide certified articles indicating date and time of formation. SUSPEND: States may delay company formation if information is missing. States may contact original submitter to obtain needed information. REJECT: State may reject company formation, if for example, information is missing or not in compliance with state law.

Duration of entire process:
5 minutes to 60 days

Sources: GAO; Art Explosion (images).

[a]Share information applies only to corporations.

[b]In two states, New Mexico and Nebraska, the filing fee for corporations was a range. The median was calculated using the lowest fee in the range.

Types of Companies

Businesses may be incorporated or unincorporated. A corporation is a legal entity that exists independently of its shareholders—that is, its owners or investors—and that limits their liability for business debts and obligations and protects their personal assets. For example, the owners of a small store may desire limited liability protection in case a customer is accidentally injured inside the store and decides to sue. In this hypothetical case, the owners' personal assets, such as their home and retirement savings, generally would not be subject to any award if the customer won the lawsuit. Limited liability means that owners or shareholders in a business entity are personally responsible only for the amount they have invested in the business, while the corporation itself is responsible for the debts and other obligations it incurs. The exception occurs when a court "pierces the corporate veil," or disregards the legal entity that is the corporation, and holds the owners, shareholders, and sometimes the officers and directors

responsible for the corporation's acts and obligations.[11] In contrast, the owners of unincorporated businesses, such as partnerships and sole proprietorships, are generally liable for all debts and liabilities incurred by their businesses. However, these types of businesses also offer tax advantages that corporations do not.[12]

The limited liability company (LLC) is a fairly new business form that is a hybrid of the corporation and the partnership. Wyoming passed the first law permitting formation of LLCs in 1977, and Florida followed suit in 1982. By the mid-1990s, all states had enacted LLC statutes. Like a corporation, an LLC protects its owners, which are referred to as members, from some debts and obligations; like partnerships and sole proprietorships, however, it may confer certain tax advantages.[13] In addition, LLCs can choose a more flexible management structure than corporations. Table 1 shows the key characteristics of the different types of U.S. businesses.

[11]Piercing the corporate veil is justified only in extraordinary circumstances where a court finds that a unity of interest and ownership between an individual and a corporation exists to such an extent that recognizing a separate existence between the two would result in an injustice. In such cases, a court may disregard the corporate entity and impose personal liability on the individual. See 1 Fletcher Cyclopedia of Private Corp. §41 and 45 Am. Jur. Proof of Facts 3d 1.

[12]Corporations are generally subject to income taxes on the corporation's taxable income. 26 U.S.C. § 11. Shareholders are generally subject to income taxes on dividends they receive from corporations with respect to its stock. 26 U.S.C. § 61(a)(1)(7). Certain small business corporations on the other hand may elect under the federal tax code to be taxed as an S corporation, which generally allows corporate income to pass through to the shareholder level before it is subject to federal income taxation. 26 U.S.C. §§ 1361(a)(1), 1363 and 1366. Partners in business are generally liable for income tax in their separate, individual capacity rather than the partnership being liable for income tax. 26 U.S.C. § 701.

[13]In late 1996, the IRS issued regulations that generally allowed LLCs to elect how they will be treated for federal tax purposes—that is, as sole proprietorships (disregarded entities), partnerships, or corporations, depending on the number of members. 26 C.F.R. §§ 301.7701-2 & 301.7701-3.

Table 1: Basic Types of U.S. Businesses

Business form	Key characteristics
Corporation	An artificial construct (usually a business entity) created by law that acts as a separate and distinct legal entity apart from its owners and that has other legal rights, such as the ability to issue stock.
C corporation (for tax purposes)	Generally, any corporation that is not an S corporation.
S corporation (for tax purposes)	A small business corporation that elects to be taxed as an S corporation under the federal tax code. The taxable income of an S corporation is passed through to the shareholders and taxed at the shareholder level.
Limited liability company (LLC)	A company that offers its owners (members) some protection from responsibility for the company's debts and obligations. An LLC may have only one member and may be managed by its members or managers.
Partnership	An association of two or more persons who jointly own and conduct a business and agree to share the profits and losses of the business.
Limited partnership	A partnership consisting of one or more limited partners who contribute capital to and share in the profits of the partnership but who are responsible for the company's debts only up to the amount of their contribution and one or more general partners who control the business and are personally liable for its debts.
Limited liability partnership	A partnership in which the participants are not responsible for negligent acts committed by other partners or by employees not under the partner's supervision. Certain businesses (typically law firms or accounting firms) are allowed to register under state statutes as this type of partnership.
Limited liability limited partnership	A partnership in which general and limited partners are not responsible for the partnership's debts and obligations.
Sole proprietorship	A business operated by one person who owns all assets and is responsible for all of the liabilities.

Sources: Black's Law Dictionary (8th ed. 2004); Uniform Limited Liability Company Act, § 202(a) (1996), 26 U.S.C. §§ 1361, 1363 and 1366; Uniform Limited Partnership Act 2001 Refs.; and Annos., Prefatory Note (Main Vol. 2003).

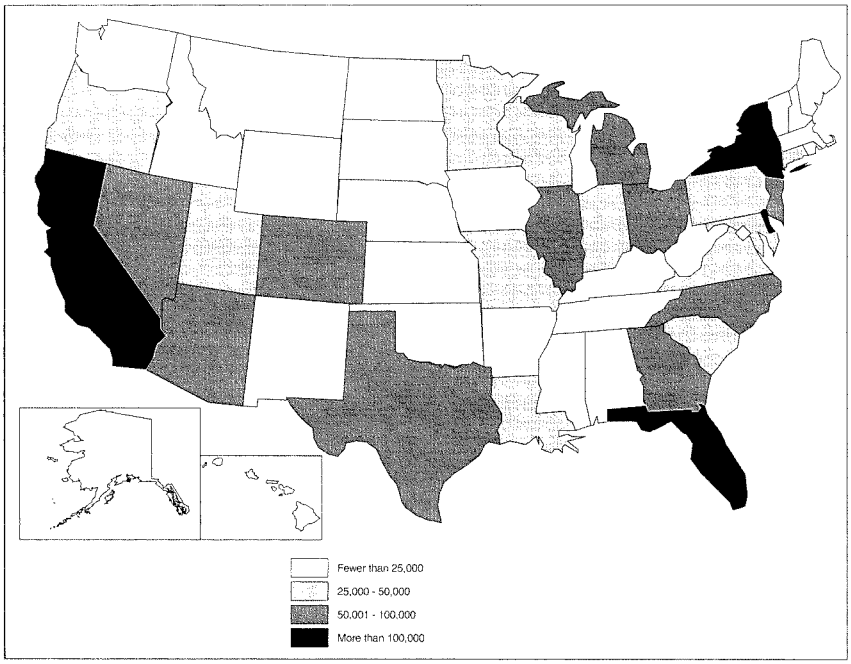
Corporations and LLCs

Historically, the corporation has been the dominant business form, but recently the LLC has become increasingly popular. According to our survey, 8,908,519 corporations and 3,781,875 LLCs were on file nationwide in 2004. That same year, a total of 869,693 corporations and 1,068,989 LLCs were formed. Figure 2 shows the number of corporations and LLCs formed in each state in 2004. Five states—California, Delaware, Florida, New York, and Texas—were responsible for 415,011 (47.7 percent) of the corporations and 310,904 (29.1 percent) of the LLCs. As shown in figure 3, Florida was the top formation state for both corporations (170,207 formed) and LLCs (100,070) in 2004. New York had the largest number of corporations on file in 2004 (862,647) and Delaware the largest number of LLCs (273,252). Data from the International Association of Commercial Administrators (IACA) shows that from 2001 to 2004, the number of LLCs formed increased

rapidly—by 92.3 percent—although the number of corporations formed increased only 3.6 percent.[14]

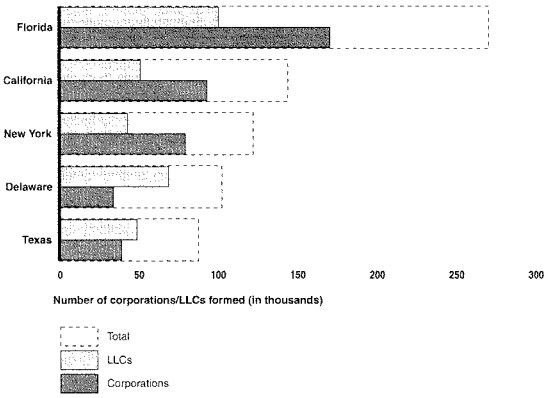
[14]IACA is a professional association for government administrators of business organization and secured transaction record systems at the state, provincial, and national level in any jurisdiction. The IACA data include domestic, foreign, and professional companies. Domestic companies are those doing business in the same state in which they are incorporated or formed. Foreign companies do business in a state, but they are incorporated or formed in another jurisdiction, either in another U.S. state or a foreign country. Professional corporations may include professional services, such as those performed by doctors, dentists and attorneys. Combining figures for these different types of companies overestimates the number of companies formed under the state statutes examined in this report, which covers only domestic companies. Some states did not report data to IACA.

Figure 2: Domestic Corporations and LLCs Formed in States in 2004



Sources: GAO survey of state officials responsible for company formation (data); Art Explosion (map).

Figure 3: Number of Domestic Corporations and LLCs Formed in the Top Five States in 2004



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

Most States Collect Limited Information on Company Ownership and Management

Most states do not require ownership information at the time a company is formed, and while most states require corporations and LLCs to file annual or biennial reports, few states require ownership information on these reports. Similarly, only a handful of states mandate that companies list the names of company managers on formation documents, although many require managers' information on periodic reports. States may require other types of information on company formation documents, but typically they do not ask for more than the name of the company and the name and address of the agent for service of process (where legal notices for the company should be sent). Most states conduct a cursory review of the information submitted on these filings, but none of the states verify the identities of company officials or screen names against federal criminal records or watch lists.

Information States Collect on Company Ownership

The owners of a company are, in the case of a corporation, the shareholders of that corporation and in the case of an LLC, the members of that LLC.[15] According to our survey results, none of the states collect ownership information in the formation documents—articles of incorporation—for corporations (see fig. 4). State statutes generally do, however, require corporations to prepare and maintain lists of shareholders that, unlike formation documents, are not filed with the state or part of the public record.[16]

With respect to LLCs, states generally require a manager-managed LLC to name the designated manager instead of a member on the formation document—articles of organization. However, the manager is not necessarily an owner of the LLC.[17] LLCs usually prepare and maintain operating agreements that name the owners, members, and their financial interests in the company, but these operating agreements are not filed with the state or part of the public record. According to our survey results, four states—Alabama, Arizona, Connecticut, and New Hampshire—request some ownership information when an LLC is formed.[18] For example, in Alabama, the formation documents must list the names and mailing addresses of the initial members of an LLC. A Connecticut official said that either a member's or a manager's name was required on the articles of organization. In New Hampshire, a member or manager is required to sign the articles of organization. Arizona statutes mandate that manager managed LLCs must list on formation documents the name and address of each member owning more than a 20 percent interest and that member-managed LLCs must list all members' names and addresses. Depending on the management structure of an LLC, ownership information

[15]Companies may have complex structures with multiple organizational layers—beyond the two-tier parent/subsidiary construct—of different types of business entities, and the shareholders of a corporation and members of an LLC could be individuals or other businesses. Therefore, identifying the individual who is the beneficial owner directing the company and receiving the proceeds or other advantages of the company may involve uncovering the ownership of various layers of entities.

[16]Unless otherwise specified, data are from our survey of state officials responsible for company formations.

[17]An LLC can be member managed, with the owners collectively running the business, or manager managed, with one or more persons or entities—either designated members or an outside party—taking the managerial role.

[18]One state did not respond to the survey question on providing names of owners of corporations, and two states did not respond to the question on the addresses of owners.

may be included on the formation documents in more states. If an LLC is managed by its members, some states require the LLC to provide the name and address of at least one member on the formation document.

Most states require corporations and LLCs to file periodic—annual or biennial—reports, but not many states require ownership information on these reports (see fig. 4).[19] With respect to corporations, three states (Alaska, Arizona, and Maine) indicated on our survey that the name of at least one owner was required on corporations' periodic reports. In Alaska, any person owning more than a 5 percent interest in a corporation must be listed on the periodic report, according to a state official. An official from Arizona said the state requires that corporate periodic reports list the names and addresses of shareholders owning more than 20 percent of company stock. In Maine, statutes require that periodic reports include the names and addresses of shareholders of a corporation only if there are no directors.

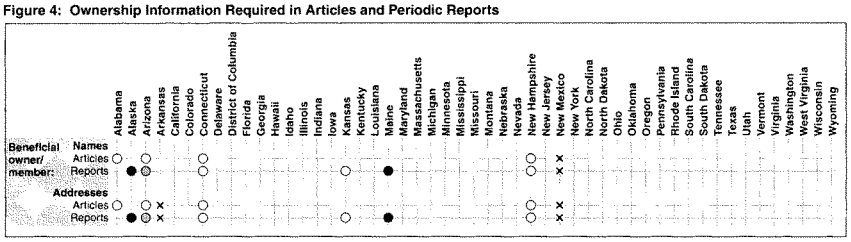
With respect to LLCs, our survey showed that five states require LLCs to list at least one member on their periodic reports.[20] As with corporations, Alaska requires the name and address of any person owning more than a 5 percent interest in an LLC to be listed on the company's periodic report. A state official told us that LLCs in Kansas are required to list on their periodic reports the names and post office addresses of members owning at least 5 percent of the capital in the company.[21] Connecticut and New Hampshire require either a manager or at least one member name on their periodic reports. Maine requires the name and business or residential address of each manager, or if there are no managers, each member with a street address on the periodic report. Finally, in states that require a manager's or managing member's name on periodic reports, the reports for member-managed LLCs might include a member's name.

[19]Forty-eight states require an annual or biennial report for corporations, and 37 states require an annual or biennial report for LLCs. In some states, such as Alabama, New Jersey, and Oklahoma, the annual report may be submitted to a different office, such as the department of revenue, rather than the office that handles formation filings. In addition, an Iowa official told us that as of January 1, 2006, LLCs are required to submit biennial reports.

[20]The five states are Alaska, Connecticut, Kansas, Maine, and New Hampshire. One state did not respond to this survey question.

[21]In 2004, Kansas removed a requirement that corporations list the names and post office addresses of shareholders owning at least 5 percent of capital stock in order to limit the reporting requirements for corporations.

Figure 4: Ownership Information Required in Articles and Periodic Reports



○ LLCs only
◎ Corporations only
● Both corporations and LLCs
× No response[a]

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

[a]New Mexico and Arkansas did not respond to some of our survey questions. Arkansas responded on our survey that a member's address is not required for LLC articles or reports. However, the state did not respond to the question asking whether the address of an owner of a corporation is required on articles or reports. We found from our legal review that Arkansas does not require the address of an owner on articles or periodic reports. New Mexico did not respond to our survey questions on the information required about owners or members. Our legal review found that New Mexico does not require corporations to list the name or address of an owner on articles or periodic reports. For LLCs, we found that New Mexico does not require member names and addresses on formation documents or periodic reports.

Information States Require on Company Management

Less than half of the states require the names and addresses of company management or directors on company formation documents. Management may include officers—chief executive officers, secretaries, and treasurers—who help direct a corporation's day-to-day operations, as well as managers or managing members of LLCs.[22] Directors serve on the governing board of a corporation and are responsible for making important business decisions, especially those that legally bind the corporation. Two states require officers' names and addresses on company formation documents, 10 states require the names of directors, and 9 states require the addresses of directors (see fig. 5). Some states have additional

[22]Management of LLCs is in the hands of either managers or managing members, depending on the structure of the LLC. In a manager-managed LLC, one or more owners or an outsider is assigned to take responsibility for managing the LLC. These managers make decisions and act as agents of the LLC. A managing member is an owner that participates in the management of the business.

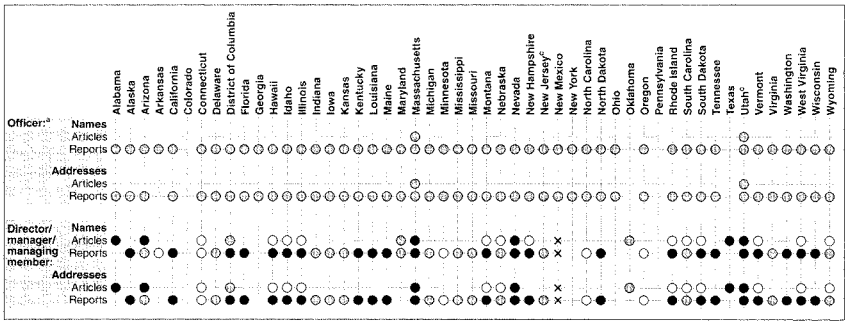
information requirements for company formations. For instance, our review of state statutes found that Louisiana does not require information on directors on the incorporation documents, but does require directors' names and addresses on an initial report that must be filed with the incorporation documents. We also found that Oklahoma requires the names and addresses of the directors only if the persons incorporating the company are not responsible for its operations after the incorporation documents are filed. More states require management information on LLCs. Nineteen states require the names of managers or managing members on formation documents, and 18 states require their addresses.[23]

Most states require the names and addresses of corporate officers and directors and of managers of LLCs on periodic reports (see fig. 5). For corporations, 47 states require the names of officers on periodic reports, and 46 states require officers' addresses. Thirty-eight states require directors' names and 37 require directors' addresses. For LLCs, 28 states require the manager's or managing member's name, and 27 states require their addresses. However, even if states require disclosure of directors' names, those listed may not be the individuals who are truly directing the company because in some cases, the individuals could be nominee directors that act only as instructed by the beneficial owner of the company.[24] Also, managers may or may not be owners of the LLC.

[23]One state did not respond to this survey question.

[24]A nominee director may be an individual who is located where the business was formed and may sign for the business on behalf of the beneficial owner. Typically, the nominee director will have no knowledge of the business affairs or accounts, cannot control or influence the business, and will not act unless instructed to by the beneficial owner. We did not review state statutes on the use of nominee directors. While this mechanism may serve legitimate purposes, it can also be used to conceal identities and evade scrutiny. See Organization for Economic Co-operation and Development (OECD), *Behind the Corporate Veil, Using Corporate Entities For Illict Purposes* (Paris, 2001); and *U.S. Money Laundering Threat Assessment* (Washington, D.C., December 2005).

Figure 5: Management Information Required in Articles and Periodic Reports



○ LLCs only
◎ Corporations only
● Both corporations and LLCs
× No response[b]

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

[a]Information on officers applies only to corporations.

[b]New Mexico did not respond to some of our survey questions. New Mexico did respond that corporate directors' names and addresses are required for both articles and reports, but did not respond to the questions about the names and addresses of LLC managers/managing members. However, we found in our review of state statutes that New Mexico does not require LLC manager names and addresses on formation documents or periodic reports.

[c]New Jersey responded on the survey that the names and addresses of corporate directors are required for reports only and that the names and addresses of LLC managers/managing members are not required for articles or reports. However, our review of state statutes found that the names and addresses of corporate directors are also required on articles and that the names and addresses of LLC managers/managing members are required on reports. We were unable to clarify this discrepancy with New Jersey state officials. Utah responded to the survey that the names and addresses of corporate officers and directors are required on articles; however, our review of state forms found that this information is optional.

States May Also Collect Other Information

States may also ask for other general information about a company, including its name; the name and address of the agent for service of process (where legal notices for the company should be sent); and for corporations, information about the number and types of shares the company will issue. Appendix III shows the type of information that each state collects on formation documents. Many states specify that the agent's address must be a physical street address and not a post office box. In

addition, a majority of the states include on their formation documents space for an individual to sign as the incorporator (in the case of a corporation) or organizer (in the case of an LLC) of the company.[25] The incorporator or organizer may be the agent who is forming the company on behalf of the owners or it may be an individual affiliated with the company being formed. Most states permit an individual or entity to serve as incorporator without regard to state residency or later participation in the company, but at least two states require that the incorporator be associated with the company in some way. For example, the articles of incorporation for Arkansas and California state that if a newly incorporated company has chosen initial officers or directors, one or more of them must sign as the incorporator. Otherwise, an unaffiliated individual can sign as the incorporator.

Many states require a brief statement of purpose or a principal office address in order to form a corporation or LLC.[26] In reviewing state statutes and state forms, we found that 20 states require a statement on the purpose of a corporation and 16 require a statement of purpose for LLCs on formation documents. In some states that ask for a statement of purpose, a general statement such as "the purpose of the corporation is to engage in any lawful act or activity..." is sufficient. Alaska requires an additional form that discloses the North American Industry Classification System (NAICS) number that most closely describes the activities of a corporation.[27] Fourteen states require a principal office address to form a corporation, and 23 states require a principal office address to form an LLC. The principal office generally means either the address of the company's place of business or its mailing address. Therefore, even in states where a principal office address is required, this address may not indicate the company's actual place of business. For example, Arizona's form asks for a

[25]Many states also ask for this individual's address more often for corporations than for LLCs. The primary role of the incorporator is to execute and deliver the formation document to the state company formation office. Although state statutes may not require this information, states may request or require this information be included on the company formation documents.

[26]Some states may require this information for corporations or LLCs, but not both. Appendix II has information on each state's information requirements for company formation documents.

[27]The North American Industry Classification System is a system for classifying businesses that was developed jointly by the United States, Canada, and Mexico for the collection, analysis, and publication of statistical data related to the business economy across North America.

known place of business in Arizona, but the instructions for the form state that this address may be in care of the address of the company's agent.

Some states have unique requirements for information on newly forming companies. For example, the articles of incorporation forms for Louisiana, Rhode Island, and South Dakota must be notarized. Similarly, an attorney licensed to practice in South Carolina must sign company formation documents in that state. Private sector officials told us that more states used to require a notary's signature on company formation documents, but that most had repealed this provision. A Louisiana state official said that requiring a notary's signature was a "historical" decision and, despite an effort to change the law, was likely to remain a requirement.

A few states (Louisiana, Massachusetts, Mississippi, and Pennsylvania) also require a federal taxpayer identification number (TIN) on some company formation documents.[28] Kansas requests a TIN on formation documents, but it is not required by statute. Louisiana and Massachusetts state officials told us that even though a TIN is required, company formation documents are not rejected if it is not included. These states originally used the TIN as a tracking number for filings. For instance, the Kansas Department of Revenue uses the information to match companies in its database. A Massachusetts official said that the state was moving away from using TINs in all cases and now assigns a private unique identification number to each company for tracking purposes. While the requirement to include a TIN is still in place for LLCs in Massachusetts, it was recently deleted from the corporation statute because the Secretary of State's office received many complaints about this number being publicly available on filing documents.

Forty-two states reported on our survey that their information requirements for persons or entities from outside the United States forming a U.S. company were the same as for U.S. citizens. Those states that say there was a difference also said that the difference was simply that proof of the company's existence had to be included and that documents had to be translated into English. For example, Minnesota and North Carolina commented that if an entity from another country was applying to conduct

[28]A taxpayer identification number is an identification number used by the Internal Revenue Service in the administration of tax laws. It can be either a Social Security number issued by the Social Security Administration (SSA) or another number, such as an employer identification number (EIN), issued by the IRS.

business in those states, the entity must provide proof of good standing or a document certifying that the company existed in the original country.[29] Alaska is the only state that requires the name and address of each alien affiliate or a statement on the articles of incorporation that there are no alien affiliates. An "alien affiliate" is an individual from another country who has some ownership or control of a company or an entity controlled by an individual or a corporation from another country.[30] An Alaska state official said that this information was originally required to identify offshore fisheries and their owners.

State Officials Reported That They Generally Reviewed Documents for Basic Information but Did Not Verify the Information

Nearly all of the states reported that they reviewed filings for the required information and fees and checked to see if the proposed name was available (see table 2). In Arizona, for example, state officials said that the main reasons filings were rejected were that required information, such as the agent's address or signature or the type of management structure of an LLC, was missing and that the company name was not distinguishable from an existing entity's name. Other state officials said they also rejected filings because they were missing key information, the company name was not available, or the fee was not included. Many states also reported that they reviewed filings to ensure compliance with state laws.[31] In Virginia, for instance, filings are reviewed for more than just the required information. An attorney in the state office reviews all formation filings for substantive issues. For example, Virginia law requires that shareholders elect directors, and state officials said that they would reject a filing if the articles stated that the company's directors would be chosen by a different method.

None of the states reported verifying the identities of incorporators or company officials or using federal criminal records or watch lists to screen names. State officials gave several reasons for not taking this step when reviewing formation documents. In interviews and on the survey, many state officials emphasized that their role was authorized by statute as only administrative, not investigative. In fact, 45 states reported that they did

[29]Minnesota also commented that an agent is required for persons or entities from other countries forming a Minnesota company.

[30]An "alien affiliate" could also be an entity that was either created or organized in another country or whose principal place of business is located outside of the United States.

[31]We do not have information on the extent of this legal review in all of the states that responded that they conduct such a review.

not have investigative authority to take action if they identified information that could indicate criminal activity, although some state officials said they can refer suspicious activity to law enforcement. Only two states—Colorado and North Carolina—reported that they did have investigative authority.[32] Further, two states noted that their state statutes required them to file formation documents as long as the documents contained the required information. In addition, one state official said that states did not have the resources to verify the information submitted on formation documents and other officials commented on the survey that verification would significantly increase the costs and workloads of their offices. Another stated that the staff would not know how to determine the validity of information individuals provided to verify their identity.

While states do not verify the identities of individuals listed on company formation documents, an individual may be charged with perjury in some states if law enforcement officials find in the course of an investigation that an individual submitted false information on a company filing. We found in our review of state forms that 10 states note the penalties for providing false information on their company formation documents. One state official provided an example of a case in which state law enforcement officials charged two individuals with, among other things, perjury for providing false information about an agent on articles of incorporation.

[32]Four other states responded either "no response" or "do not know" to this question.

Table 2: Steps States Take to Review Articles of Incorporation/Organization and Periodic Reports

	Corporations				LLCs			
Processing steps	**Articles only**	**Reports only**	**Both**	**Not performed or no response**	**Articles only**	**Reports only**	**Both**	**Not performed or no response**
Review for availability of company names	47	0	3	1	45	0	2	4
Review for presence of information and fees	11	39	0	1	16	2	31	2
Determine whether submitted information is in compliance with state law	10	1	35	5	16	2	28	5
Verify with picture IDs the identities of incorporators, directors, or officers	0	0	0	51	0	0	0	51
Use federal criminal records or watch lists to screen names of incorporators, directors, or officers	0	0	0	51	0	0	0	51
Direct staff to look for suspicious activity or fraud in filings	2	0	4	45	3	0	3	45

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

A few states reported that they directed staff to look for suspicious activity or fraud in company filings. For example, an official in Alabama told us that staff who reviewed filings looked for anything out of the ordinary, such as a bank from another country that wanted to form a company in Alabama but would not provide the required information. An official in Missouri said that despite not having a formal procedure or policy for reviewing filings for suspicious activity, staff were trained to look for things that were out of the ordinary. Such things might include discrepancies like two signatures of the same name with different handwriting. However, most states reported that they did not direct staff to look for suspicious information. According to an official in Alaska, the state has no formal mechanism for identifying or reporting suspicious information. The official said that staff would notice unusual fictitious names on filings, but with a filing fee of $250 in Alaska, this type of activity was rare. Two state officials told us that when staff noticed something unusual, they typically contacted the applicant for an explanation but still usually filed the documents. If something appeared especially unusual, they referred the issue to state or local law enforcement or the Department of Homeland Security. One official said his office had

never received a response from law enforcement about issues that had been forwarded.

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

The roles of company formation agents and agents for service of process differ, as do the state statutes that govern them.[33] Company formation agents submit documents on a company's behalf, and agents for service of process receive legal and tax documents for clients. Most states do little to oversee these agents and do not verify information about them. Further, states generally do not require agents to collect information on company ownership or management or to verify the information they collect. The agents we interviewed generally collect only contact information and any information required by the states and do not verify the information. In some circumstances—primarily with international clients and clients requesting special services—some agents may verify a client's identity.

Company Formation Agents and Agents for Service of Process Play Different Roles

Company formation agents are firms that help individuals form companies by filing required formation documents and other paperwork with the appropriate state agencies. Although individuals may file their own formation documents directly, a company formation agent can facilitate the process. Agents for service of process can be either persons or entities that are designated to receive important tax and legal documents on behalf of businesses. For example, if a company is being sued, the agents for service of process will accept the legal paperwork and forward it to their company contacts. Historically, the role of agents was to ensure companies had a presence in each state they operated in and were able to be reached. Our review of state statutes showed that almost all states require companies to designate an agent for service of process on company formation

[33]We interviewed a total of 12 third-party agent companies that provide company formation and service of process services. The companies ranged from large national companies to small companies. In this report, we refer to company formation agents and agents for service of process as simply "agents" unless otherwise specified. Some agents and state officials told us that most companies are formed by individuals who also designate themselves as the agent for service of process. Anecdotally, agents told us that they may work with up to 30 percent of the total companies formed.

documents.[34] These agents may provide other services, such as filing amendments and periodic reports, assisting with mergers and acquisitions, obtaining certificates of good standing, and conducting other public record searches. Agents may also provide assistance in setting up bank accounts or providing directors, although only a couple of the 12 agents we contacted said that they would provide these services, and then only in special situations.[35] According to a few agents we interviewed, large companies are more likely to hire agents, especially large companies that need an agent for service of process in multiple states.

Most states have basic requirements for agents for service of process. Forty-six states indicated on our survey that they required agents for service of process to have a physical address in the state (not a post office box) where documents could be received, while seven states required agents to keep specific office hours. Individuals serving as agents for service of process generally must be state residents or have a state address, but firms acting as agents generally must be authorized to do business in the state and must have filed company formation documents. A few states have additional requirements for agents. For example, in Maine, an agent must be a natural person, while in Louisiana, a professional law corporation or partnership may serve as the agent.[36] In Virginia, agents for service of process must be individuals who are both a resident and an officer of the company being formed, members of the state bar, or companies authorized to do business in the state, and must specify their qualification on the company formation documents.

[34]In New York, the Secretary of State serves as the designated agent but another agent may be designated. Minnesota and Pennsylvania require a registered office but the name of an agent is not required. Louisiana does not require an agent on the formation documents, but does require an agent to be listed on the initial report that is filed with the formation document.

[35]Typically, the nominee or dummy director is a mere figurehead and will have no knowledge of the business affairs or accounts, cannot control or influence the business, and will not act unless instructed to by the beneficial owner. Special circumstances could arise, for example, if a bank required someone independent of a corporation to serve as director for purposes of granting a loan.

[36]A natural person is a legal term and means a "human being."

Few States Verify Information from or Otherwise Oversee Agents

We found limited incidences of state oversight of agents. A few state officials we spoke with reported checking company formation documents to ensure that agents had a local address, but in general they did not check to see whether the address was valid. One state official said the office verified addresses only in special cases. Delaware reviews its agents' addresses if several hundred transactions occur from the same address to ensure it is an actual address and not a post office box. In addition, Delaware is unique in allowing approximately 40 agents to have direct access to the state's database to enter or access company information. The state contracts with these agents, and in return they must meet certain guidelines and pay access fees. The state reserves the right to terminate these contracts at any time but thus far has not done so because of nefarious behavior. State officials in Florida and Wyoming told us that they checked their records to ensure that companies acting as agents for service of process were authorized to conduct business in the state.

Thirty-nine states said they did not track the number of agents for service of process operating in the state and 36 did not have an official listing of agents. However, a couple of states have registration requirements for operating within their boundaries. Wyoming requires agents serving more than five corporations to register with the state annually, under a law that was enacted after some agents gave false addresses for their offices, according to a state official. To register, agents must pay a $25 annual fee and complete a form each January giving contact information, including a physical and mailing address, and indicating whether the applicant or any company principal has ever been convicted of a felony. The state official said that the office kept the information on file in case an agent was investigated. California law requires any corporation serving as an agent for service of process to file a certificate with the Secretary of State's office and to list the California address where process can be served and the name of each employee authorized to accept process. Seventeen states indicated on the survey that they provide the names of all or some agents on a Web site, and 6 states reported having some requirements for agents wanting to be listed on the Web site.[37] For example, Delaware requires a business to have been operating for at least 1 year, to be in good standing, and to serve more than 50 clients.

[37]Seventeen states indicated on our survey that they provided the names of all or some agents. However, we were unable to verify the listing of agents for all of these states.

Although the notion is controversial, some state officials and agents said that some level of uniform registration or certification in the industry might be desirable, for several reasons. One agent told us that the few agents who do not follow the current rules give the industry a bad name and that regulation would eliminate some of these agents. Another agent felt that registration would create some standards in the industry and provide some legitimacy for firms conducting business in international jurisdictions that require registration. However, some agents felt that regulation would be difficult if not detrimental to the industry. One agent felt that if the industry were regulated, individuals would avoid using agents and form their companies themselves. Another agent believed that the costs associated with meeting standards could be high enough to drive smaller firms out of business. In either case, both agents that supported and opposed regulation said that the industry should be involved in efforts to develop some type of registration or regulation that would affect their business.

Agents We Talked with Said They Generally Do Not Collect Ownership and Management Information on Companies Because States Do Not Require Them to Collect It

Agents we spoke with generally collected only contact information and the information required by a state for company formation documents or periodic reports. This information may include contact names for billing and for forwarding service of process, annual reports, or tax notifications. These agents said they may have only one contact name for a company. According to several agents, they rarely collect information on ownership since states do not require it. In general, agents said they collect the names and addresses of officers and managers, if required, and when serving as an incorporator, agents may collect information on the company directors or shareholders, even if it is not required. This information allows agents to resign as incorporators and pass on the authority to conduct business to the new company principals. Depending on the size of the company, the directors and the officers may also be the owners, but one agent told us that he did not try to determine if they were. Several agents also told us that they do not always work directly with the principals of the company because the agents interact directly with law firms or transact a large part of their business online, and therefore may not have access to additional information not required by the state. One agent also noted that collecting ownership information was not necessary to doing his job.

Even if agents collect information such as the names of officers and directors, a few agents said that they might not keep records of the information. For example, two agents told us that their firms did not keep a database of company information, in part because company documents filed with the state are part of the public record. Because the information is

public, one agent felt it was not necessary to bear the additional cost of storing it internally. According to our review of state statutes, some states have record retention requirements that oblige corporations to make shareholder lists or the stock ledger available at the registered office within the state (which may be the agent's office), although the requirements vary by state. For example, in Nevada, the registered office is required to keep the stock ledger or a file listing the location of the ledger, and in New Mexico, a list of shareholders must be available at a company's registered office 10 days prior to a shareholders' meeting.

Agents Are Not Required to Verify Information in Company Filings, but a Few Do

States generally do not require agents to verify the information collected from clients, and few agents we interviewed do. In general, agents told us they do not verify the validity of names or addresses provided, screen names against watch lists, or require picture identification of company officials. The extent of agents' verification might include checking that the minimum statutory requirements have been met, researching an address if a client's mail is returned, or comparing a credit card address to a company's address. One agent said that his firm generally relied on the information that it received and that in general did not feel a need to question the information, although another agent said that his firm might request additional information to assess risk if something about a potential client seemed suspicious.

Two agents with whom we spoke indicated that they collected additional information that could be used to verify the identity of clients, often when working with international clients, although the choice to verify information did not appear to be based on a formal risk assessment. These agents said they might check names against caller identification systems on their telephones or against the Office of Foreign Assets Control (OFAC) list of Specially Designated Nationals and Blocked Persons.[38] One agent said that her firm created a document to collect additional information from

[38]OFAC is an office within the U.S. Department of the Treasury that administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals, as well as a master list of "Specially Designated Nationals and Blocked Persons" (SDN) that includes numerous foreign agents and front organizations, terrorists, terrorist organizations, and narcotics traffickers. See the U.S. Department of Treasury's Web site: http://www.treas.gov/offices/enforcement/ofac/. All U.S. persons, both individuals and entities, are responsible for ensuring they do not do business with a person or entity listed on the SDN list. Undertaking any type of business or financial transaction with a person or entity on this list is illegal under federal law.

clients from unfamiliar countries. This agent's document was based in part on federal standards for financial institutions from the USA PATRIOT ACT.[39] On the document, the agent asks for a federal tax identification number (TIN); company ownership information; information from the company Web site; e-mail addresses; and, for individuals, identification, proof of occupation, and citizenship status.

Another agent we interviewed in Delaware asked for identification and used a specific agreement with certain international clients. In some cases, international agents contact the Delaware agent for assistance in forming U.S. companies for their clients in other countries. According to this agreement, international agents must verify the identity of an individual wishing to form a company through the Delaware agent by requiring their client to provide the principals' names, addresses, dates and places of birth, nationalities, and occupations, as well as certified copies of their passports, proof of address, and a reference letter from a bank.[40] This agent also required a client requesting mail forwarding services to provide additional information, such as a Social Security number, in addition to the information required by the U.S. Postal Service on its mail forwarding form. The agent said the firm collected this information to screen potential clients and protect the firm and that it would stop representing a client if the client generated a significant amount of service of process, complaints, or visits from investigative agents. In general, the agent felt the additional requirements were not burdensome. Another agent noted that any extra time added to the process was a result of the time required for the client to provide the information.

[39]Title III of the USA PATRIOT ACT of 2001, passed after the September 11, 2001, terrorist attacks, amended U.S. anti-money-laundering laws and imposed new requirements on financial institutions. Section 326 of Title III required the Secretary of the Treasury to develop regulations establishing minimum standards for financial institutions to follow when verifying the identity of its customers in connection with the opening of an account. These regulations require financial institutions to establish a written customer identification program (CIP) that includes procedures for obtaining minimum identification information from customers that open an account with the financial institution, such as a person's date of birth, a government identification number, and physical address. The regulations stipulated that the CIP must include risk-based procedures for verifying the identification of a customer that enable the financial institution to form a reasonable belief that it knows the true identity of the customer. See Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (USA PATRIOT Act) of 2001, Pub. L. No. 107-56, 115 Stat. 272 (2001).

[40]Proof of address can be satisfied by providing a utility bill, an original bank statement, or a letter from an employer.

In addition, a few other agents said that they used the OFAC list to screen names on formation documents or on other documents required for other services provided by their company, although several agents told us they were not aware of the OFAC list. A few agents we interviewed in Delaware used commercially available software to screen client names against the OFAC list, a step strongly encouraged by the Secretary of State. However, one agent told us that his staff had never gotten a match on the list. One agent felt that running checks on the names listed on company documents could add time to the process but would likely not be a burden. Other agents found the list difficult to use and saw using it as a potentially costly endeavor. OFAC officials reported that they had also heard from agents that screening names against the OFAC list would result in increases in the time and cost of the process, which could lead to a loss in business.

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

Law enforcement officials are concerned about the use of U.S. shell companies to facilitate or hide criminal activity. Law enforcement officials we interviewed noted that they often used the information available from states in investigating shell companies that were suspected of criminal activities and said that, in some cases, the names of officers and directors on company filings had generated additional leads. However, officials also said that the information states collected was limited, noting that it could provide a place to start but that some cases had been closed because of insufficient information on beneficial owners.

Law Enforcement Officials Are Concerned about the Use of U.S. Shell Companies to Facilitate Criminal Activity

Law enforcement officials and other reports indicate that shell companies have become popular tools for facilitating criminal activity, particularly laundering money.[41] In December 2005, several agencies of the federal government, including the Departments of the Treasury, Justice and Homeland Security, issued the first governmentwide analysis of money laundering in the United States, which described, among other things, how shell companies can be used to launder money. Shell companies can aid criminals in conducting illegal activities by providing an appearance of legitimacy—for example, an artificial source of income or proof of the type of transactions legitimate companies conduct. Shell companies can also provide access to the U.S. financial system through U.S. bank accounts or offshore accounts in banks that have a correspondent relationship with a U.S. bank.[42] For example, in a Financial Crimes Enforcement Network (FinCEN) December 2005 enforcement action, FinCEN determined, among other things, that the New York branch of ABM AMRO, a banking institution, did not have an adequate anti-money-laundering program and had failed to monitor approximately 20,000 funds transfers—with an aggregate value of approximately $3.2 billion—involving the accounts of U.S. shell companies and institutions in Russia or other former republics of the Soviet Union.[43]

Determining a precise number of criminal cases involving the use of shell companies to hide illicit activity is difficult because forming such companies is not a crime but rather is sometimes used as a method for moving money that may be associated with a crime. Therefore, the use of shell companies for illicit activities is not tracked by law enforcement or

[41]Our review focuses on state information requirements when companies are formed and when they submit periodic reports. Other reports cite additional state practices that may also facilitate criminals hiding their identity such as allowing bearer shares, nominee directors, and nominee shareholders. See U.S. Departments of the Treasury, Justice, Homeland Security, et al, U.S. Money Laundering Threat Assessment Working Group, *U.S. Money Laundering Threat Assessment* (Washington, D.C., December 2005); and Organization for Economic Co-operation and Development (OECD), *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes* (Paris, 2001).

[42]A correspondent account is an account that a foreign bank opens at a U.S. bank to gain access to the U.S. financial system and to avoid bearing the costs of licensing, staffing, and operating its own offices in the United States. Many of the largest international banks serve as correspondents for thousands of other banks.

[43]Without admitting or denying the allegations, ABN AMRO Bank N.Y. agreed on December 19, 2005, to enter into a consent agreement to the assessment of civil money penalty.

government agencies.[44] However, law enforcement officials told us they are seeing a wide range of indicators that suggest the increased use of U.S. shell companies for illicit activities.

- FinCEN officials told us they see many suspicious activity reports (SAR) filed by financial institutions that potentially implicated shell companies in the United States. For example, FinCEN reported in the U.S. Money Laundering Threat Assessment that financial institutions filed 397 SARs between April 1996 and January 2004 involving shell companies, East European countries, and correspondent bank accounts. The aggregate amount of activity reported in these SARs totaled almost $4 billion.

- Justice officials said that law enforcement officials from other countries have asked the United States to help them track down the individuals that had formed U.S. shell companies to hide illicit activity, but the lack of ownership information is obstructing their investigations. For example, a review by Justice of requests for legal assistance in 2005 from Russia and Ukraine found 30 requests for assistance from Russian authorities and 75 requests from Ukraine authorities involving U.S. shell companies. These requests typically ask for assistance in identifying individuals associated with the U.S. companies. However, Justice's attempts to gather information in response to these requests on the companies are obstructed by the lack of information maintained by states and agents. These requests often involve serious crimes occurring in other countries but implicate a U.S. company. For example, in early 2006, one request was seeking information on a U.S. corporation allegedly used to smuggle a toxic controlled substance between two Eurasian countries because the name of the U.S. corporation was on the foreign customs papers.

- OFAC expressed concerns that shell companies can be used to facilitate transactions with targets (individuals, entities, or countries) of U.S. economic sanctions. In one example, during the period when the United States maintained sanctions against Yugoslavia (Serbia and Montenegro), a U.S. company formation agent filed incorporation papers for a Serbian entity, which then opened bank accounts in the

[44]The 2005 *U.S Money Laundering Threat Assessment* reported that the U.S. government currently does not have a systematic way of collecting data on the total amount of money laundering activity being apprehended by federal law enforcement agencies or the methods used to launder money.

United States as a U.S. company to transfer money through the United States.

- The FBI told us they currently have over 100 ongoing cases investigating market manipulation and that the majority of these cases involve the use of shell companies. One closed case, for example, involved the sale of fraudulent private placement offerings to the investing public. The convicted individuals used U.S. shell companies to give investors the impression that they were investing in legitimate companies, but instead the individuals stole the investors' proceeds. In some cases, individuals have used shell companies to pump up the price of a stock and then sell their entire position in the stock while legitimate investors are left with worthless stock.

- The FBI has also expressed concern about the use of third-party agents to form thousands of shell companies in the United States for criminals operating in other countries; the criminals then use the shell companies to open U.S. bank accounts. The FBI believes that U.S. shell companies are being used to launder as much as $36 billion from the former Soviet Union. An FBI analysis of the use of these third-party agents found that they often register the shell company using nominee officers to keep the foreign beneficial owner anonymous and use companies created at an earlier date—"aged shelf companies"—to give banks and regulatory authorities the impression the company has longevity.

Law enforcement officials provided us with examples of cases involving the use of U.S. shell companies. According to a Department of Justice report on Russian money movements, many of the investigations involving shell companies use common schemes to launder money and conceal money movements. In a "fictitious services" scheme, the criminals enter into a contract with a company purportedly offering an intangible service, such as consulting. The consulting company is actually a shell company owned by the criminals, so that payments for consulting services are actually payments into a bank account under their control. In one case involving a fictitious services scheme, a former public official from the Russian Federation allegedly helped to unlawfully divert international nuclear assistance funds that were intended to upgrade the safety of nuclear power plants operating in Russia and several former republics of the Soviet Union. The indictment stated that the suspects formed shell companies in Pennsylvania and Delaware that received the nuclear assistance payments and then diverted over $15 million of this money to corporate bank accounts. Ultimately the money was allegedly transferred

to other personal bank accounts in the United States and other countries and the transfers concealed behind fictitious business contracts. The subjects of the indictment allegedly used at least $9 million to fund business investments and loans for their personal enrichment.

IRS investigations have also uncovered the use of U.S. shell companies in tax evasion schemes. In one tax evasion case, two co-conspirators used nominee names to open bank accounts and form U.S. corporations in Florida to hide their assets and income to avoid tax liabilities. One co-conspirator was sentenced to 10 years in prison and ordered to pay $1.6 million in restitution. The other co-conspirator was sentenced to 25 years imprisonment for his involvement in the tax evasion scheme, as well as a related investment fraud scheme.

ICE officials also told us they have encountered the use of U.S. shell companies in their investigations. ICE officials interviewed a third-party agent who had registered approximately 2,000 companies for international clients. The registrations took place mostly in Oregon, but also in Arkansas, Colorado, Idaho, Iowa, Kentucky, Montana, South Dakota, Washington, and West Virginia. The investigation was prompted by a bank that had reported suspicious transactions in an account of one of the companies registered by this agent. This case was subsequently closed because the agent moved from the area and could not be found.

Information from Company Filings and Agents Is Available and Useful to Law Enforcement, but Is Often Too Limited to Solve Cases

Law enforcement officials obtain some company information from states and agents through a variety of methods. Our review of states' Web sites found that 46 states provide some company information online for free, but that states post different amounts of company information on their Web sites.[45] For instance, Virginia officials told us that while the name of the incorporator is on the articles of incorporation, it is not added to the on line database. In addition, Delaware lists only the company name and the name and address of the agent online, while Florida makes copies of all documents available with all of the information they contain, including names of directors and managers. Given the variations in what is available online, law enforcement officials may request paper copies of filings that could provide more information. Law enforcement officials may also

[45]The states that do not provide information online for free are Arkansas, Hawaii, Maine, New Jersey, and Texas. In these states, we found that some information is available online for a fee.

obtain company information from agents, although some law enforcement officials said they do not usually request information from agents because too little would be available, and one state law enforcement official said the agents might tell their clients about the investigation. Some agents told us they usually collect the same information as the state, but other agents and law enforcement officials indicated that agents might have additional information that could be useful in investigations, such as contact addresses and methods of payment.

While ownership information is typically not available from states or agents, some law enforcement officials said the names of officers and directors and other information on forms could be helpful in some investigations. If ownership information is not available, law enforcement officials said that the names of officers and directors—even false names—could provide productive leads. In addition, law enforcement officials said that other information, such as addresses, could be investigated and also might provide productive leads.

In other cases, though ownership information is not required, the actual owners may include personal information on the state's documents. For example, 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. In another IRS case, a man in Texas used numerous identities and corporations formed in Delaware, Nevada, and Texas to sell or license a new software program to investment groups. He received about $12.5 million from investors but never delivered the product to any of the groups. The man used the corporations to hide his identity and to provide a legitimate face to his fraudulent activities. He also used the companies to open bank accounts to launder the money obtained from investors. IRS investigators found from state documents that he had incorporated the companies himself and often included his co-conspirators as officers or directors. The man was sentenced to 40 years in prison.

In some cases, law enforcement officials have evidence of a crime but cannot connect an individual to the criminal action without ownership information. For example, 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.[46] 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. These cases were not prosecuted because investigators could not identify critical ownership information. Most of the law enforcement officials we interviewed said they had also worked on cases that reached dead ends because of the lack of U.S. company ownership information.

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

State officials, agents, and others we interviewed said that collecting company ownership information could be useful to law enforcement and other interested parties. As we have discussed, investigations can be closed because of a lack of information, such as the names of the beneficial owners of a company. But if states or agents collected additional information on companies, filing times could increase, and a few states worried that costs could increase and company start-ups could be deterred. Further, information collected when companies were being formed might not be complete or up to date, as officers and directors might not have been chosen and the ownership could change after the company was formed. In addition, including such information in public records could cause concerns about privacy and related issues. State officials, agents, and other experts in the field suggested internal company records, financial institutions, and the IRS as alternative sources that might already be collecting this information. However, obtaining information from these

[46]Dispersing assets among as many different types of entities and jurisdictions as possible is also a way to protect assets. The goal of this approach is to create complex structures that, in effect, provide multiple protective trenches around assets, making it challenging and burdensome to pursue. See GAO, *Environmental Liabilities: EPA Should Do More to Ensure That Liable Parties Meet Their Cleanup Obligations*, GAO-05-658 (Washington, D.C.: Aug. 17, 2005).

sources also has limitations because the information may not be up to date or available.

States and Agents Acknowledged Benefits of Having Additional Information on Company Ownership but Raised Concerns about Collecting It

Collecting ownership information when companies are formed could have some positive impacts for law enforcement as well as members of the public searching for this information. As shown in figure 6, 21 states in our survey said that if more ownership information were collected at company formation, that additional information would be available to law enforcement and the public. And as we have discussed, law enforcement investigations can benefit from knowing who owns and controls a company. A couple of state officials said that collecting such information would also allow them to be more responsive to consumer demands they have received for this information. For example, officials in Arizona and the District of Columbia told us that they often received phone calls from the public asking for ownership information they could not provide. In addition, one agent suggested that requiring agents to collect more ownership information could discourage dishonest individuals from using agents and could reduce the number of unscrupulous individuals in the industry.

State officials and agents noted that collecting additional information could increase filing times, and a few were concerned about other negative effects. Our survey showed that 29 states reported that the time needed to review and approve formations would increase if information on ownership was collected, since more data would need to be recorded in their databases (see fig. 6). A few states calculated that they would incur additional costs in modifying their forms, databases, and online filing systems to accommodate the new requirements. One state official said the extra time that would be required to review filings would reduce the benefits of electronic filing. Agents we interviewed also said that collecting and storing ownership information would increase the time necessary to provide their services and raise costs for both themselves and their clients. Other agents said that collecting and verifying ownership information would be difficult because they may have contact only with law firms and not company officials when a company is formed. State officials and others also noted that individuals could easily provide false names if ownership information were required without being verified.

Figure 6: Implications of All of the States Collecting Information on Company Ownership

	Number of states that responded on the following impacts			
	Decrease	Increase	Stay the same	Not applicable or no response
Time to approve company formations	0	29	15	7
Fees charged for company formations	0	8	31	12
Number of companies formed in the state	6	5	23	17
Information available to the public	0	21	17	13
Information available to law enforcement officials and courts	0	21	14	16

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

Our survey results showed that in nearly half the states (23), officials thought the number of companies formed in their jurisdictions would stay about the same if all of the states collected this additional information (see fig. 6). But some state officials and others we interviewed said that if the requirements were not uniform, states with the most stringent requirements could lose business to other states or even countries, potentially losing state revenue. Some state officials noted the importance of the fees generated from company formations to state general revenue funds. For example, a Delaware official said that 22 percent of the state's revenue comes from the company formation business. Also, Nevada and Oregon officials stated that their offices were revenue-generating offices for the state. State officials, agents, and industry experts commented that states would be unlikely to pass comparable laws because state officials have such different opinions about the amount of information that should be disclosed.[47] As a result, individuals could form companies in states where the requirements were easiest to follow. Agents also expressed concern that they could lose business if they collected ownership information, because individuals might be more likely to form their own companies and serve as their own agents.

[47]The National Conference of Commissioners on Uniform State Laws approved the Uniform Limited Liability Company Act and the American Bar Association, Committee on Corporate Laws approved the Model Business Corporation Act to serve as uniform legislation for states to consider. Various states have used these legislative proposals when adopting their state statutes for business corporations and LLCs.

Individuals forming businesses could also be affected by new requirements for collecting company information. Some officials noted that the additional time required to review filings could slow down and might derail business dealings. One state official commented that such requirements would create a burden for honest business people who would have provided accurate information in the first place but would not deter criminals, who would provide false information in any case. According to a report on the use of companies for illicit purposes, requiring companies to disclose up front and to update ownership information may impose significant costs, particularly on small businesses.[48] A few state and some private sector officials noted that an increase in the time and costs involved in forming a company might reduce the number of companies formed, because entrepreneurs and investors might be less likely to take the risks involved in forming or investing in new companies.

Some state officials also noted that to change the information requirements, state legislatures would have to pass new legislation and grant company formation offices new authority. A few states indicated that collecting additional information would require higher fees that would also need to be set by their state legislatures. State officials also noted that since they are administrative agencies, they generally do not have the authority to question or verify the information provided on the forms and would need additional authority from state legislatures to do so.

State and private sector officials pointed out that ownership information collected at formation or on periodic reports might not be complete or up to date. Information collected at formation, for instance, might not be useful because ownership information can change frequently throughout the year. For example, an official from Delaware commented that many privately held LLCs and corporations in Delaware and other states may have thousands of shareholders and LLC members that buy and sell shares and memberships on a daily basis. Another state official commented that collecting this information at formation would not be useful without requiring that it be updated frequently. In addition, since LLCs can be owned by individuals or other businesses, even if states required LLCs to list a member name, the name provided may not be that of an individual but

[48]See OECD, *Behind the Corporate Veil*. This report examined the misuse of different types of companies in both onshore and offshore jurisdictions, including corporations, trusts, foundations, and partnerships with limited liability features. The report excluded companies engaged in financial services activities and those whose shares are publicly traded or listed on a stock exchange.

another company. Disclosing ownership information on periodic reports, however, could mean that a year or more would pass before it was collected—too long to be of use in many investigations. In addition, we found that some states do not require these reports.[49] Further, once it is formed, a shell company being used for illicit purposes in the United States or other countries may not file required periodic reports. Law enforcement officials told us that many companies under investigation for suspected criminal activities had been dissolved by the states in which they were formed for failing to submit periodic reports.

State Officials and Others Were Concerned about Privacy Issues

State officials, agents, and other industry experts said the need for access to information on companies must be weighed against privacy issues. Company owners may want to maintain their privacy in part because state statutes have traditionally provided this privacy and in part to avoid lawsuits against them in their personal capacity. Some business owners may also seek to protect personal assets through corporations and LLCs. One state law enforcement official also noted that if more information were easily available, criminals and con artists could take advantage of it. He noted that information available on official Web sites was sometimes used to target companies for scams. For example, the official described a case in which an individual sent letters that appeared to be from a secretary of state's office to companies listed on the state Web site, telling the recipients that they were to file their annual meeting minutes with the state, although no such requirement existed. The individual offered to provide filing services for a fee, and collected the fees from companies, but did not forward any minutes to the state. Providing more easily accessible information to the public could result in more such activities.

Business owners might be more willing to provide ownership information if it were not disclosed in the public record. Some state officials we interviewed said that since all information filed with their office is a matter of public record, keeping some information private would require new legislative authority. The officials added that storing new information would be a challenge because their data systems are not set up to maintain

[49]Our review of state statutes indicated that 14 states did not require periodic reports for LLCs and that 3 did not require them for corporations. In at least 3 states (Alabama, New Jersey, and Oklahoma), the annual report is submitted to a different office, such as the department of revenue, than the office that handles formation filings. In addition, biennial reports were required to be filed by corporations in 7 states and by LLCs in 5 states.

confidential information. However, one official from Maryland said that keeping some information private would not be a problem since the office that accepted company formation and periodic report filings also handled tax filings and already had procedures for keeping information such as taxpayer identification numbers confidential. An official in Oregon also told us that the Corporations Division office had recently enacted procedures to keep some information private in cases such as domestic abuse. Individuals can petition the state to have information removed from databases available online and redacted in the paper file, but it is still available to law enforcement. The Arizona Corporation Commission also tries to remove Social Security numbers from its Web site if applicants include them on their paper forms, but maintains the information on paper forms.[50]

Two Foreign Jurisdictions Have Had Mixed Experiences with Requiring the Collection of Company Ownership Information

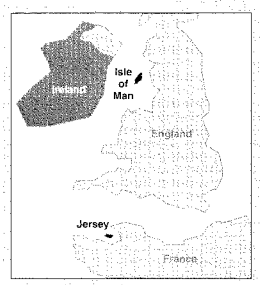
Because states do not typically collect and verify ownership information and because state and private sector officials could not quantify the extent of the possible costs of taking these steps, we reviewed the experiences of Jersey and Isle of Man in implementing the regulation of firms that provide services such as company formation (company service providers).[51] Fewer companies are formed in both jurisdictions, especially by local residents, than in the United States, and the number of company service providers is much smaller.[52] However, some of the concerns states and agents expressed about increased regulation also have been born out in Jersey and the Isle of Man, although officials also pointed to certain benefits of collecting ownership information and the new regulatory regime. Company service providers in both jurisdictions must be licensed, and are subject to periodic monitoring and inspections by government agencies. In both of

[50]Arizona requires companies to include a Certificate of Disclosure with their articles of incorporation and annual reports that includes information about certain types of felonies and bankruptcies. Persons who have been convicted of specific types of felonies must include their Social Security numbers and other personal information, and according to Arizona officials, this information may be publicly available.

[51]Jersey and Isle of Man use the term trust companies or company service providers to refer to firms that provide company formation and registered agent services. We refer to these types of firms in the United States as agents. We chose to speak with officials from Jersey and the Isle of Man because they are two of a small number of jurisdictions that require disclosure of beneficial ownership when a company is formed.

[52]Jersey has about 30,000 incorporated entities and 183 company service providers, and the Isle of Man has about 35,000 incorporated entities and 180 company service providers.

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.

these jurisdictions, company service providers are required to conduct due diligence to verify the identity of their clients and obtain company ownership information to form a new company. The ownership information is not maintained in the public record, but is kept at the registry in Jersey and with company service providers in Isle of Man and is available only to law enforcement.

Despite strong initial resistance, the company service provider industry in these two jurisdictions is now perceived as successful because licensed companies have continued to remain profitable. In addition, one company service provider told us that the regulations have instilled a degree of professionalism in the company service provider industry. Further, law enforcement officials can obtain information about company ownership when they need it.

However, government and private sector officials told us that implementing these regulations was a significant challenge. Both jurisdictions experienced consolidation in the company service provider industry. Some companies merged, and others moved to locations with fewer requirements or went out of business because they either did not want to comply with the new regulations or could not charge fees high enough to cover due diligence costs. One company service provider said the time required to form a company increased, as the due diligence requirements company service providers must follow can take weeks to complete depending on the client, though once documents are submitted to the Jersey or Isle of Man registry offices, formations are finished in 48 hours or less. The workload of company service providers has also increased. One company service provider told us that the company had increased its staff by 25 percent to 30 percent because of the requirement that the company verify customer information. Fewer companies are formed in Isle of Man, according to an Isle of Man official. Before the regulations, Isle of Man had 40,000 incorporated entities, but it now has 35,000. Finally, because ownership is fluid, it is a challenge to keep the information up to date. In Isle of Man, the responsibility for keeping information up to date lies with the company service providers. In Jersey, ownership information is updated on annual reports.

Other Potential Sources of Company Information May Be Available, but Obtaining Information from These Sources May Also Be Challenging

State officials, agents, and others told us that some other sources of company ownership information that law enforcement officials could access existed, including internal company documents, financial institutions, and the IRS.

Internal Company Documents

Our review of state statutes found that all states require corporations to prepare a list of shareholders, typically before the mandatory annual shareholder meeting, and that almost all states require that this list be maintained at the corporation's principal or registered office.[53] Industry experts told us that LLCs also usually prepare and maintain operating agreements that generally name the members and outline their financial interests.[54] These documents are generally not public record, but law enforcement officials can subpoena them to obtain ownership information, and ICE officials in one field office said they always looked at LLC operating agreements during an investigation. However, accessing these lists may be problematic, and the documents themselves might not be accurate or even exist. For example, law enforcement officials said that shell companies may not prepare these documents and that U.S. officials may not have access to them if the company is located in another country. In addition, law enforcement officials may not want to request these documents in order to avoid tipping off a company about an investigation.

Industry experts also cautioned that even these internal documents may not reveal the true beneficial owners of a company. For example, the list could include nominee shareholders, which would reduce the usefulness of the shareholder list because the shareholder on record may not be the

[53]Delaware, Kansas, and Oklahoma statutes do not expressly state that a corporation is required to maintain a list of shareholders, but shareholders must be able to extract information on shareholders from corporate documents maintained by the corporation.

[54]Some states may not require written operating agreements. If there is no operating agreement, the LLC follows default provisions of the LLC act of the state where the company was formed.

beneficial owner.[55] In addition, shareholders could sell their stock and not register the sale with the company; in such cases, the new owners would not be known. Shareholders could also sell their stock before the filing date and then buy it back after the filing date to avoid being listed. Further, in states that allow bearer shares, the owners' names are anonymous because bearer share certificates do not contain the names of the shareholders.[56] Therefore, while law enforcement authorities could obtain lists of shareholders from companies by subpoena, further investigation might still be needed to find the true beneficial owners.

Financial Institutions

Financial institutions may also have ownership information on some companies. Customer Identification Program (CIP) requirements implemented by the USA PATRIOT ACT in 2001 establish minimum standards for financial institutions to follow when verifying the identity of their customers in connection with the opening of an account.[57] Under these standards, financial institutions must collect the name of the company, its physical address (for instance, its principal place of business), and an ID number, such as the tax identification number. The regulations also mandate that financial institutions develop risk-based procedures for verifying the identity of each customer to the extent that doing so is reasonable. For example, representatives from financial institutions told us that they typically requested a company's articles of incorporation when a new account was opened to verify that the entity existed. One representative said that his institution also checked names against the OFAC list and requested photo identification from all signers on the account. Industry representatives noted that institutions may also compare the customer information with information obtained from a consumer

[55]With publicly traded shares, nominees (e.g., shares registered in the names of stockbrokers) are commonly and legitimately used to facilitate the clearance and settlement of trades. Nominee shareholders can also be used in privately held companies to shield beneficial ownership information.

[56]According to the U.S. Money Laundering Threat Assessment, Nevada and Wyoming allow the use of bearer shares, which accord ownership of a company to the person who possesses the share certificate.

[57]Section 326 of the USA PATRIOT ACT directs Treasury and the federal financial regulators to adopt CIP requirements for all "financial institutions," which is defined broadly to encompass a variety of entities, including, among others, (1) banks that are subject to regulation by one of the federal banking regulators, as well as credit unions that are not federally insured, private banks, and trust companies; (2) securities broker dealers; (3) futures commission merchants and introducing brokers; and (4) mutual funds. See 31 U.S.C. § 5312; 31 C.F.R. part 103.

reporting agency, public database, or other sources. Finally, based on a risk assessment, the institution may obtain information about individuals with authority or control over the account in order to verify their identities.[58]

Representatives of financial institutions told us that although they are not required to obtain ownership information in all cases, they may investigate high-risk applicants to uncover the ultimate beneficial owners. These applicants may include casinos, companies that are not listed on world stock exchanges, companies with complex structures, or companies from certain high-risk countries.[59] For such applicants, financial institutions may ask about information such as beneficial owners and officers of the company. Financial industry representatives said that conducting the necessary due diligence on a company absorbs time and resources, because institutions must sometimes peel back layers of corporations or hire private investigators to find the actual beneficial owner or owners of a company.

One financial institution we interviewed collects the name, date of birth, and tax identification number of all individuals with ownership and control of a corporation or LLC. However, officials from some institutions told us that obtaining such information on all applicants would be an added burden to an industry that is already subject to numerous regulations. Some industry officials also said that financial institutions may not want to request ownership information in all cases for fear of losing a customer. In addition, industry representatives noted that collecting ownership information at financial institutions might not always be useful or available, because ownership might change after the account was opened and not all companies opened bank or brokerage accounts. Furthermore, Department of Justice officials noted that, in some instances, the financial activity of a shell company under investigation does not involve U.S. financial institutions. Finally, correspondent accounts create opportunities to hide the identities of the account holders from the banks themselves. A foreign bank can open a correspondent account with a U.S. bank to avoid bearing

[58]See GAO, *USA PATRIOT ACT: Additional Guidance Could Improve Implementation of Regulations Related to Customer Identification and Information Sharing Procedures*, GAO-05-412 (Washington, D.C.: May 6, 2005).

[59]Industry representatives told us that high-risk countries include those that are listed on the OFAC list of countries that U.S. entities are prohibited from doing business with and countries that are identified by the Financial Action Task Force on Money Laundering (FATF) as "non-cooperative countries and territories."

the costs of licensing, staffing, and operating its own offices in the United States. Many of the largest international banks serve as correspondents for thousands of other banks. The USA PATRIOT ACT requires financial institutions that provide correspondent accounts to foreign banks to maintain records of the foreign bank's owners and of the name and address of an agent in the United States designated to accept service of process for the foreign bank for records regarding the correspondent account.[60] However, law enforcement and industry representatives told us that the foreign banks may commingle funds from many different customers into one correspondent account, making it difficult for U.S. banks to identify the individuals with access to the account.[61]

IRS

IRS was mentioned as another potential source of company ownership information for law enforcement, but IRS officials pointed to several limitations with this data. First, IRS may not have information on all companies formed. The agency collects company ownership information on certain forms, such as the application for an employer identification number (EIN) (SS-4).[62] Form SS-4 requires the name and tax identification number (such as the Social Security number) of the principal officer if the business is a corporation, or general partner if it is a partnership, or owner if it is an entity that is disregarded as separate from its owner (disregarded

[60]31 U.S.C. § 5318(k)(3)(B)(i).

[61]In January 2006, FinCEN issued a final rule to implement the requirements in section 312 of the USA PATRIOT ACT that requires U.S. financial institutions to establish policies, procedures, and controls to detect and report money laundering through correspondent accounts. See 71 Fed Reg. 496 (Jan. 4, 2006). According to the rule, financial institutions must assess the money-laundering risk of correspondent accounts based on the nature of the foreign financial institution's business, the type of account, the institution's relationship with the foreign financial institution, the anti-money-laundering regime of the jurisdiction that issued the charter or license of the foreign financial institution, and information about the foreign financial institution's anti-money-laundering record. In addition, U.S. financial institutions must apply risk-based procedures and controls to each correspondent account, including a periodic review of account activity to determine consistency with anticipated activity. 31 C.F.R § 103.176.

[62]The Internal Revenue Code authorizes IRS to collect such information as may be necessary to assign an identifying number to any person. 26 U.S.C. § 6109(c).

entity), such as a single member LLC.[63] Disregarded entities owned by a corporation enter the corporation's name and EIN. However, not all LLCs are required to have EINs.[64] In addition, the name of an owner may be on the form LLCs file to select how they will be taxed. IRS also currently collects some general ownership information, including an identifying number, name, and address, on certain LLCs on separate schedules that the company files with the IRS.[65] For LLCs that are taxed as partnerships, this form specifies whether members are member-managers or another type of member of an LLC and reports the member's share of the company profits, losses, and capital. But if an LLC has only one member, the individual reports income on an individual tax return.[66] In addition, IRS classifies certain LLCs as corporations for tax purposes, and others may choose to be

[63]IRS regulation, 26 C.F.R. § 301.7701-2, classifies the following entities as corporations, among others, for tax purposes: an business entity organized under a federal or state statute when the statute indicates that the entity is incorporated or is a corporation; an association; a state joint-stock company or joint-stock association; an insurance company; a state-chartered depository company whose deposits are federally insured; and certain foreign entities. Nevertheless, certain LLCs may elect how they will be treated for tax purposes. See 26 C.F.R. §§ 301.7701-3 and 301.7701-2. Specifically, single owner LLCs may elect to be treated for tax purposes either as a sole proprietorship (referred to as an entity to be disregarded as separate from its owner) or as a corporation, and LLCs with two or more owners may elect to be treated for tax purposes either as a partnership or as a corporation. Moreover, there are certain defaults under the tax rules. Single owner LLCs are treated by default as an entity to be disregarded as separate from its owner, and LLCs with more than two owners are treated by default as partnerships unless an election is filed with IRS.

[64]For example, a single member LLC with no employees is not required to have a separate EIN.

[65]S corporations and LLCs that are taxed as a partnership do not pay taxes on their income but instead allocate the income to shareholders or members, who are required to report it annually to IRS with their individual tax returns. Allocated income is reported to IRS by the company with the company's tax return on a corresponding Schedule K-1. Copies of the Schedule K-1 are provided to shareholders and members for use when filing their respective annual returns (examples of the appropriate forms include Schedule K-1 (Form 1065) for LLCs filing as partnerships and Schedule K-1 (Form 1120S) for S corporations.

[66]The owner of a single member LLC reports the business activities of the LLC on the individual's tax return. See, for example, Schedule C (Form 1040), which requests the name of the business. However, this information is not required, and the field asking for the information states that it may be left blank. If left blank, there is no way for the IRS to determine that the individual is the owner of an LLC.

classified as corporations.[67] Ownership information is available for LLCs that are classified as corporations and file as S corporations, but generally not for those that are taxed as C corporations.[68]

Second, IRS officials reported that the ownership information the agency collected may not be complete or up to date. As we have discussed, the agency does not have information on every company, because some companies do not request or need EINs. In addition, some EINs become inactive after a certain period, dropping off the IRS database. For example, Department of Justice officials told us that U.S. shell companies being used in foreign criminal activity are sometimes inactive in the United States. In addition, ownership information on LLCs owned by foreign individuals or entities would only be available if the LLC obtained an EIN for income that was subject to tax in the United States. Further, data gathered on IRS forms may not always be accurate. In a recent report, we found that data transcription errors made by IRS staff entering data into a database and invalid taxpayer identification numbers submitted by companies lowered the accuracy of these data.[69] IRS officials also noted that the information collected might not always be useful in finding the ultimate beneficial owner of a company, because another entity could be listed as the owner, requiring further investigation to identify the true owner. Finally, IRS officials said that the information in the agency's records might not be up to date because IRS was not always notified when ownership changed.

Third, law enforcement officials could have difficulty accessing IRS taxpayer information. As part of the administration of federal tax laws, IRS investigators can use IRS data in their investigations of tax and related

[67]Federal tax laws automatically classify and tax the following LLCs as corporations: a business formed under a federal or state statute or a federally recognized Indian tribe if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic; an association or joint stock association; a state-chartered business conducting banking activities if any of its deposits are insured by the Federal Deposit Insurance Corporation; a business wholly owned by a state or foreign government; certain foreign entities; and insurance companies.

[68]C corporations file Form 1120, which asks if a controlling shareholder (or group of related persons) owns 50 percent of a stock. Therefore, in some limited instances, IRS may be able to identify the owners of an LLC that files as a C corporation.

[69]The most frequent transcription errors dealt with names and addresses. IRS also found transcription errors in dollar amounts and taxpayer identification numbers. See GAO, *Tax Administration: IRS Should Take Steps to Improve the Accuracy of Schedule K-1 Data*, GAO-04-1040 (Washington, D.C.: Sept. 30, 2004).

statutes, but access by other federal and state law enforcement is restricted by 26 U.S.C. § 6103.[70] IRS officials said that federal law enforcement officials can access IRS information provided by taxpayers (or their representatives) when a federal court issues an ex parte order.[71] Under 26 U.S.C. § 6103(i)(1), the federal law enforcement agency requesting the information through an ex parte order must show that it is engaged in preparation for a judicial, administrative or grand jury proceeding to enforce a federal criminal statute or that the investigation may result in such a proceeding.[72] Information IRS receives from a source other than taxpayers (or their representatives), such as taxpayers' employers or banks, can be obtained without a court order.[73] Moreover, in certain limited situations, there are additional provisions currently in the tax code providing for disclosure of such information relating to criminal or terrorist

[70]Tax administration is defined at 26 U.S.C. § 6103(b)(4) to mean "(A)(i) the administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws or related statutes (or equivalent laws and statutes of a State) and tax conventions to which the United States is a party, and (ii) the development and formulation of Federal tax policy relating to existing or proposed internal revenue laws, related statutes, and tax conventions, and (B) includes assessment, collection, enforcement, litigation, publication, and statistical gathering functions under such laws, statutes, or conventions." Whether a particular statute is "related" to the internal revenue laws depends on the nature and purpose of the statute and the facts and circumstances in which the statute is being enforced or administered. Typically, according to IRS, where violation of another statute is committed in contravention of the internal revenue laws, then the former may be considered a "related statute" and IRS's investigation is considered tax administration. 26 U.S.C. § 6103(a) sets up the general rule that returns and return information for use in federal criminal investigations shall be confidential and may not be disclosed except as authorized under the Internal Revenue Code.

[71]26 U.S.C. § 6103(i)(1) permits the disclosure of returns and return information upon the grant of an ex parte court order by a federal district court judge or magistrate upon application by certain high level Department of Justice officials. Because the proceeding is ex parte, the taxpayer will not know that the government has applied for an ex parte court order or that its application has been granted.

[72]To grant an ex parte order, the court must determine that there is reasonable cause to believe, based upon information believed to be reliable, that a specific criminal act has been committed, there is reasonable cause to believe that the return or return information is or may be relevant to a matter relating to the commission of such act, and the return or return information is sought exclusively for use in a federal criminal investigation or proceeding concerning such act, and the information sought to be disclosed cannot reasonably be obtained, under the circumstances, from another source. 26 U.S.C. § 6103 (i)(1)(B).

[73]See e.g., 26 U.S.C. § 6103(i)(2).

activities or emergency circumstances.[74] State law enforcement officials can access IRS information for enforcement of state tax laws when IRS has sharing agreements with state taxing authorities.[75] Law enforcement officials can also obtain IRS information with the taxpayer's consent.[76] Officials in one ICE field office told us that they have obtained IRS information; however, officials in another ICE field office said that obtaining this information was difficult. IRS officials commented that collecting additional ownership and control information on IRS documents would provide IRS investigators with more detail when conducting investigations but that the agency's ability to collect and verify such information would depend on the availability of resources.

Observations

States and agents collect a variety of information when individuals form companies, but most state statutes do not require that they collect or verify information on ownership. Therefore, minimal information is collected on the owners of these companies. During our review, we encountered a variety of legitimate concerns about the merits of collecting ownership information on companies formed in the United States. Many of these concerns reflected conflicting interests. On the one hand, federal law enforcement agencies were concerned about the lack of information, because criminals can easily use U.S. shell companies to mask the identities of those engaged in illegal activities. From a law enforcement perspective, having more information would make using U.S. shell companies for illicit activities harder and give investigators more information to use in pursuing the actual owners. In addition, since U.S. shell companies are used in criminal activity abroad because of their perceived legitimacy, collecting more information when a company is formed could improve the integrity of the company formation process in the United States. On the other hand, states and agents were concerned about increased costs, potential revenue losses, and privacy protection. Collecting more information would require more time and resources and could reduce the number of start-ups. Approving applications could take longer, potentially creating obstacles for those forming companies for

[74]26 U.S.C. § 6103((i)(3) and (7). The authority for disclosures to combat terrorism expires on December 31, 2006.

[75]26 U.S.C. § 6103(d).

[76]26 U.S.C. § 6103(c).

legitimate business purposes. And importantly, because information on companies is currently part of the public record, requiring certain information on ownership could be considered a threat to the current system, which values the protection of privacy and individuals' personal assets.

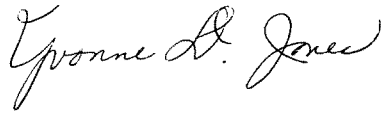
Any requirement that states, agents, or both collect more ownership information on certain types of companies would need to balance these conflicting concerns. Further, such a requirement would need to be uniformly applied in all U.S. jurisdictions. If it were not, those wanting to set up shell companies for illicit activities would simply move to the jurisdiction that presented the fewest obstacles, undermining the intent of the requirement.

Agency Comments and Our Evaluation

We provided a draft of this report to the Departments of Justice, Homeland Security, and the Treasury. Justice and Treasury provided technical comments that were incorporated into the report, where appropriate.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the report date. At that time, we will send copies to the Departments of Justice, Homeland Security, and the Treasury; and interested congressional committees. We will also make copies available to others on request. In addition, the report will be available at no charge on GAO's Web site at http://www.gao.gov. The survey and a more complete tabulation of state-by-state and aggregated results can be viewed at http://www.gao.gov/cgi-bin/getrpt?GAO-06-377SP.

If you or your staff have any questions regarding this report, please contact me at (202) 512-8678 or jonesy@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.



Yvonne D. Jones
Director, Financial Markets
and Community Investment

Appendix I

Objectives, Scope, and Methodology

This report describes states' company formation and reporting requirements and the information that is routinely obtained and made available to the public and law enforcement officials regarding ownership of nonpublicly traded corporations and limited liability companies (LLC) formed in each state given concerns about the potential for using companies for illicit purposes. Specifically, this report discusses

1. the kinds of information—including ownership information—that the 50 states and the District of Columbia collect during company formation and the states' efforts to review and verify it;

2. the roles of third-party agents, such as company formation agents, and the kinds of information they collect on company ownership;

3. the role of shell companies in facilitating criminal activity, the availability of company ownership information to law enforcement, and the usefulness of such information in investigating shell companies; and

4. the potential effects of requiring states, agents, or both to collect company ownership information.

To respond to the first objective and describe the ways company formation and periodic reporting documents can be filed, we conducted a Web-based survey of the 50 states and the District of Columbia on formation and reporting practices. We worked to develop the questionnaire with social science survey specialists. Because these were not sample surveys, there are no sampling errors. However, the practical difficulties of conducting any survey may introduce errors, commonly referred to as nonsampling errors. For example, differences in how a particular question is interpreted, in the sources of information that are available to respondents, or in how the data are entered into a database can introduce unwanted variability into the survey results. We took steps in the development of the questionnaires, the data collection, and data analysis to minimize these nonsampling errors. For example, prior to administering the survey, we pretested the content and format of the questionnaires with state officials in Florida, Maine, Maryland, Virginia, and Washington, D.C., to determine whether (1) the survey questions were clear, (2) the terms used were precise, (3) respondents were able to provide the information we were seeking, and (4) the questions were unbiased. An official from the International Association of Commercial Administrators (IACA) also reviewed a draft of the survey. We made changes to the content and format

of the final questionnaires based on pretest results. We sent the finalized survey to contacts responsible for company filings in secretary of state offices (or their equivalents) in all 50 states and the District of Columbia. See *Survey of State Officials Responsible for Company Formation*, GAO-06-377SP, for the final version of the survey and state-by-state results. We received survey responses from each of the 50 states and the District of Columbia. In that these were Web-based surveys whereby respondents entered their responses directly into our database, the possibility of data entry error was minimized. We also performed computer analyses to identify inconsistencies in responses and other indications of error. We contacted survey respondents as needed to correct errors and verify responses. In addition, a second independent analyst verified that the computer programs used to analyze the data were written correctly.

To test the reliability of survey data, we compared state responses on our survey with data states provided to IACA in its 2005 annual report of jurisdictions for four key variables—the number of LLCs and corporations filed in 2004 and the total number on file. The data were markedly the same, with very high correlations and no significant differences in mean values. Based on this testing, we believe our reporting of the trends based on the number of corporations and LLCs to be reliable. We also corroborated the survey results with information we collected from a systematic review of state Web sites and state statutes. Where we found a discrepancy on key variables, we contacted the relevant state official for clarification of the state's requirement. Our review of the state corporation statutes included analysis of provisions regarding company formation, registered agents, shareholder identification, requirements for record keeping, and periodic reporting. In addition, we reviewed provisions in state LLC statutes relating to company formation, periodic reporting, and registered agents. We also reviewed the content of company formation forms and other information available on state Web sites. The data collected from our review of state statutes and Web sites is as of October 2005. We also visited Arizona, Delaware, Florida, Nevada, and Oregon to conduct in-depth interviews with state officials about practices in these states. We selected these states because of the number of companies formed there or unique practices we identified from the statutes, forms, or survey responses.

To respond to the second objective and describe the roles of third-party agents, we interviewed academics with expertise in corporate and LLC law, selected professional agents, and state officials. In selecting agents to interview, we interviewed only companies that act as agents for service of

process for more than one client. We chose a range of large national companies (three) as well as midsize or small companies (nine). We interviewed selected agents about the information they collect on companies and analyzed survey results on states' requirements regarding oversight of these agents. We also interviewed officials from the National Public Records Research Association, an association that represents companies providing corporate services and public records research, and the Nevada Resident Agent Association, which represents a number of resident agents in Nevada. In addition, we reviewed state statutes for requirements regarding becoming an agent for service of process.

To respond to the third objective and determine what information states and agents make available to law enforcement and the public, we reviewed company formation and periodic reporting forms on state Web sites and reviewed state Web sites for the type of information made available online and other methods individuals may use to obtain information. In addition, we interviewed selected state officials and agents about the methods they use to provide information. We also interviewed selected state and federal law enforcement officials about their experiences in obtaining company information from states to aid their investigations, including officials from the following state and federal agencies: the Arizona Attorney General, Drug Enforcement Agency, Federal Bureau of Investigation, the Florida Attorney General, Immigration and Customs Enforcement, Internal Revenue Service/Criminal Investigations, Financial Crimes Enforcement Network, U.S. Attorneys Office, and Office of Foreign Assets Control.

To respond to the fourth objective and determine the implications of requiring states or agents to collect company ownership information, we analyzed survey results and interviewed selected state officials and a range of professional agents. To determine how other jurisdictions have implemented regimes requiring collection of ownership information, we interviewed officials from Jersey and Isle of Man, which require the collection of this information, about the implications of implementing these requirements. Jersey and Isle of Man are two of a small number of jurisdictions that require disclosure of beneficial ownership information when a company is formed. We also reviewed an Organization for Economic Co-operation and Development report describing requirements in one of the jurisdictions. To determine other potential sources of company information, we asked academics, agents, state officials, law enforcement officials, and representatives of professional associations their perspectives on where this information could be obtained. We also reviewed state statutes on requirements for company record keeping. In

addition, we interviewed representatives of selected financial institutions and the IRS about the company information they typically collect.

We conducted our work from May 2005 through March 2006 in Arizona, Delaware, Florida, Maryland, Nevada, New York, Oregon, Virginia, and Washington, D.C. We performed our work in accordance with generally accepted government auditing standards.

Company Formation and Reporting Documents Can Be Submitted in a Variety of Ways

Company formation and reporting documents can be submitted in person or by mail, and many states also accept filings by fax. Review and approval times can depend on how documents are submitted. For example, a District of Columbia official told us that a formation document submitted in person could be approved in 15 minutes, but a document that was mailed might not be approved for 10 to 15 days. Most states reported that documents submitted in person or by mail were approved within 1 to 5 business days, although a few reported that the process took more than 10 days. Officials in Arizona, for example, told us that it typically took the office 60 days to approve formation documents because of the volume of filings the office received.

In 36 states, company formation documents, reporting documents, or both can be submitted through electronic filing (fig. 7 shows the states that provide a Web site for filing formation documents or periodic reports).[1] In addition, some officials indicated that they would like or were planning to offer electronic filing in the future. Of the 36 states that allow electronic filing, 23 or more reported a moderate or greater benefit in the following areas as a result of electronic filing:

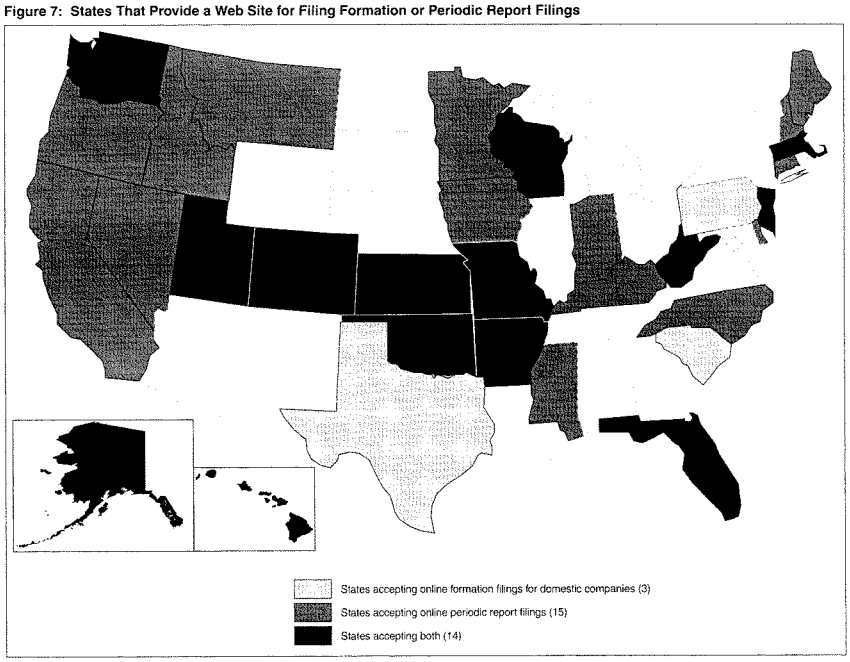
- less paperwork;
- reduced staff time for recording and processing filings;
- less need to store paper records;
- electronic transfer of filing fees; and
- built-in edit and data reliability checks.

State officials also commented that they had seen their error or rejection rates fall, and had been able to improve their customer service with electronic filing. States said that there were some or moderate costs associated with electronic filing, such as increased expenses for technology (hardware and software) and staff training. Overall, according

[1]Electronic filing includes the ability to file a document through a Web site, e-mail, or fax. Five states reported that they offer e-mail filing for company formation documents, and four states reported that they offer e-mail filing for periodic reports. In addition, 27 states reported that they accept formation or periodic report filings by fax.

to our survey, 28 of the 36 states that offer electronic filing reported that the benefits exceeded the costs.

Figure 7: States That Provide a Web Site for Filing Formation or Periodic Report Filings



Sources: GAO survey of state officials responsible for company formation (data); Art Explosion (map).

Company Formation Fees

As shown in table 3, in many cases states charge the same or nearly the same fee for forming a corporation or an LLC. In others, such as Illinois, the fee is substantially different for the two business forms. We found that in two states, Nebraska and New Mexico, the fee for forming a corporation may fall into a range. In these cases, the actual fee charged depends on the number of shares the new corporation will have. As stated earlier, the median company formation fee is $95, and fees for filing periodic reports range from $5 to $500.

Table 3: State Company Formation Fees as of November 2005

State	LLCs	Corporations
Alabama	$75	$40
Alaska	250	250
Arizona	50	60
Arkansas	50	50
California	70	100
Colorado	125	125
Connecticut	60	150
Delaware	90	50
District of Columbia	150	89
Florida	125	79
Georgia	100	100
Hawaii	50	50
Idaho	100	100
Illinois	500	150
Indiana	90	90
Iowa	50	50
Kansas	165	90
Kentucky	40	40
Louisiana	75	60
Maine	175	145
Maryland	100	100
Massachusetts	500	275
Michigan	50	60
Minnesota	135	135
Mississippi	50	50
Missouri	105	58

(Continued From Previous Page)

State	LLCs	Corporations
Montana	70	70
Nebraska	100	60-300
Nevada	75	75
New Hampshire	100	50
New Jersey	125	125
New Mexico	50	100-1,000
New York	200	125
North Carolina	125	125
North Dakota	125	80
Ohio	125	125
Oklahoma	100	50
Oregon	50	50
Pennsylvania	125	125
Rhode Island	150	230
South Carolina	110	135
South Dakota	125	125
Tennessee	300	100
Texas	200	300
Utah	52	52
Vermont	75	75
Virginia	100	25
Washington	175	175
West Virginia	100	50
Wisconsin	170	100
Wyoming	100	100

Source: GAO analysis of state Web sites.

Thirty states reported offering expedited service for an additional fee. Of those, most responded that with expedited service, filings were approved either the same day or the day after an application was filed. Two states reported having several expedited service options. Nevada offers 24-hour expedited service for an additional $125 above the normal filing fees, 2-hour service for an extra $500, and 1-hour, or "while you wait," service for an extra $1,000. Delaware offers same day service for $100, next day service for $50, 2-hour service for $500, and 1-hour service for $1,000.

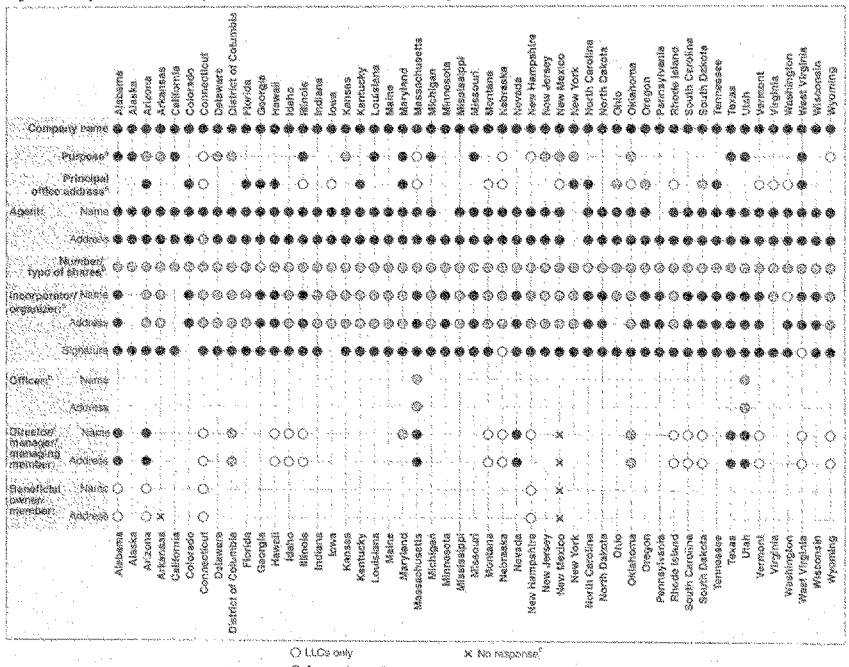
Appendix III

Information on Company Formation Documents

This appendix includes a table of the information states require in their company formation documents for corporations and LLCs. As shown in figure 8, states collect different information on their company formation documents. Most states require the company name, agent name and address, and the name and signature of the incorporator or organizer, and for corporations, information about the number and types of shares the corporation will issue. The requirements for the company's purpose, principal address, and names and addresses of owners and management are not as consistent across the states.

Figures 9 and 10 are examples of company formation documents from two states that have different information requirements.

Figure 8: Key Information Required on Articles of Incorporation/Organization



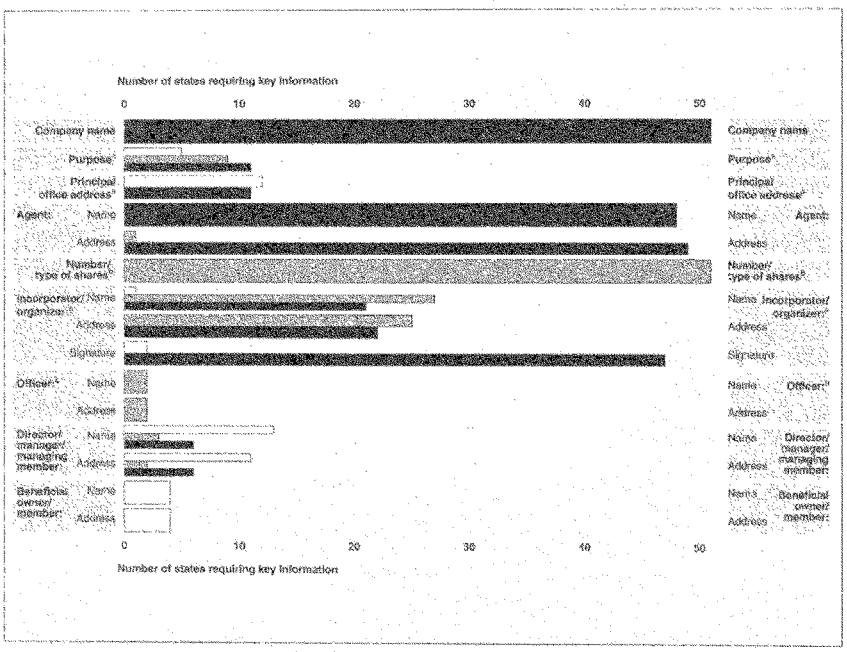
○ LLCs only

⊖ Corporations only

● Both corporations and LLCs

✕ No response[f]

Sources: GAO survey of state statutes and company formation documents; GAO survey of state officials responsible for company formation.



[a]Although state statutes may not require this information, some states request or require this information be included on the company formation documents.

[b]Information on number and type of shares and officer names and addresses applies only to corporations.

[c]New Mexico and Arkansas did not respond to some of our survey questions. However, we found from our legal review that Arkansas does not require the address of a beneficial owner on articles or periodic reports. Our legal review also found that New Mexico does require corporations to list the names and addresses of directors, but not officers or beneficial owners on articles of incorporation. For LLCs, we found that New Mexico does not require the names and addresses of members or managers on formation documents.

Figure 9: Sample Articles of Incorporation Form for a Corporation

STATE *of* DELAWARE
CERTIFICATE *of* INCORPORATION
***A* CLOSE CORPORATION**
Of

_____
(name of corporation)

- **First:** The name of this Corporation is _____
_____.
- **Second:** Its Registered Office in the State of Delaware is to be located at _____
_____(street), in the City of_____
_____County of _____Zip Code_____. The name of the registered agent is _____
_____.
- **Third:** The nature of business and the objects and purposes proposed to be transacted, promoted and carried on , are to engage in any lawful act of activity for which corporations may be organized under the General corporation Law of Delaware.
- **Fourth:** The amount of the total stock of this corporation is authorized to issue is _____shares (number of authorized shares) with a par value of _____ per share.
- **Fifth:** The name and mailing address of the incorporator are as follows:
  Name _____
  Mailing Address _____
  _____Zip Code_____
- **Sixth:** All of the corporation's issued stock, exclusive of treasury shares, shall be held of record by not more than thirty (30) persons.
- **Seventh:** All of the issued stock of all classes shall be subject to one or more of the restrictions on transfer permitted by Section 202 of the General Corporation Law.
- **Eighth:** The corporation shall make no offering of any of its stock of any class which would constitute a "public offering" within the meaning of the United States Securities Act of 1933, as it may be amended from time to time.
- **I, The Undersigned,** for the purpose of forming a corporation under the laws of the State of Delaware, do make, file and record this Certificate, and do certify that the facts herein stated are true, and I have accordingly hereunto set my hand this _____day of _____, A.D. 20_____.

BY:_____
(Incorporator)
NAME:_____
(type or print)

Source: Delaware Division of Corporations.

Figure 10: Sample Articles of Organization Form for an LLC

DO NOT PUBLISH THIS SECTION

ARTICLE 1
The company (also referred herein as "limited liability company," "limited company," or the abbreviations "L.L.C.", "L.L.", "LLC" or "L.C.", if any, are the business designee of a trademark or trademark, select Designation of Trademark Holder form)

ARTICLE 2
May be in care of the statutory agent

ARTICLE 3
The statutory agent must provide a street address. If statutory agent has P.O. Box, street they must also provide a street address/location. The agent must sign the Articles or provide a formal to acceptance of appointment.

The agent must consent to be appointed by executing the consent.

ARTICLE 4
Complete this section only if you desire to select a date in advance when the company will dissolve. If no expiration date is desired, leave this section blank.

ARTICLES OF ORGANIZATION

A.R.S. §29-672

1. Name. The name of the limited liability company is:

_____

2. Known Place of Business. The address of the company's known place of business in Arizona is:

_____

_____

3. Statutory Agent. (In Arizona) The name and street address of the statutory agent of the company is:

_____

_____

_____

Acceptance of Appointment By Statutory Agent

I _____ (Printed Name), having been designated to act as Statutory Agent, hereby consent to act in that capacity until removed or resignation is submitted in accordance with the Arizona Revised Statutes.

_____
Signature of Statutory Agent

_____
[If signing on behalf of a company serving as statutory agent, print company name here]

4. Dissolution. The latest date, if any, on which the limited liability company must dissolve is:

_____

DO NOT PUBLISH THIS SECTION
ARTICLE 5
Check which management structure will be applicable to your company. Provide name, city and address for each person.

5. Management.

☐ Management of the limited liability company is **vested in a manager or managers.** The names and addresses of each person who is a manager AND each member who owns a twenty percent or greater interest in the capital or profits of the limited liability company are:

Name:	[ ] member [ ] manager	[ ] member [ ] manager
Address:		
City, State, Zip:		
Name:	[ ] member [ ] manager	[ ] member [ ] manager
Address:		
City, State, Zip:		

☐ Management of the limited liability company is **reserved to the members.** The names and addresses of each person who is a member are:

Name:	[ ] member	[ ] member
Address:		
City, State, Zip:		
Name:	[ ] member	[ ] member
Address:		
City, State, Zip:		

The person(s) executing this document must sign the manager or member(s) of the company.

EXECUTED this _____ day of _____, _____

_____ [Signature] _____ [Signature]

Your fax and phone number is optional.

_____ [Print Name Here] _____ [Print Name Here]

PHONE _____ FAX _____

[illegible]
[illegible]

See A.R.S. §29-601 et seq. for more info.

Source: Arizona Corporation Commission.

Appendix IV

GAO Contact and Staff Acknowledgments

GAO Contact

Yvonne D. Jones, (202) 512-8678 or jonesy@gao.gov

Staff Acknowledgments

In addition to the contact named above, Kay Kuhlman (Assistant Director), LaKeshia Allen, Todd M. Anderson, Carolyn Boyce, Emily Chalmers, William R. Chatlos, Jennifer DuBord, Marc Molino, Jill M. Naamane, and Linda Rego made key contributions to this report.

Glossary

Agent for service of process	A person or entity authorized to accept service of process or other important tax and legal documents on behalf of a business. Agents for service of process may be known as registered agents, resident agents, statutory agents, or clerks in different states.
Articles of incorporation	A corporate formation document setting forth basic terms governing the corporation's existence. The articles are filed in most states with the secretary of state during the formation process. This document is called a "certificate of incorporation" for corporations formed in Connecticut, Delaware, New Jersey, New York and Oklahoma; "articles of organization" for corporations formed in Massachusetts; and a "charter" for corporations formed in Tennessee.
Articles of association or articles of organization	A governing document legally creating a nonstock organization, similar to "articles of incorporation" described above for incorporated entities. This document is called a "certificate of formation" for limited liability companies formed in Mississippi, New Hampshire, New Jersey, and Washington, and a "certificate of organization" for limited liability companies formed in Pennsylvania.
Bearer security	An unregistered security payable to the holder. For instance, a bearer stock certificate is owned by the person legally holding (in possession of) the certificate even when no one else knows who holds the certificate. Bearer shares may be bought, sold, or exchanged in complete privacy.
Beneficial owner	Shareholders with the power to buy or sell their shares in the company, but who are not registered or reflected in the company's records as the owners. A beneficial owner is the natural person who ultimately owns or exercises effective control over a legal entity, transaction, or arrangement.
Certificate of existence	A certificate issued by a state official as conclusive evidence that a corporation is in existence or authorized to transact business in that state. The certificate generally sets forth the corporation's name, and that it is duly incorporated under the law of that state or authorized to transact business in that state; that all fees, taxes and penalties owed to that state

have been paid; and that the corporation's most recent annual report has been filed, and articles of dissolution have not been filed. Also may be known as a certificate of good standing or certificate of authorization.

Company formation agent

A person or business that acts as an agent for others by filing documents with officials of the selected jurisdiction for the formation of legal business entities. Such agents may also act, or arrange for another person to act, as a director or secretary of a company, a partner of a partnership, or a nominee shareholder for another person. Other business services may also be provided, such as providing a registered office, or a business, correspondence, or administrative address for a company.

Corporate veil

The legal doctrine of separating the acts of a corporation from the acts of its shareholders, which prevents the shareholders from being held personally liable for the acts of the corporation.

Piercing the corporate veil

An equitable doctrine where the separate existence of a corporation is disregarded by the law and the shareholders are held responsible for the acts and obligations of the corporation. This doctrine has also been used in certain circumstances to impose liability on corporate officers and directors. Piercing the corporate veil is justified only in extraordinary circumstances where a court finds that a unity of interest and ownership between an individual and a corporation exists to such an extent that recognizing a separate existence between the two would result in an injustice. In such cases, a court may disregard the corporate entity and impose personal liability on the individual.

Corporation

An artificial being (usually a business entity) created by law that provides authority for the entity to act as a separate and distinct legal person apart from its owners and provides other legal rights, such as the right to exist indefinitely and to issue stock.

Federal law classifies corporations created by state law into S corporations and C corporations for purposes of federal income taxes as follows:

S corporation	A small business corporation that elects to be taxed as an S corporation under the federal tax code.[1] The taxable income of an S corporation is passed through to the shareholders and taxed at the shareholder level.
C corporation	A corporation that is not an S corporation.
Director	A person elected or appointed to serve as a member of the board of directors for a corporation, which generally manages the corporation and its officers.
Dummy (or nominee) director	A member of a corporation's board of directors who is a mere figurehead and who has no true control over the corporation. Typically, a nominee director may have no knowledge of the business affairs or accounts, may not exercise independent control of or influence over the business, and may not act unless instructed to act by the beneficial owner.
Limited liability	Liability restricted by law or contract, such as the liability of the owners of a business entity for only the capital invested in the business.
Limited liability company (LLC)	A company whose owners (members) have limited liability (see "limited liability") and that is managed either by managers or its members. An LLC consists of one or more members (see "member").
Manager-managed company	A limited liability company that designates in its articles of organization that it is a manager-managed company. In this type of LLC, each member is not generally an agent of the LLC solely because of being a member of the LLC. Rather, each manager is such an agent.
Member (LLC)	An owner of an LLC interest; similar to a shareholder in a corporation.

[1]A small business corporation may have no more than one class of stock and may not have more than 100 shareholders, all of whom must be individuals, estates, certain trusts, or certain exempt organizations and may not be nonresident aliens.

Member-managed company	A limited liability company that does not designate in its articles of organization that it is a manager-managed company. In this type of LLC, each member is an agent of the LLC and may generally act on behalf of the LLC for the purpose of the LLC's business.
Nominee	An individual or entity designated to act on behalf of another, such as a nominee director acting on behalf of a beneficial owner (see "beneficial owner"). Most often in offshore tax avoidance schemes, the nominee may pretend to be the owner of an entity, asset, or transaction to provide a veil of secrecy as to the beneficial owner's involvement.
Officer	A person elected or appointed by a corporation's board of directors to manage and oversee the day-to-day operations of the organization, such as a chief executive officer, chief financial officer, chief administrative officer, and secretary.
Partnership	An association of two or more persons jointly owning and conducting a business together where the individuals agree to share the profits and losses of the business.
Limited partnership	A partnership consisting of one or more limited partners who contribute capital to and share in the profits of the partnership, but whose liability for partnership debts is limited to the amount of their contribution and one or more general partners who control the business and are personally liable for the debts of the partnership.
Limited liability partnership (LLP)	A partnership where a partner is not liable for the negligent acts committed by other partners or by employees not under the partner's supervision. Certain businesses (typically law firms or accounting firms) are allowed to register under state statutes as this type of partnership.
Limited liability limited partnership (LLLP)	A partnership where general and limited partners are not liable for the partnership's debts and obligations because of their status as a partner.
Service of process	The delivery of legal process or other legal notice, such as a writ, citation, summons, or a complaint or other pleading filed in a civil court matter.

Sole proprietorship	A business where one person owns all of the business assets, operates the business, and is responsible for all of the liabilities of the business in a personal capacity.

Financial Action Task Force

Groupe d'action financière

THIRD MUTUAL EVALUATION REPORT ON
ANTI-MONEY LAUNDERING AND
COMBATING THE FINANCING OF TERRORISM

UNITED STATES OF AMERICA

23 JUNE 2006

Permanent Subcommittee on Investigations
EXHIBIT #3

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5. LEGAL PERSONS AND ARRANGEMENTS & NON-PROFIT ORGANIZATIONS

5.1 Legal Persons – Access to beneficial ownership and control information (R.33)

5.1.1 Description and Analysis

998. In preventing the use of legal person for illicit purposes, the U.S. government primarily relies on an investigatory approach.[83]

Federal laws

999. The U.S. uses a combination of the following mechanisms to comply with Recommendation 33:

(a) corporate reporting requirements.

(b) general purpose compulsory powers available to certain law enforcement, regulatory supervisors and judicial authorities during an investigation; and

(c) a tax registration system for employers administered through the issue of Employer Identification Numbers (EIN)

SEC corporate reporting requirements for publicly traded companies

1000. The U.S. imposes reporting requirements at the federal level for companies (both domestic and foreign) that offer securities to the public, or whose securities are listed on a U.S. stock exchange. These account for approximately 10,000 of the over 13 million active legal entities registered in the U.S.

1001. For the purposes of investor protection and fair dealing, Section 13(d)(1) of the Securities Exchange Act requires any person who acquires either directly or indirectly the beneficial ownership of more than 5% of a class of equity security, (required to be registered with the SEC), to file a statement with the SEC and the issuer of that security within 10 days of acquisition. The statement must disclose the identity and amount of shares held by the beneficial owner. Rule 13d-1 made pursuant to this provision sets out the detail of the reporting requirements. Section 13(d)(2) requires any material change to the statements to be reported with the SEC. These forms are required to be submitted electronically and are made available immediately, so the public will be able to search for a report.[84]

1002. There are further reporting requirements imposed on beneficial owners by the SEC which are aimed at the prevention of illegal insider trading. "Insiders" under section 16(a) of the Securities Exchange Act includes not only directors and officers of the issuer, but also any person who is the beneficial owner of more than 10% of any class of equity security (other than an exempted security[85]) that is registered under the Securities Exchange Act. Such persons must disclose their holdings to the company and are required to file certain statements, known as "insider reports", with the SEC. Within 10 days of becoming a reporting

[83] This is Option 3 in the OECD paper entitled "Behind the Corporate Veil" (2001) (see p.83-88).

[84] Certain exemptions from the 10 day reporting rule are permitted for institutional funds where they were not acquired for takeover reasons [17 CFR 240.16a-1(a)(1)]. Those funds exempted from the 10 day rule are still required to file a statement with the SEC by the end of the calendar year if, at the time of filing that statement, the fund is still a beneficial owner of more than 5% of the class of equity shares. However, if the fund owns more than 10% of the class of equity securities at the end of any month, the fund must file the statement within 10 days of the end of the month [17 CFR 240.13d-1(b)(2)]. Further, while non-institutional holders of more than 5% but less than 20% of the class of equity security, and without takeover intent, must file a statement within 10 days of acquisition, such holders may file the same abbreviated statement as the exempt institutional funds [17 CFR 240.13d-1(c)].

[85] Rule 3a12-3 (17 CFR 240) provides that securities registered by a foreign private issuer are exempt from Section 16.

person (officer, director or 10% beneficial holder), the beneficial owner must file a statement (Form 3) of the amount of all equity securities in that issuer which is beneficially owned by that person. The person is required to file a further statement (Form 4) when there is any change in such ownership[86] indicating any changes. "Ownership" is broadly defined to include either investment control and/or voting interest.

1003. Certain securities are exempt from registration and therefore exempt from these reporting requirements. Categories exempt from registration are: private offerings to a limited number of persons or institutions, offerings of a limited size, intrastate offerings and securities of municipal, State and Federal governments. Further, a company is not required to file reports with the SEC in the rare case that it "goes private", or reduces the number of its shareholders to fewer than 300.

Compulsory powers available during an investigation

1004. The DOJ and other federal law enforcement entities (including DEA, FBI, and ICE), in addition to the IRS, SEC and CFTC have general purpose compulsory powers enabling them to obtain beneficial ownership and control information for legal persons created in, or operating in, the U.S. These powers are triggered when illicit activity is suspected.

1005. In criminal matters, federal law enforcement entities can utilize judicial processes in obtaining records of beneficial ownership. Information is generally obtained through the use of the Grand Jury Subpoena. This type of process involves the assistance of the Assistant United States Attorney (AUSA) assigned to the investigation. The AUSA represents the Grand Jury and authorizes the issuance of the subpoena.[87] The agent will then "serve" the subpoena upon the recipient (bank, title company, business, a registered agent, individual, etc.). AUSAs may subpoena witnesses, compel the attendance and testimony of witnesses, and require the production of any records (including books, papers, documents, and other tangible things which constitute or contain evidence) which the Attorney General finds relevant or material to the investigation. The attendance of witnesses and the production of records may be required from any place in any State or in any territory or other place subject to the jurisdiction of the United States at any designated place of hearing. Depending upon the type of record requested the length of time from service to compliance can vary. In most instances there is compliance by a date specified on the subpoena. There are other types of judicial process that can be used to obtain records/testimony, but the most common is the subpoena. Compliance with the subpoena is compulsory and is subject only to the constitutional bar against self incrimination. The privilege against self-incrimination does not extend to legal persons or legal arrangements.

1006. As part of any federal criminal investigation, the prosecutor can also apply to a federal court for the issue of a search warrant to be executed upon a legal person. The Constitutional requirements of due process mean that courts cannot automatically issue a search warrant. Evidence on oath, usually by affidavit, that the legal burden of suspicion of a felony has been met, is required.

1007. In some select types of investigations law enforcement has administrative subpoena authority. The scope of this authority, preconditions to its use and who can exercise this authority will depend on the particular statute. Some statutes, such as the Internal Revenue Code, use the term "administrative summons" rather than "subpoena". As with a grand jury subpoena the administrative subpoena generally

---

[86] Statements are also required where the owner purchased or sold any security based swap agreement involving the equity security.

[87] *Subpoena duces tecum:* A process by which the court, at the instances of a party, commands a witness who has in his possession or control some document or paper that is pertinent to the issues of a pending controversy, requires production of books, paper and other things. *Subpoena ad testificandum* - Subpoena to testify: A technical and descriptive term for the ordinary subpoena.

has a compliance date, records are then provided by that date by the recipient of the subpoena. If the statute permits, the administrative subpoena can be immediately issued at the first line investigative supervisory level without the need for a court order.

1008. The SEC's subpoena powers under section 21(b) of the Securities Exchange Commission Act enable it to compel the production of documents or testimony from any person or entity anywhere within the U.S. where the SEC has reason to believe there has been a violation of federal securities laws.

Employer identification number

1009. The IRS uses an Employer Identification Number (EIN) as an information tool to identify taxpayers that are required to file various business tax returns. Title 26 IRC 6109, requires any "person," including a legal person, who is required to file a return to include a prescribed identification number in order to properly identify that person. Treasury regulation 1.6109-1(a)(ii)(c states that any person other than an individual ("such as corporations, partnerships, non-profit organizations, trust estates and similar non-individual persons") must use an employee identification number as prescribed identification number for the purposes of Title 26 IRC 6109. Information contained in the application forms for EINs is used as a tool to identify potential taxable accounts of employers, sole proprietors, corporations, partnerships, estates, trusts, and other entities.

1010. A legal person or arrangement must apply to the IRS for an EIN if any one of the following conditions applies:

(a) it has employees;

(b) it has a qualified retirement plan;

(c) it files returns for employment taxes, excise taxes or income taxes;

(d) it opens a checking, saving or brokerage account or applies for a safe deposit box.

1011. Apart from their tax responsibilities, BSA regulations also require that all persons other than individuals (such as a corporation, partnership or trust) must provide an EIN or other taxpayer identification number when opening an account.[88]

1012. EINs are obtained by filing Form SS-4 with the IRS, which requires the following information about the entity:

(a) the legal name and mailing address of the entity;

(b) the name and social security number (or other tax identification number) of the principal officer, general partner, grantor, owner or trustor;

(c) type of entity, including the state in which it is incorporated (if the entity is a corporation);

(d) the date that the business was started; and

(e) the type of business activity.

1013. IRS officials confirmed that it is possible that a legal arrangement may not need an EIN and that such situations would be rare. However, it should be noted that it is a common typology that a corporation would be established to hold assets (e.g. real estate) which would not require the use of an account at a

[88] 31 CFR 103.121(2)(iii).

financial institution or the employment of personnel and, therefore, there would be no requirement under U.S. law to apply for an EIN.

1014. The U.S. describes the requirement for legal persons to apply for an EIN as a "starting point" for acquiring beneficial or controlling ownership of that legal person in that entities are required to provide certain information in the application form (Form SS-4) which is filed with the IRS. This includes the entity's legal and trade names, its mailing address and, depending on the type of entity, the name of either the principal officer, general partner, grantor, owner, or trustor, as well as any other tax identifier number of this person. The principal officer is the individual who is to be the contact person for the IRS. This person could be a manager, director, employee or agent acting on behalf of the legal person and, therefore, may not be an adequate, accurate and timely source of information on the beneficial ownership and control of the legal person.

1015. The concept of ownership under the EIN regime is different from the concept of beneficial ownership under the FATF Recommendations. This is demonstrated by the EIN rules relating to "change of ownership" in the legal entity. A new EIN is required when there is a "change of ownership" in these legal persons or arrangements. For U.S. federal tax purposes, change of ownership does not mean change in beneficial ownership, but rather a change in the type of taxable organization or a change in the location of the organization.[89] Where there is a change of beneficial ownership or control of the particular legal entity, but no change in the type of taxable organization, there is no requirement to apply for a new EIN.

1016. The IRS is invested with compulsory powers to verify that the information placed on an EIN application is accurate. The IRS has four compliance divisions that can verify EIN information during the course of the audits of the legal persons. The IRS advises that very few legal entities would be audited to ascertain the accuracy of information contained in the application for an EIN.[90]

1017. Federal law enforcement entities are able to share information both domestically and internationally through mechanisms described elsewhere in this report. However, IRS-CI can only share this information directly with law enforcement agencies when conducting a money laundering or terrorist financing investigation jointly with a criminal tax investigation. Where there is no criminal tax investigation (and therefore no IRS-CI involvement) law enforcement agencies do not have direct access to the IRS Form SS-4s or the information contained therein. In such cases, law enforcement agencies can obtain this information by requesting an *ex parte* order from a U.S. Judge.[91] EIN information placed on the application form to the IRS is not authorized to be disclosed by the IRS to AML/CTF regulators.

State laws

1018. The formation, operation and dissolution of U.S. corporations are governed mostly by state law. Corporations and other types of licensed business entities in any state in the U.S. are also subject to certain federal criminal laws, and corporate or other business activity suspected of being illegal under federal law is subject to investigation and enforcement under federal jurisdiction. The Model Business Corporation Act (MBCA) is a model act originally developed by the American Bar Association in the 1980's to

[89] A trust becomes a corporation; an unincorporated association becomes a corporation; a corporation reincorporates in another state; a state corporation reincorporates under an Act of Congress; an individual/sole proprietor changes to a partnership; an individual/sole proprietor changes to a corporation; or a corporation becomes a partnership.

[90] Once a criminal investigation has commenced, IRS-CI will also become involved. During the course of a criminal investigation, IRS-CI can use an administrative summons, or a grand jury subpoena, or apply for a search warrant to compel the receipt of the records to prove true ownership of a legal person.

[91] 26 USC 6103(i).

encourage uniformity within the corporation laws of each U.S. state. The MBCA is only a guide for state governments, but most states have adopted significant portions of the MBCA for their corporate laws. The corporate laws in each state have evolved quite differently, with some states promoting the concept of establishing corporations within the state for the purpose of conducting business outside the state.

1019. Ordinarily, forming a corporation is a simple process, much of which may be performed by a competent legal secretary. The actual mechanics of creating a corporation vary from state to state, although they are usually quite similar. Every state requires the filing of a corporate governance document (called the "articles of incorporation, "certificate of incorporation," or "charter") with a state official (usually the Secretary of State) together with the payment of a filing fee. The Office of the Secretary of State reviews each filing to ensure that it meets the state's statutory requirements; however, the information contained in the filing is generally not verified. Thirteen states have additional filing requirements. Delaware, for example, requires local filing in the county in which the corporation's registered office is located in addition to filing in the state office. Twelve states, including Arizona, require that evidence be submitted that the statutory agent has accepted his/her appointment. Arizona, Georgia and Pennsylvania also require publication of the entity's formation by way of a notice in a local newspaper.

1020. The articles of incorporation must, generally, set forth the following information: (1) the name of the proposed corporation; (2) the period of its duration; (3) the purpose for its formation (a requirement which, in some states, may be satisfied by the very general statement of "for any lawful purpose"); (4) the amount of capital stock; (5) the address of the corporate office or place of business, and the name of its registered agent; (6) the number and names of the founding board of directors (who may, in some cases, only serve until the first annual shareholders meeting); and, (7) the names and addresses of the incorporator(s). All states provide that the incorporators must sign the articles of incorporation, and their signatures must, ordinarily, be verified. Additionally, some states require that duplicate originals of the articles of incorporation be filed with the secretary of state.[92]

1021. All states require that every corporation maintain a registered office within the state and a registered/statutory agent at that office. The registered office may, but need not be, the corporation's business office. One of the primary purposes of the requirements for a registered office and registered agent are to provide an agent for service of process and a place of delivery for legal/tax notices and other official communications. The original registered office and registered agent is specified in the articles of incorporation; if either is changed thereafter a statement describing the change must be filed with the secretary of state. Many attorneys suggest that they be designated as the registered agent and their office be designated as the registered office.

1022. The following case studies describe the situation in the states of Delaware and Nevada. The assessment team focused on these particular states since they actively promote the establishment of corporations by non-residents.

[92] Subsequent to the on-site visits, in April 2006, the Government Accountability Office (GAO) published a document entitled "Company Formations: Minimal Ownership Information is Collected and Available" which states that "Most states do not require ownership information at the time a company is formed, and while most states require corporations and LLCs to file annual or biennial reports, few states require ownership information on these reports. Similarly, only a handful of states mandate that companies list the names of company managers on formation documents, although many require managers' information on periodic reports. States may require other types of information on company formation documents, but typically they do not ask for more than the name of the company and the name and address of the agent for service of process (where legal notices for the company should be sent). Most states conduct a cursory review of the information submitted on these filings, but none of the states verify the identities of company officials or screen names against federal criminal records or watch lists".

A Case Study – Delaware

Delaware is one of the leading states within the U.S. for the incorporation of business entities. There are currently some 695,000 active entities registered in Delaware, including approximately 50% of the corporations publicly traded on the U.S. stock exchanges. The state is considered to be particularly attractive for the undertaking of mergers and acquisitions. New business formations are currently running at about 130,000 per annum, with the majority being established in the form of "alternative entities" (i.e. non-traditional corporations). Many are formed for the purposes of a single transaction (e.g. structured finance), upon the completion of which the company may typically be allowed to lapse. Also, Delaware entities are widely used for asset protection purposes by private individuals. Possible legal structures include Stock Corporations, Non-Stock Corporations, Close Corporations, Foreign Corporations, Limited Liability Companies, Foreign Limited Liability Companies, General Partnerships, Foreign Partnerships, Statutory Trusts, Foreign Statutory Trusts, Limited Partnerships and Foreign Limited Partnerships.

The primary reasons commonly given for Delaware's popularity are that:

(a) Delaware's laws governing corporations, limited liability companies, limited partnerships and statutory trusts are among the most advanced and flexible laws in the nation.

(b) Jurisdiction over most questions arising under Delaware's corporation, limited liability company, statutory trust and partnership laws is vested in the Delaware Court of Chancery, which has developed over 200 years of legal precedent in corporation and business law, and is noted for its sophistication and its mediation between the rights of investors and managers.

(c) The Delaware State Legislature seeks routinely (on an annual basis) to update its laws, while maintaining a stable core.

Key Delaware corporate and other business legislation includes: the General Corporation Law, Revised Uniform Partnership Act, Limited Partnership Act, and Limited Liability Company Act. The concept of the Limited Liability Company (LLC) was first created in 1992, and since then it has become the vehicle of choice for the majority of businesses wishing to establish a Delaware entity. One of its primary attractions is the ability to combine a tax treatment similar to that of a partnership with the limited liability of a corporate structure. However, another key feature is that the LLC can dispense with most of the common trappings of a corporation (e.g. board meetings, minutes, etc), with the relationship between the shareholders and the management typically being defined in a written LLC agreement, and not in statute except for certain default rules that apply in the absence of an agreement.

The vast majority of Delaware corporations and LLCs are established by non-residents in order to do business outside the state. The only territorial obligation is that all entities must have a physical registered address within the State of Delaware for the service of process. Typically, such an address is provided by a registered agent (see below), many of whom cite as a particular attraction the fact that entities can be established without the principals having to go to Delaware. Incorporation is routinely possible within 24 hours, and the Delaware Division of Corporations offers a one-hour service on demand.

All information held on the corporate registry is available to the public. However, there is no obligation to file the name of any shareholder or beneficial owner when establishing either a corporation or an LLC. Section 102 of the General Corporation Law requires such information in principle, but notes that "if the powers of the incorporator or incorporators are to terminate upon the filing of the certificate of incorporation, the names and mailing addresses of the persons who are to serve as the directors until the first annual meeting of the stockholders or until their successors are elected" should be supplied. The initial directors may simply be appointees by the registered agents. Section 219 provides that a list of the

stockholders eligible to vote must be drawn up by the company ten days before any meeting of the stockholders, but the substantial case law on the relative rights of nominee stockholders and beneficial owners clearly shows that the practice of using nominees is not unusual and is common practice in the United States where mutual funds hold a large percentage of all publicly-held stock. Bearer shares are expressly prohibited by section 158 of the Law.

In the case of LLCs there are no requirements to file the names of either the managers or members at formation. Section 18-201 of the Limited Liability Company Act requires the submission only of the name of the company, the registered address and "any other matters the members determine to include therein" (i.e. disclosure is entirely voluntary). Other features of both corporations and LLC are:

(a) one person can be the sole director and officer of a corporation or the sole member and manager of a LLC;

(b) shareholders can act in writing rather than holding meetings;

(c) records need not be kept in the state of Delaware; and

(d) no obligations are imposed on registered agents with respect to customer identification or record-keeping.

As a result of the requirement to maintain a physical address in the state, anyone from out of state wishing to establish a Delaware corporation must use the services of a registered agent to provide the appropriate address. Section 132 of the General Corporation Law provides that the registered agent may, among others, be an individual resident in the state, a corporation, a limited partnership, a limited liability company or a statutory trust. At present some 30,000 natural persons, professional service providers or companies offer this service in Delaware, although the vast majority are dedicated agents representing just one company. Approximately 240 formation agents represent more than 50 companies each. Delaware offers a special one-hour service for registration, when a registered agent facilitates formation.

The role of the agent may range from fulfilling the minimal legal requirements of maintaining a physical presence in the State of Delaware for service of process, including subpoenas, to a much broader range of client services. The degree of knowledge that the agent might have of its client will, therefore, vary significantly. There is no legal obligation to verify the identify of the customer, and in cases where the ultimate customer may be a private individual, it would typically be the case that the agent would deal with an intermediary, such as an attorney or other professional adviser. As a matter of business practice, the agent would seek to maintain three contact points, one for onward service of process, one for tax affairs, and one for the billing of fees (who could be one and the same person).

There are currently no controls imposed on the majority of registered agents. The limited exception is for those agents who wish to have access to online incorporation facility. In order to be considered for such access (which facilitates, but is not a necessary pre-requisite, for using the one-hour and other expedited filing services), an agent simply has to meet certain performance criteria. Specifically, he/she must have been actively involved in the business of providing registered agents services for at least one year, he/she must hold a deposit account with the Division of Corporations, and he/she must enter into a standard contractual arrangement with the Division. Registered agents with online access do facilitate the overwhelming majority of all Delaware business formations.

The Delaware state authorities are conscious of the potential reputational damage that can be caused by unscrupulous or incompetent registered agents, and are considering introducing amendments to Section 132 to impose some degree of regulation over their activities. This might involve defining the role of the agent relative to the service of process, requiring agents to retain client contact information

including the name, business address and phone number of a natural person who is a director, officer, employee or designated agent of the company, and requiring a Delaware business license. Legislation may also provide for some sanctions for agents who consistently fail to meet their obligations or have been convicted of a felony or engaged in practices intended or likely to deceive or defraud the public, including the possibility of the authorities making an application to the Court of Chancery to have an agent closed down. There is no proposal to extend a broader regulatory regime to this sector, or to require registered agents to adopt due diligence standards with respect to their clients.

In many respects, registered agents in Delaware are in competition for business with TCSPs operating in traditional offshore financial centers (OFCs). The style of advertising by many tends to portray an image that the standards of secrecy offered are greater than those in most OFCs. For example, one Internet site, when talking of the attraction of Delaware for non-resident aliens, states:

> "To our many international clients, anonymity is important. Many of our clients select single-member Delaware LLCs as one component of their asset protection strategy. The Delaware LLC provides the anonymity that most international jurisdictions do not offer. As a Delaware Registered Agent, (name of company) is NOT required to keep any information on the beneficial owner, and the State of Delaware does NOT require that the beneficial owner is disclosed."

In terms of seeking to acquire information on the ownership and control of state-registered entities, the law enforcement and regulatory authorities in Delaware have a range of investigative powers including subpoena powers when fraud or other illegal activity is suspected. Delaware's authority, as a state, does not extend beyond the state borders except through the exercise of statutorily provided long-arm jurisdiction, and, given the very limited amount of information that might typically be held within the state with respect to the owners and activities of the majority of Delaware-incorporated entities, these investigative powers on their own would appear to be encumbered by the process of exercising such jurisdiction in order to trace beneficial ownership. It is possible, as previously described, for federal law enforcement agents to access beneficial ownership information regarding a Delaware corporate vehicle or other business formation through parallel jurisdiction when a federal offense is suspected.

A Case Study – Nevada

In recent years, Nevada has sought to mount a challenge to Delaware as the favored location for incorporation by out-of-state residents. It currently has approximately 280,000 active business entities registered with the Division of Corporations, with 80,000 to 85,000 new registrations each year. About 30,000 entities fail to renew their registration each year, suggesting that many are established for one-off transactions. The establishment of LLCs has been available in Nevada since the early-1990s, and they currently account for about 50% of new registrations.

About 20% of the registrations are completed by residents of Nevada, in part reflecting the fact that Las Vegas has one of the country's highest population growth rates. However, a significant proportion (about 40%) of the registrations emanate from persons in California, with the other 40% largely spread around the other states within the U.S. California provides a major source of business because of its geographical proximity, its high rate of taxation, and the sheer size of its economy. There is reported to have been a dramatic decline in the number of registrations on behalf of non-U.S. persons since the introduction of the USA PATRIOT Act.

The primary advantages commonly cited for registration in Nevada are:

(a) the absence of any state corporation tax;

(b) the absence of an information sharing agreement with the IRS;

(c) one person can hold all corporate positions;

(d) minimal filing requirements, both on initial registration and annually thereafter; and

(e) a high degree of privacy offered by these filing requirements.

More generally, Nevada is also seen to offer better indemnification to officers and directors than any other state. This, together with the tax advantages associated particularly with the LLC structure, make Nevada favored as a jurisdiction for holding assets. Delaware law, by contrast, has a tradition of being more conducive to the interests of investors, and is, therefore, more widely used as a base for raising capital. A significant proportion of Nevada registrations are on behalf of private individuals, rather than established corporations.

The process for the registration of a corporate or other entity is not onerous. Where it does not physically conduct business in the state, each entity must appoint a resident agent in Nevada, and submit to the Division of Corporations a form containing the name and address of the agent, the number of shares and their par value, the name of the incorporators, and a letter from the resident agent accepting his/her appointment. Within two months of registration, the entity must also file the names of the president, secretary and treasurer. Thereafter, an annual filing containing the names of the officers is required. Nevada does not offer a "fast track" incorporation process, and all filings (which subsequently become available to the public) are currently made by physical documentation. There is no requirement at any stage to file the name of the beneficial owners or controllers, and the names of the incorporators and officers submitted to the Division of Corporations may be those of the agents or other nominees. In the case of an LLC, if the entity appoints a manager, there is no requirement to include the names of the managing members (i.e. the owners) on the annual filing. There is no obligation imposed on the agents to know, or to maintain records of, the beneficial owner.

Nevada is one of only two states in the U.S. where bearer shares are not prohibited (the other being Wyoming), although there has been speculation that a bill will shortly be introduced to the state legislature to outlaw them. However, the authorities and agents have reported that the use of bearer shares by investors is extremely limited, probably due to the fact that they offer no particular advantage over registered shares, which have minimal filing requirements, and as bearer instruments, pose a risk of loss.

The Division of Corporations has no authority to refuse a filing provided that it is completed correctly, that the name selected for the entity does not replicate that of an existing entity, and that it does not use a term that is given statutory protection under state regulatory laws (e.g. bank, trust, insurance, etc). The Division does not verify the accuracy of the information contained in the filing. The Division has no investigatory powers in relation to any of the registered entities, and any concerns that it may have, including potential fraudulent filing of documents, must be passed to the Attorney General or the district attorney for investigation.

In 2003 provisions were introduced requiring all corporations to apply for a business license from the Department of Taxation. The application form for the license asks for details of the beneficial owners. However, in 2005 an amendment was adopted that limited the obligation to entities "providing service or conducting business for profit" in Nevada. This amendment was introduced specifically to take outside the scope of the process all private investment, asset holding or similar vehicles that do not conduct a physical business in Nevada. To date, only about 50% of the affected corporations have made the requisite filings. In addition, the accuracy of the information contained in the filing is not verified. The information in the possession of the Department of Taxation is protected by privacy laws, and it may only be accessed by law

enforcement under a grand jury subpoena, supported by a Governor's Order.

As in the case of Delaware, the statutory role of the resident agents is to provide an address for service of notice, but they will usually also provide services relating to the submission of the initial registration, and to any subsequent routine filings. The function may be provided by any person (individual or corporate) that has a physical presence in the state, but in most cases it is performed by professional agents. For example, the Resident Agents Association has as its membership 40 firms that, between them, represent approximately 50,000 registered companies. There is no obligation on the agents to identify the beneficial owner of the entities for which they act, and an attempt in recent years to require disclosure of beneficial ownership by the registered agents without a proper court order (i.e. a subpoena) did not pass through the legislature. By law the agents must either hold the entities' stock register at the registered address, or maintain a record of where the register is held. In many cases, the register is held outside the state, and there is no restriction on the use of nominee shareholders. Bearer shares are also permitted. Of particular note is that many of the service provider websites advertise their ability to open bank accounts within the state on behalf of the client corporation.

The resident agents are not subject to any form of regulatory oversight, and proposals in the past to introduce a regulatory framework in Nevada have been deflected under pressure from the agents.

Summary of state issues

1023. The activities of the TCSPs are clearly instrumental in the rapid growth of company formation in these states. While the use of the states (Delaware, in particular) for capital formation by quoted companies will be transparent through the SEC and exchange disclosure requirements, reliable information on the identity of individuals for whom the very large number of private investment vehicles are being formed is held, at best, with the TCSPs. In many cases, such information, or its location, may be unknown even to the TCSPs. While many agents will undoubtedly wish to identify their clients for their own business reasons (e.g. reputation risk, assurances on fee payments), it is clear that others are actively marketing the states as locations where anonymity can be assured.

1024. In its threat assessment published in January 2006, the U.S. authorities have highlighted the risks posed by the incorporation arrangements in states such as Delaware, Nevada and Wyoming. Some of the conclusions in this assessment are very stark, e.g.

> "The FBI has found that certain nominee incorporation services (NIS) form corporate entities, open full-service bank accounts for those entities, and act as the registered agent to accept service of legal process on behalf of those entities in a jurisdiction in which the entities have no physical presence. An NIS can accomplish this without ever having to identify beneficial ownership on company formation, registration, or bank account documents. The FBI believes that U.S. shell companies and bank accounts arranged by certain NIS firms are being used to launder as much as USD 36 billion a year from the former Soviet Union. It is not clear whether these NIS firms are complicit in the money laundering abuse.
>
> Several international NIS firms have formed partnerships or marketing alliances with U.S. banks to offer financial services such as Internet banking and wire transfer capabilities to shell companies and non-U.S. citizens. The FBI reports that the U.S. banks participating in these marketing alliances open accounts through intermediaries without requiring the actual account holder's physical presence, accepting by mail copies of passport photos, utility bills, and other identifying information.

FinCEN reports that 397 SARs were filed between April 1996 and January 2004 involving shell companies, Eastern European countries, and the use of correspondent bank accounts. The aggregate violation amount reported in those 397 SARs totaled almost USD 4 billion.

The State of New York Banking Department recently noted that Suspicious Activity Reports filed by New York banks indicate an increase in the volume of shell company wire transfer activity through high-risk correspondent bank accounts, both in terms of dollar amounts and the number of transactions. These reports indicate that money is passing through correspondent accounts established for Eastern European banks."

1025. FinCEN has indicated that in the longer term it will be mounting a three-pronged program to raise awareness further. First, this will involve an advisory to banks, highlighting the threat assessment and specifying the type of questions that it would expect banks to be asking when dealing with certain types of corporate customer. Second (possibly before the end of 2006), it plans to issue the long awaited notice of proposed rulemaking with respect to CIP requirements for company formation agents. Third, it will engage in an immediate outreach program to the key states to encourage them to legislate for greater transparency of ownership of corporate entities. However, with respect to the third objective, FinCEN recognizes that the federal government has no authority to force the states to amend their domestic legislation, and must, therefore, rely on their goodwill.

1026. In discussions with the state authorities, it was clear that there was a realization of the threats posed by the current "light-touch" incorporation procedures, including the failure to obtain meaningful information on individuals who effectively control the entities. However, the states primarily see this activity as a revenue-raising enterprise to substitute in part for their partial tax-free environment, and the company formation agents represent a powerful lobby to protect the status quo. Therefore, any proposals to enhance the disclosure requirements have not progressed, with defenders of the status quo arguing that, since the money laundering threat only crystallizes when the company gains access to the financial system, an effective safeguard should already exist in the form of the institutions' CDD obligations.

Bearer Shares

1027. The issue of bearer shares is prohibited in all States and Territories in the U.S. apart from Nevada and Wyoming. Website searches reveal a level of promotion of trading in these instruments in these States. As discussed, the Corporations Division in Nevada advised, however, that they were not aware of any trading in bearer shares in that state. This was separately confirmed by legal practitioners in that jurisdiction. There are no State laws regulating the issue of bearer shares in either state and in particular there are no systems to ensure that information regarding beneficial or control ownership is available.

5.1.2 Recommendations and Comments

1028. The U.S. relies on a combination of systems and measures to satisfy the requirements for access by authorities to accurate and current information on the beneficial ownership and control of legal persons upon suspicion in order to investigate money laundering. At both the federal and state level there is a range of investigatory powers available to law enforcement and certain regulators to compel the disclosure of ownership information. It is acknowledged that these are generally sound and widely used. However, the system is only as good as the information that is available to be acquired. In the case of companies that do not offer securities to the public or whose securities are not listed on a U.S. stock exchange, the information available within the jurisdiction is often minimal with respect to beneficial ownership. In the case of the states visited, the company formation procedures and reporting requirements are such that the information on

beneficial ownership may not be adequate and accurate, and competent authorities would not be able to access this information in a timely fashion.

1029. It is recommended that the U.S. authorities undertake a comprehensive review to determine ways in which adequate and accurate information on beneficial ownership may be available on a timely basis to law enforcement authorities for companies which do not offer securities to the public or whose securities are not listed on a recognized U.S. stock exchange. It is important that this information be available across all states as uniformly as possible. It is further recommended that the federal government seek to work with the states to devise procedures which should be adopted by all individual states to avoid the risk of arbitrage between jurisdictions. As the January 2006 threat assessment indicates, the U.S. authorities are well aware of the problems created by company formation arrangements, and have formulated an initial program to try to address the issue. This should be pursued in a shorter timescale than seems to be envisaged at present. In particular, the proposal to bring company formation agents within the BSA framework, and to require them to implement AML Programs and CIP procedures should be taken forward in the very near future.

5.1.3 Compliance with Recommendations 33

	Rating	Summary of factors underlying rating
R.33	NC	• While the investigative powers are generally sound and widely used, there are no measures in place to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. • There are no measures taken by those jurisdictions which permit the issue of bearer shares to ensure that bearer shares are not misused for money laundering.

5.2 Legal Arrangements – Access to beneficial ownership and control information (R.34)

5.2.1 Description and Analysis

1030. In the U.S. a trust is a legal entity that is created under state law. The IRS retains oversight of income generated by trusts through federal tax laws.

1031. Virtually all U.S. state jurisdictions recognizing trusts have purposely chosen not to regulate trusts like other corporate vehicles. The U.S. authorities confirm that this is because in the U.S. a trust is essentially a contractual agreement between two private persons. This means that, unlike corporations, there are no registration requirements, other than tax filing requirements imposed on trusts by the IRS. Trusts are subject to the same general investigative powers exercised by those regulators and law enforcement agencies as discussed in Section 5.1, beneficiaries have some corporate reporting requirements under the Securities Exchange Act, and trusts also have obligations to apply for an EIN.

IRS Filing Requirements

1032. For U.S. federal tax purposes, there are three types of trusts:

(a) **Simple Trust:** A trust that requires that all income be distributed currently, with no authority to make charitable contributions or permanently set aside any amount for charitable purposes. A trust can be a simple trust only for a year during which it distributes income and makes no other

TABLES

Table 1: Ratings of Compliance with FATF Recommendations
Table 2: Recommended Action Plan to improve the AML/CFT system

Table 1. Ratings of Compliance with FATF Recommendations

The rating of compliance vis-à-vis the FATF Recommendations should be made according to the four levels of compliance mentioned in the 2004 Methodology [Compliant (C), Largely Compliant (LC), Partially Compliant (PC), Non-Compliant (NC)], or could, in exceptional cases, be marked as not applicable (na).

Forty Recommendations	Rating	Summary of factors underlying rating[129]
Legal systems		
1. ML offense	LC	• The list of domestic predicate offenses does not fully cover 2 out of the 20 designated categories of offenses specifically (insider trading and market manipulation, and piracy). • The list of foreign predicate offenses does not cover 8 out of the 20 designated categories of offenses. • The definition of "transaction" in s.1956(a)(1) means that mere possession as well as concealment of proceeds of crime , does not constitute the laundering of proceeds. • The definition of "property" in relation to the section 1956(a)(2) offense (international money laundering) only includes monetary instruments or funds.
2. ML offense–mental element and corporate liability	C	• The Recommendation is fully observed.
3. Confiscation and provisional measures	LC	• Where the proceeds are derived from one of the designated categories of offenses that are not domestic or foreign predicate offenses for ML, a freezing/seizing or confiscation action cannot be based on the money laundering offense. • Property of equivalent value which may be subject to confiscation cannot be seized/restrained.
Preventive measures		
4. Secrecy laws consistent with the Recommendations	C	• This Recommendation is fully observed.
5. Customer due diligence	PC	• No obligation in law or regulation to identify beneficial owners except in very specific circumstances (i.e. correspondent banking and private banking for non-U.S. clients). • No explicit obligation to conduct ongoing due diligence, except in certain defined circumstances. • Customer identification for occasional transactions limited to cash deals only. • No requirement for life insurers issuing covered insurance products to verify and establish the true identity of the customer, (except for those insurance products that fall within the definition of a "security" under the federal securities laws). • No measures applicable to investment advisers and commodity trading advisors. • Verification of identity until after the establishment of the business relationship is not limited to circumstances where it is essential not to interrupt the normal course of business. • No explicit obligation to terminate the business relationship if verification process cannot be completed. • The effectiveness of applicable measures in the insurance sector (which went into force on 2 May 2006) cannot yet be assessed.

[129] These factors are only required to be set out when the rating is less than Compliant.

6. Politically exposed persons	LC	• Measures relating to PEPs do not explicitly apply to MSBs, the insurance sector, investment advisers and commodity trading advisors.
7. Correspondent banking	LC	• No obligation to require senior management approval when opening individual correspondent accounts.
8. New technologies & non face-to-face business	LC	• No explicit provision requiring life insurers MSBs, or investment advisers and commodity trading advisors to have policies and procedures for non-face-to-face business relationships or transactions.
9. Third parties and introducers	LC	• No explicit obligation on relying institution to obtain core information from introducer. • No measures have been applied to investment advisers and commodity trading advisors, or the insurance sector.
10. Record keeping	LC	• Life insurers of covered products are only required to keep limited records of SARs, Form 8300s, their AML Program and related documents.
11. Unusual transactions	LC	• In the insurance, and MSB sectors, there is no specific requirement to establish and retain (for five years) written records of the background and purpose of complex, unusual large transactions or unusual patterns of transaction that have no apparent or visible economic or lawful purpose (outside of the SAR, CTR and Form 8300 requirements). • No measures have been applied to investment advisers and commodity trading advisors.
12. DNFBP – R.5, 6, 8-11	NC	• Casinos are not required to perform enhanced due diligence for higher risk categories of customer, nor is there a requirement to undertake CDD when there is a suspicion of money laundering or terrorist financing (R.5). • Accountants, dealers in precious metals and stones, lawyers and real estate agents are not subject to customer identification and record keeping requirements that meet Recommendations 5 and 10. • None of the DNFBP sectors is subject to obligations that relate to Recommendations 6, 8 or 11 (except for casinos in relation to R.11).
13. Suspicious transaction reporting	LC	• The existence of a USD 5,000 threshold for reporting suspicious activity. • No measures have been applied to investment advisers and commodity trading advisors. • The effectiveness of measures in the insurance and mutual funds sectors cannot yet be assessed.
14. Protection & no tipping-off	C	• The Recommendation is fully observed.
15. Internal controls, compliance & audit	LC	• AML Program requirements have not been applied to certain non-federally regulated banks, investment advisers and commodity trading advisors. • It is not yet possible to assess the effectiveness of these measures in the insurance sector. • There is no obligation under the BSA for financial institutions to implement employee screening procedures.
16. DNFBP – R.13-15 & 21	NC	• Casinos are the only DNFBP sector that is required to report suspicious transactions; however, there is a threshold on that obligation. • Accountants, lawyers, real estate agents and TCSPs are not subject to the "tipping off" provision or protected from liability when they choose to file a suspicious transaction report. • Accountants, lawyers, real estate agents and TCSPs are not required to implement adequate internal controls (i.e. AML Programs). • Dealers in precious metals, precious stones, or jewels are required to implement AML programs; however, the effectiveness of implementation cannot yet be assessed. • There are no specific obligations on accountants, lawyers, real estate agents or TCSPs to give special attention to the country advisories that FinCEN has issued and which urge enhanced scrutiny of financial transactions with countries that have deficient AML controls.

17. Sanctions	LC	• Some banking and securities participants are not subject to all AML/CFT requirements and related sanctions at the federal level. • The effectiveness of the measures in the insurance sector can not yet be assessed. • There are concerns about how effectively sanctions are applied in the MSB sector given the current level of the IRS's resources.
18. Shell banks	C	• The Recommendation is fully observed.
19. Other forms of reporting	C	• The Recommendation is fully observed.
20. Other NFBP & secure transaction techniques	C	• This Recommendation is fully observed.
21. Special attention for higher risk countries	LC	• In the insurance sector, there is no specific requirement to establish and retain written records of transactions with persons from/in countries that do not or insufficiently apply the FATF Recommendations. • No measures have been applied to investment advisers and commodity trading advisors.
22. Foreign branches & subsidiaries	LC	• BSA requirements do not apply to the foreign branches and offices of domestic life insurers issuing and underwriting covered life insurance products.
23. Regulation, supervision and monitoring	LC	• Some securities sector participants are not subject to supervision for AML/CFT requirements. • The effectiveness of the measures in the insurance sector can not yet be assessed. • Concerns about IRS examination resources.
24. DNFBP - regulation, supervision and monitoring	PC	• There is no regulatory oversight for AML/CFT compliance for accountants, lawyers, real estate agents or TCSPs. • The supervisory regime for Nevada casinos is currently not harmonized with the BSA requirements.
25. Guidelines & Feedback	C	• The Recommendation is fully observed.
Institutional and other measures		
26. The FIU	LC	• The effectiveness of FinCEN, is impeded by: - perceptions concerning the value of its products and the risk that over-emphasis on FinCEN's network function will weaken its place in the AML/CFT chain; - the handling of the huge amount of 14 million reports of which 70% are still filed in a paper format; - the fact that SAR filing is only done in 30-60 days after detection; and - insufficient adequate/timely feedback to reporting institutions. • Since terrorism-related information in requests from foreign FIUs is shared with law enforcement—for networking—without the prior authorization of the foreign FIU, the U.S. does not act in accordance with international principles of information exchange established by the Egmont Group.
27. Law enforcement authorities	C	• The Recommendation is fully observed.
28. Powers of competent authorities	C	• The Recommendation is fully observed.
29. Supervisors	C	• This Recommendation is fully observed.
30. Resources, integrity and training	LC	• The IRS is not adequately resourced to conduct examinations of the entities that it is responsible for supervising, in particular, the MSB and insurance sectors.
31. National co-operation	LC	• There remains a gap between the policy level and operational level law enforcement work. • More refined coordination is needed amongst law enforcement agencies with overlapping jurisdictions.

32. Statistics	LC	• Freezing, seizing and confiscation statistics are not specified into ML and TF related seizures and confiscations. • No statistics on TF related confiscations. • FinCEN collects and maintains substantial valuable statistical BSA data, which can be used to provide a partial picture of the effectiveness of the U.S. AML/CFT regime; however, FinCEN's data would need to be coupled with that of other federal agencies and departments in order to produce a comprehensive view of overall effectiveness of U.S. AML/CFT systems. • MLA and extradition statistics are not broken down annually, and do not show the time required to respond to a request.
33. Legal persons – beneficial owners	NC	• While the investigative powers are generally sound and widely used, there are no measures in place to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. • There are no measures taken by those jurisdictions which permit the issue of bearer shares to ensure that bearer shares are not misused for money laundering.
34. Legal arrangements – beneficial owners	NC	• While the investigative powers are generally sound and widely used, there is minimal information concerning the beneficial owners of trusts that can be obtained or accessed by the competent authorities in a timely fashion.
International Co-operation		
35. Conventions	LC	• Not all conduct specified in Article 3 (Vienna) and Article 6 (Palermo) has been criminalized, and there is no a sufficiently comprehensive list of foreign predicates related to organized criminal groups as required by Article 6(2)(c) (Palermo).
36. Mutual legal assistance (MLA)	LC	• Dual criminality may impede MLA where the request relates to the laundering of proceeds that are derived from a designated predicate offense which is not covered.
37. Dual criminality	C	• This Recommendation is fully observed.
38. MLA on confiscation and freezing	LC	• Dual criminality may impede MLA where the request relates to the laundering of proceeds that are derived from a designated predicate offense which is not covered.
39. Extradition	LC	• Dual criminality may impede extradition where the request relates to the laundering of proceeds that are derived from a designated predicate offense which is not covered. • List-based treaties do not cover ML.
40. Other forms of co-operation	C	• This Recommendation is fully observed.
Nine Special Recommendations	**Rating**	**Summary of factors underlying rating**
SR.I Implement UN instruments	LC	• Not all UN1267 designations are transposed in the OFAC list.
SR.II Criminalize terrorist financing	C	• This Recommendation is fully observed.
SR.III Freeze and confiscate terrorist assets	LC	• Compliance monitoring in non-federally regulated sectors (e.g. insurance, MSBs) is ineffective. • Not all S/RES/1267(1999) designations are transposed in the OFAC list.
SR.IV Suspicious transaction reporting	LC	• The existence of a USD 5,000 threshold for reporting suspicious activity. • No measures have been applied to investment and commodity trading advisers. • The effectiveness of measures in the insurance and mutual funds sectors cannot yet be assessed.

SR.V International co-operation	LC	• List-based treaties do not cover FT.
SR VI AML requirements for money/value transfer services	LC	• The limitations identified under Recommendation 5, 8, 13 and SR.IV with respect to the MSB sector also affect compliance with Special Recommendation VI. • Major concerns with respect to resources of the IRS for monitoring of this sector.
SR VII Wire transfer rules	LC	• Threshold of USD 3,000 instead of USD 1,000 as is required by the revised Interpretative Note. • It is not mandatory to include all required originator information on batch transfers.
SR.VIII Non-profit organizations	C	• This Recommendation is fully observed.
SR.IX Cross Border Declaration & Disclosure	C	• The Recommendation is fully observed.

Table 2: Recommended Action Plan to Improve the AML/CFT System

AML/CFT System	Recommended Action (listed in order of priority)
1. General	
2. Legal System and Related Institutional Measures	
2.1 Criminalization of Money Laundering (R.1 & 2)	• Expand the list of foreign predicate offenses to include all of the domestic predicate offenses (including piracy, market manipulation and insider trading). • Amend the list of SUA to include the offenses of piracy, market manipulation and insider trading. • Take legislative measures to ensure that the definition of "transaction" is broadened to cover all conduct as required by the Vienna and Palermo Conventions. • Take legislative measures to ensure that the scope of the section 1956(a)(2) offense is broadened include proceeds other than funds or monetary instruments.
2.2 Criminalization of Terrorist Financing (SR.I)	• There are no recommendations for this section.
2.3 Confiscation, freezing and seizing of proceeds of crime (R.3)	• Extend domestic and foreign predicates to fully cover all 20 categories of predicate offenses listed in the Glossary to the FATF 40 Recommendations. • Take measures to ensure that property which may be subject to equivalent value confiscation may be seized/restrained to prevent its being dissipated.
2.4 Freezing of funds used for terrorist financing (SR.III)	• Take further efforts to improve compliance monitoring of all targeted entities, particularly the state-regulated sectors and DNFBPs. • Given that the reliability of the 1267 list has been improved through successive rounds of corrections and additions of identifiers, the U.S. should consider revising its approach to listing the Taliban as an entity, rather than including individual names, particularly where those names have sufficient identifiers.
2.5 The Financial Intelligence Unit and its functions (R.26)	• FinCEN should invest in a faster and more efficient reporting system with a preference to: (1) mandatory e-filing for all reporting institutions, and (2) the use of a single form for all reporting institutions. • FinCEN should ensure that it receives adequate and continual feedback from law enforcement agencies using the BSA-direct system so that it does not lose its important position within the AML/CTF chain. • FinCEN should improve its guidance and feedback with a view to improving the quality of reports filed by reporting entities. • FinCEN should also ensure that its information and guidance for reporting entities is combined and/or coordinated with the law enforcement agencies and regulators that issue similar or related material. • FinCEN should focus on the challenge of promoting the added-value of its analytical products to law enforcement. • Law enforcement agencies should work at the operational level to change their perceptions concerning the value of FinCEN's products (i.e. by promoting within their agencies a broader use of FinCEN's ability to produce operational and/or strategic analysis). • The U.S. should handle terrorism-related information received in requests from foreign FIUs in accordance with international principles of information exchange.
2.6 Law enforcement, prosecution and other competent authorities (R.27 & 28)	• There are no recommendations for this section.

2.7 Cross Border Declaration & Disclosure	• Further invest in the detection and investigation as well as the resources, techniques and methods to counter outgoing cross-border transportations of cash or any negotiable bearer instrument. • Focus on conducting thorough border checks of people, vehicles, trains, cargo, etc., without allowing the level of thoroughness to be dictated by the volume of traffic waiting to cross the border.
3. Preventive Measures – Financial Institutions	
3.1 Risk of money laundering or terrorist financing	• Extend AML/CFT measures to investment advisers and commodity trading advisors, and the limited number of depository institutions that are currently not covered,
3.2 Customer due diligence, including enhanced or reduced measures (R.5 to 8)	• Introduce a primary obligation to identify the beneficial owners of accounts (which may, of course, be implemented on a risk-based approach with respect to low-risk customers or transactions). • Implement a CIP requirement for the insurance sector. • Introduce an explicit obligation that financial institutions should conduct ongoing due diligence, rather than rely on an implicit expectation within the SAR requirements and on the existing guidance. • In the case of occasional transactions, extend the customer identification obligation to non-cash transactions. • Other than with respect to non-face-to-face business, securities transactions, and life insurance business, limit the circumstances in which institutions may open an account prior to completing the verification process, and introduce a presumption that institutions should close an account whenever the verification cannot be completed, for whatever reason. If necessary, accompany this with some form of indemnification against other conflicting statutes. • Introduce an explicit requirement that the opening of individual correspondent accounts should involve senior management approval. • Extend AML/CFT obligations (including the PEPs requirements) to investment advisers and commodity trading advisors, in line with those applicable to the rest of the securities industry. • Publish confirmation that, despite the promulgation of the final section 312 rule, the 2001 Guidance on PEPs remains in force and that it applies to all relevant financial institutions. • Introduce an explicit requirement for the life insurance and MSB sectors to address the specific risks associated with non-face to face business relationships or transactions. • Extend the obligation for AML Programs and CIP (as applicable) to all depository institutions to remove the historical anomaly.
3.3 Third parties and introduced business (R.9)	• Introduce a requirement that the relying bank or other financial institution should obtain immediately from the introducing institution details relating to the identity of the account holder, the beneficial owner, and the reason for which the account is being opened. • Extend such measures to investment advisers and commodity trading advisors, and the insurance sector (including insurance agents and brokers).
3.4 Financial institution secrecy or confidentiality (R.4)	• There are no recommendations for this section.

3.5 Record keeping and wire transfer rules (R.10 & SR.VII)	• Ensure that NACHA completes its current process of developing and approving a rule that would allow cross-border ACH transfers to meet the new FATF requirements with respect to batch transfers before January 2007. • Ensure that the threshold is lowered to USD 1,000 before January 2007. • Extend full record-keeping requirements to the insurance sector, including insurance brokers and agents. • Consider simplifying the record keeping framework.
3.6 Monitoring of transactions and relationships (R.11 & 21)	• Extend the requirement to establish and retain (for five years) written findings that relate to unusual transactions to those participants in the securities sector that are currently not subject to a requirement to file SARs. • Require insurers to establish and retain written records of transactions with persons from/in countries that do not or insufficiently apply the FATF Recommendations to the extent that this is not already addressed by the AML program and SAR requirements • Extend the requirements to establish and retain written records of transactions with persons from/in countries that do not or insufficiently apply the FATF Recommendations to those participants in the securities sector that are currently not covered.
3.7 Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV)	• Remove the threshold from the reporting obligation. • Extend the SAR obligations to investment advisers and commodity trading advisors. • Consider imposing direct SAR reporting requirements on independent insurance agents and brokers. • Clarify that confidentiality of SARs applies to the more limited disclosure restrictions under the BSA (i.e. to any person involved in the transaction) to put current practice beyond doubt.
3.8 Internal controls, compliance, audit and foreign branches (R.15 & 22)	• Extend the AML Program requirement to the limited number of non-federally regulated depository institutions that are currently exempted. • Complete the process of extending AML Program requirements to unregistered investment companies, investment advisers and commodity trading advisors. • Ensure that insurance companies are required to apply AML/CFT measures to their foreign branches and subsidiaries. • Require all financial institutions (not just those in the securities sector) to screen prospective employees for high standards.
3.9 Shell banks (R.18)	• There are no recommendations for this section.
3.10 The supervisory and oversight system - competent authorities and SROs. Role, functions, duties and powers (including sanctions) (R.23, 29, 17 & 25)	• In the securities and insurance sectors issue guidance similar to the FFEIC manual. • Extend AML Program requirements to the limited number of uninsured, state-chartered banks and other depository institutions that are currently exempt. • Consider providing more and better resources to examining AML compliance in the privately insured credit union sector. • Ensure that the new AML/CFT measures applicable to the insurance sector are implemented effectively. • Once AML/CFT measures are applied to the investment advisers and commodity trading advisors, ensure that they are effectively supervised, monitored and (if appropriate) sanctioned for compliance. • Ensure that the IRS has sufficient resources to undertake comprehensive examinations of the large number of institutions for which it is responsible.

3.11 Money value transfer services (SR.VI)	• Undertake a thorough review of the workload and resources of the IRS in the area of BSA compliance to ensure that the allocation of responsibilities is delivering the most effective and efficient results (i.e. are other agencies better placed to take on some of these responsibilities?). • Irrespective of any reallocation of responsibilities, it is clearly the case that the IRS needs to be allocated significantly more resources simply to address the MSB sector. • Extend the examination program for agents quite extensively. • Make further efforts to standardize the AML examination procedures both between the states, and between the individual states and the IRS.
4. Preventive Measures – Non-Financial Businesses and Professions	
4.1 Customer due diligence and record-keeping (R.12)	• Explicitly require casinos to perform enhanced due diligence for higher risk categories of customers and to undertake CDD when there is a suspicion of money laundering or terrorist financing. • Extend customer identification, record keeping and account monitoring obligations that are consistent with FATF Recommendations to these sectors as soon as possible. • Extend obligations that relate to Recommendations 6, 8 or 11 to all DNFBPs. (This does not apply to casinos in relation to R.11). • In the short term, a proposed final rule should be issued to expedite the introduction of AML obligations for "persons involved in real estate closings and settlements." • Prepare an advance notice of proposed rulemaking in the near future in relation to the TCSP sector to extend both the AML Program and CIP requirements to this sector.
4.2 Suspicious transaction reporting (R.16)	• Remove the threshold on the SAR reporting obligation for casinos. • Extend the obligation to report suspicious transactions to the other DNFBP sectors. • Accountants, lawyers, real estate agents and TCSP should be made subject to the "tipping off" provision and should be protected from liability when they choose to file a suspicious transaction report. • Accountants, lawyers, real estate agents and TCSP should also be required to implement adequate internal controls (i.e. AML Programs). • Continued work is needed to ensure that dealers in precious metals and stones are aware of their obligation to establish AML Programs and are implementing them effectively. • The U.S. should obligate accountants, lawyers, real estate agents and TCSPs to give special attention to the country advisories that FinCEN has issued and which urge enhanced scrutiny of financial transactions with countries that have deficient AML controls.
4.3 Regulation, supervision and monitoring (R.24-25)	• Accountants, lawyers, real estate agents and TCSPs should be made subject to AML/CFT obligations and appropriate regulatory oversight. • In the case of TCSPs a registration process should be introduced for agents engaged in the business of providing company formation and related services (perhaps with a de minimis threshold to ensure that single company agents are not required to register). • The regulatory regime applied to the casino sector generally appears to be working effectively. However, the work to further harmonize Nevada's regulatory requirements with the BSA should continue as rapidly as possible.

4.4 Other non-financial businesses and professions (R.20)	• Consideration of extending BSA requirements to other sectors should proceed as quickly as possible.
5. Legal Persons and Arrangements & Non-Profit Organizations	
5.1 Legal Persons – Access to beneficial ownership and control information (R.33)	• Undertake a comprehensive review to determine ways in which adequate and accurate information on beneficial ownership may be available on a timely basis to law enforcement authorities for companies which do not offer securities to the public or whose securities are not listed on a recognized U.S. stock exchange. It is important that this information be available across all states as uniformly as possible. It is further recommended that the federal government seek to work with the states to devise procedures which should be adopted by all individual states to avoid the risk of arbitrage between jurisdictions. As the January 2006 threat assessment indicates, the U.S. authorities are well aware of the problems created by company formation arrangements, and have formulated an initial program to try to address the issue. This should be pursued in a shorter timescale than seems to be envisaged at present. In particular, the proposal to bring company formation agents within the BSA framework, and to require them to implement AML Programs and CIP procedures should be taken forward in the very near future.
5.2 Legal Arrangements – Access to beneficial ownership and control information (R.34)	• Implement measures to ensure that adequate, accurate and timely information is available to law enforcement authorities concerning the beneficial ownership and control of trusts.
5.3 Non-profit organizations (SR.VIII)	• Continue to devote resources to preventing the abuse of this sector from terrorist organizations, including ensuring the effective flow of information between competent authorities.
6. National and International Co-operation	
6.1 National co-operation and coordination (R.31)	• Continue to work towards closing the gap that still seems to remain between the policy level and the factual operational law enforcement work. • Consider expanding the HIFCA and HIDTA model, provided that it is appropriately resourced and developed • Law enforcement agencies should take more refined coordination at the operational level, perhaps in the context of the Treasury's recent government-wide analysis on money laundering. Such a study should not lead to the creation of new entities, but rather initiate a discussion on the basic law enforcement framework in a system as complex as that in the U.S.
6.2 The Conventions and UN Special Resolutions (R.35 & SR.I)	• Review the money laundering offenses to ensure all conduct required to be criminalized by the Vienna and Palermo Conventions is covered. • Include "participation in an organized criminal group" as a foreign predicate offense as required by Article 6(2)(c) of the Palermo Convention. • Transpose all S/RES/1267(1999) designations in the OFAC list.
6.3 Mutual Legal Assistance (R.36-38 & SR.V)	• A formal legal basis should be provided to allow for equivalent value seizure upon a foreign request. • Extend the list of domestic and foreign predicate offenses to all 20 designated categories.
6.4 Extradition (R.39, 37 & SR.V)	• Extend the list of domestic and foreign predicate offenses to all 20 designated categories. • Ensure that older, list based extradition treaties that were concluded before the introduction of money laundering and terrorism financing offenses in the respective legislations and that have not been supplemented since do not pose an obstacle to extradition. • Consider allowing extradition according to the principles of the UN TF Convention on an ad hoc and unilateral basis.

6.5 Other Forms of Co-operation (R.40 & SR.V)	• FinCEN should improve the quality of its analytical research reports so that they contain a more practical and deeper level of analysis tailored to the specific investigative needs of the requesting FIU.
7. Other Issues	
7.1 Resources and statistics (R. 30 & 32)	• Ensure that the IRS is adequately resourced to effectively supervise all of the entities that it is responsible for. • Ensure that all of the statistics required by R.32 are collected and maintained. • The statistics held in respect of terrorism and terrorist financing should also focus on the confiscation aspect. • Statistics relating to supervisory actions are not comprehensive. In particular, there are no statistics that measure the supervisory actions that has been taken specifically in relation to the AML/CFT obligations in the MSB sector.

U.S. Money Laundering

Permanent Subcommittee on Investigations

EXHIBIT #4

MONEY LAUNDERING THREAT ASSESSMENT

WORKING GROUP

Department of the Treasury

Office of Terrorism and Financial Intelligence (TFI)

- Office of Terrorist Financing & Financial Crime (TFFC)
- Financial Crimes Enforcement Network (FinCEN)
- Office of Intelligence and Analysis (OIA)
- Office of Foreign Assets Control (OFAC)
- Executive Office for Asset Forfeiture (TEOAF)

Internal Revenue Service (IRS)

- Criminal Investigation (CI)
- Small Business/Self Employed Division (SB/SE)

Department of Justice

Federal Bureau of Investigation (FBI)

Drug Enforcement Administration (DEA)

Criminal Division

- Asset Forfeiture Money Laundering Section (AFMLS)

National Drug Intelligence Center (NDIC)

Organized Crime Drug Enforcement Task Force (OCDETF)

Department of Homeland Security

Immigration and Customs Enforcement (ICE)

Customs and Border Protection (CBP)

Board of Governors of the Federal Reserve System

United States Postal Service (USPS)

United States Postal Inspection Service (USPIS)

U. S. Money Laundering Threat Assessment
December 2005

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Chapter 8
SHELL COMPANIES AND TRUSTS

Legal jurisdictions, whether states within the United States or entities elsewhere, that offer strict secrecy laws, lax regulatory and supervisory regimes, and corporate registries that safeguard anonymity are obvious targets for money launderers. A handful of U.S. states offer company registrations with cloaking features – such as minimal information requirements and limited oversight – that rival those offered by offshore financial centers. Delaware, Nevada, and Wyoming are often cited as the most accommodating jurisdictions in the United States for the organization of these legal entities.

The use of bearer shares, nominee shareholders, and nominee directors function to mask ownership in a corporate entity. While these mechanisms were devised to serve legitimate purposes, they can also be used by money launderers to evade scrutiny.

In general, shell companies have no physical presence other than a mailing address, employ no one, and produce nothing. One controversial but legitimate function for shell companies is to serve as a holding company for intellectual property rights. When franchisees or licensees are billed for their use of intellectual property, such as a brand name or trademark, earnings are shifted to the location of the holding company which affects where earnings are recognized and taxes are paid.

Intermediaries, called nominee incorporation services (NIS), establish U.S. shell companies and bank accounts on behalf of foreign clients. NIS may be located in the United States or off-shore. Corporate lawyers in the United States often use NIS to organize companies on behalf of their domestic and foreign clients because such services can efficiently organize legal entities in any state. NIS must comply with applicable state and federal procedures as well as any specific bank requirements. Those laws and procedures dictate what information NIS must share about the owners of a legal entity. Money launderers have also utilized NIS to hide their identities. By hiring a firm to serve as an intermediary between themselves and the licensing jurisdiction and the bank, a company's beneficial owners may avoid disclosing their identities in state corporate filings and in the documentation used to open corporate bank accounts.

Several mechanisms operate to provide corporate entities with additional anonymity. Bearer shares are negotiable instruments that accord ownership of a company to the person who possesses the share certificate. Such share certificates do not contain the name of the shareholder and are not registered, with the possible exception of their serial numbers. Accordingly, these shares provide for a high level of anonymity and are easily negotiable.

Nominee shareholders can also be used in privately-held companies to shield beneficial ownership information. The allowance of nominee shareholders undermines the usefulness of the shareholder register or the shareholder list because the shareholder of record may not be the ultimate beneficial owner. Similarly, nominee directors and companies serving as directors of a legal entity may conceal the identity of those persons controlling the company.

Trusts separate legal ownership from beneficial ownership and are useful when assets are given to minors or individuals who are incapacitated. The trust creator, or settlor, transfers legal ownership of the assets to a trustee, which can be an individual or a corporation. The trustee fiduciary manages the assets on behalf of the beneficiary based on the terms of the trust deed.

Although trusts have many legitimate applications, they can also be misused for illicit purposes. Trusts enjoy a greater degree of privacy and autonomy than other corporate vehicles, as virtually all jurisdictions recognizing trusts do not require registration or central registries and there are few authorities charged with overseeing trusts. In most jurisdictions, no disclosure of the identity of the beneficiary or the settlor is made to authorities. Accordingly, trusts can conceal the identity of the beneficial owner of assets and, as will be discussed below, can be abused for money laundering purposes, particularly in the layering and integration stages.

Vulnerabilities

Legal entities such as shell companies and trusts are used globally for legitimate business purposes, but because of their ability to hide ownership and mask financial details they have become popular tools for money launderers.

The use of these legal structures for money laundering is well-established. The United Nations noted in a 1998 report that "the principal forms of abuse of secrecy have shifted from individual bank accounts to corporate bank accounts and then to trust and other corporate forms that can be purchased readily without even the modest initial and ongoing due diligence that is exercised in the banking sector."[123]

The competition among certain states to attract legal entities to their jurisdictions has created a "race to the bottom," and a real money laundering threat. (See Figure 5) While they are often used for legitimate purposes, bearer shares, nominee shareholders, and trusts also provide money launderers with the tools to hide their identity from financial institutions and law enforcement.

As an example, a Delaware-registered company may be owned by a national of any jurisdiction, regardless of his or her place of residence. The company can be operated and managed worldwide, and is not required to report any assets. Eastern European and Russian law enforcement agencies have expressed concern that regional criminal organizations were abusing Delaware shell companies for money laundering.[124] And German prosecutors have reportedly complained that the secrecy inherent in Delaware's regime for legal entities has hindered investigations into suspicious financial activity.[125] But, Delaware is not the most permissive jurisdiction in the United States with regard to company formation. Both Nevada and Wyoming permit companies to have bearer shares and nominee shareholders, which Delaware does not.

The FBI has found that certain NIS form corporate entities, open full-service bank accounts for those entities, and act as the registered agent to accept service of legal process on behalf of those entities in a jurisdiction in which the entities have no physical presence. An NIS can accomplish this without ever having to identify beneficial ownership on company formation, registration, or bank account documents. The FBI believes that U.S. shell companies and bank accounts arranged by certain NIS firms are being used to launder as much as $36 billion a year from the former Soviet Union. It is not clear whether these NIS firms are complicit in the money laundering abuse.

Several international NIS firms have formed partnerships or marketing alliances with U.S. banks to offer financial services such as Internet banking and wire transfer capabilities to shell companies and non-U.S. citizens. The FBI reports that the U.S. banks participating in these marketing alliances open accounts through intermediaries without requiring the actual account holder's physical presence, accepting by mail copies of passport photos, utility bills, and other identifying information.[126]

FinCEN reports that 397 SARs were filed between April 1996[127] and January 2004 involving shell companies, Eastern European countries,[128] and the use of correspondent bank accounts.[129] The aggregate violation amount reported in those 397 SARs totaled almost $4 billion.

The State of New York Banking Department recently noted that Suspicious Activity Reports filed by New York banks indicate an increase in the volume of shell company wire transfer activity through high-risk correspondent bank accounts, both in terms of dollar amounts and the number of transactions.[130] These reports indicate that money is passing through correspondent accounts

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[123] Un□
Accessed at: http://www.cf.ac.uk/socsi/whoswho/levi-laundering.pdf.
[124] Simpson, Glenn R., Laundering Queries Focus on Delaware, Wall Street Journal, Sept. 30, 2004.
[125] Crawford, David, German Officials Fault U.S. on Money-Laundering Woes, Wall Street Journal, June 18, 2003.
[126] In add□
maintain a physical presence in any country – that are never licensed with a regulatory authority. Such shell banks customarily attempt to pass themselves off as operating brick-and-mortar banks and gain access to the U.S. banking system through "nested" correspondent accounts. *See supra* Chapter 2, "Banking," for more information.
[127] The date financial institutions were mandated to file Suspicious Activity Reports
[128] The eastern European countries that were identified in Suspicious Activity Report narratives with shell companies included Armenia, Belarus, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Greece, Kazakhstan, Latvia, Lithuania, Moldova, Poland, Romania, Russia, Slovenia, Turkey, Turkmenistan, Ukraine, Uzbekistan, and Yugoslavia.
[129] During this time period a total of approximately 1.5 million SARs were filed.
[130] Financial Crimes Enforcement Network, Suspicious Activity Review, Issue 7, August 2004.

established for Eastern European banks.

Trusts often constitute the final layer of anonymity for those seeking to conceal their identity. Recent changes in the trust laws of some jurisdictions have aided money launderers in their use of trusts to conceal identity and to perpetrate fraud. In certain jurisdictions, such as the Cook Islands, Nevis, and Niue, the trust laws no longer require the names of the settlor and the beneficiaries to be placed in the trust deed, permit settlors to retain control over the trust, and allow trusts to be revocable and of unlimited duration. In addition, the amended trust laws typically permit the trust deed to include a "flee clause," a provision triggered by the occurrence of certain events that directs the assets of the trust to be moved to another jurisdiction and new trustees to be appointed.

Regulation and Public Policy

Trust companies are defined as "financial institutions" under the Bank Secrecy Act. Shell companies are not specifically listed in the BSA, but could be regulated under the BSA under one of the two catch-all provisions of 31 USC 5312(a), given an appropriate record.

A Side by Side Comparison of Wyoming and Nevada and Delaware

Figure 2

Benefits	Nevada	Wyoming	Delaware
Minimal annual fees		✗	
One-person company is allowed	✗	✗	✗
Stockholders are not revealed to the State	✗	✗	✗
No annual report is required until the anniversary of the incorporation date		✗	
Unlimited stock is allowed, of any par value		✗	✗
Bearer stock can be used	✗	✗	
Nominee shareholders are allowed	✗	✗	
Share certificates are not required		✗	
Minimal initial filing fees		✗	
No minimum capital requirements	✗	✗	✗
Meetings may be held anywhere	✗	✗	✗
Officers, directors, employees and agents are statutorily indemnified	✗	✗	
Continuance procedure (allows Wyoming to adopt a company formed in another state)		✗	
Doesn't collect corporate income tax information to share with the IRS	✗	✗	

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Financial Crimes Enforcement Network

The Role of Domestic Shell Companies in Financial Crime and Money Laundering:

Limited Liability Companies

November 2006

Permanent Subcommittee on Investigations
EXHIBIT #5

Department of the Treasury
Financial Crimes Enforcement Network

The Role of Domestic Shell Companies in Financial Crime and Money Laundering: Limited Liability Companies

► Executive Summary and Key Findings

By virtue of the ease of formation and the absence of ownership disclosure requirements, shell companies – generally defined as business entities without active business or significant assets – are an attractive vehicle for those seeking to launder money or conduct illicit activity. While business entities generally, and shell companies specifically, have legitimate commercial uses, this lack of transparency in the formation process poses vulnerabilities both domestically and internationally.

The advantages of using these business entities for legitimate business purposes are in some senses outweighed by the potential for abuse presented by some entities, and by the risks to and potential deleterious effects on the financial system that result from lack of transparency regarding beneficial ownership.

Although the focus of this paper is on limited liability companies, other business entities, including trusts, business trusts, and corporations, are also vulnerable to abuse. The intent is to demonstrate the nature of the vulnerabilities that limited liability companies present, provide examples of known abuses, and present some specific steps which can be taken to reduce the risk to the financial system while preserving the advantages of limited liability companies for legitimate business use.

It is anticipated that attention will be given in the future to studying other business entities which are subject to abuse and illicit use as shell companies or to otherwise mask ownership for illicit purposes.

This report does not attempt to address tax policy issues regarding shell companies. The vulnerabilities addressed are those that relate to the use of shell companies to facilitate money laundering and financial crime in general.

Key findings

The following key findings demonstrate the vulnerability of shell companies to misuse, and the imperative to formulate appropriate responses to address the issue.

- Domestic shell companies (LLCs and other varieties) have some legitimate and legal uses, but the ability to abuse such vehicles for illicit activity must be continually monitored.
- Domestic shell companies can be and have been used as vehicles for common financial crime schemes such as credit card bust outs, purchasing fraud, and fraudulent loans.
- The use of domestic shell companies as parties in international wire transfers allows for the movement of billions of dollars internationally by unknown beneficial owners. This could facilitate money laundering or terrorist financing.
- Company formation agents and similar service providers play a central role in the creation and ongoing maintenance and support of domestic shell companies, some of which appear to be used for illicit purposes domestically and abroad.
- Based on our research, states do not appear to impose effective accountability safeguards on company formation agents and similar service providers to ensure that the business entities they create, buy, sell, and support are not violating state laws

specifying that the companies be used only for lawful and allowable purposes.[1]

- There is currently no requirement that these service providers report suspicious activity involving the shell companies they have created, bought, sold, or supported, nor are there requirements or procedures to identify beneficial owners in certain jurisdictions if illicit activity is suspected.

- Certain domestic jurisdictions, especially when serviced by corrupt or unwitting service providers, are particularly appealing for the creation of shell companies to be used for illicit purposes.

- The LLC, particularly when organized in a state which does not require reporting of information on ownership,[2] provides an attractive vehicle for a shell company because it can be owned or managed anonymously and is inherently vulnerable to abuse.

Steps Forward

FinCEN is undertaking three key initiatives to deal with the issues addressed in this report and to mitigate risks posed by shell companies:

1. Concurrent with this report, FinCEN is issuing an advisory to financial institutions highlighting indicators of money laundering and other financial crime involving shell companies, and reminding financial institutions of the importance of identifying, assessing, and managing potential risks associated with providing financial services to such entities.

2. FinCEN is continuing its outreach efforts and communication with state governments and trade groups for corporate service providers to discuss identified vulnerabilities, and to explore ways to address vulnerabilities in the state incorporation process, particularly with respect to the lack of public disclosure and transparency regarding beneficial ownership of shell companies and similar entities.

3. FinCEN is continuing to collect information and studying how best to address the role of certain businesses specializing in the formation of business entities in its effort to reduce money laundering and related vulnerabilities in the financial system through the promotion of greater transparency.

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[1] A few states – most notably Delaware — impose "standards of conduct" on persons serving as "registered agents." For example, the Court of Chancery in Delaware can enjoin a person from serving as a "registered agent" if the person has engaged in criminal conduct or in conduct that is likely to deceive or defraud the public. Service as a "registered agent" forms only part of the services that company formation agents and similar service providers often offer their clients. Moreover, a business entity need not organize or conduct activities in Delaware or any other state that imposes "standards of conduct."

[2] Although some states require the reporting of information on ownership, no state requires the reporting of information on beneficial ownership. An individual may own an LLC indirectly, through nominees and other business entities. The Securities and Exchange Commission (SEC) addresses the potential through the concept of beneficial ownership, which the SEC defines as holding the rights of ownership "directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise." The concept of beneficial ownership would require an LLC – when reporting information – to "look through" nominees and business entities.

▶ Uses and Abuses of Domestic Shell Companies

The term "shell company" generally refers to limited liability companies and other business entities with no significant assets or ongoing business activities. Shell companies – formed for both legitimate and illicit purposes – typically have no physical presence other than a mailing address, employ no one, and produce little to no independent economic value. Shell companies are often formed by individuals and businesses to conduct legitimate transactions, such as domestic and cross-border currency and asset transfers, or to facilitate corporate mergers and reorganizations.

Shell companies can be publicly traded or privately held. Although publicly traded shell companies can be used for illicit purposes, the vulnerability of the shell company is greatly compounded when it is privately held and beneficial ownership can more easily be obscured or hidden. Lack of transparency of beneficial ownership can be a desirable characteristic for some legitimate uses of shell companies, but it is also a serious vulnerability that can make some shell companies ideal vehicles for money laundering and other illicit financial activity.

One of the common uses for a shell company is in the *reverse acquisition*.[3] The procedure will often involve a simple acquisition of a shell company, with shares of a private company used as consideration. The shell company, which at one point may have been an active company publicly traded on a stock exchange, issues shares to the shareholders of a private company sufficient to give those shareholders a majority interest in the shell company, thereby effectively taking the private company public without the usual costs associated with an initial public offering, and giving shareholders of the private company control over the shell company. It should be noted that the shell company in the reverse acquisition is often a formerly active company, not one created solely to be a shell.

[3] Also known as a *reverse merger or takeover*.

The reverse acquisition process has in the past been subject to abuse. For example, if the expected value of the private company is fraudulently exaggerated, investors buying into the company may lose a considerable percentage of their investments when the company turns out to be worth much less. Those who fraudulently promoted the company have at that point already sold their stock and made a handsome profit. These "pump and dump" schemes often involve shell companies with low market capitalization whose stock trades at pennies per share on the "pink sheets" (www.pinksheets.com), OTC Bulletin Board, or other over-the-counter trading and information systems. One indicator of this scheme is concentrated trading in normally thinly traded stocks. Ralph A. Lambiase, former president of the North American Securities Administrators Association (NASAA) and director of the Connecticut Division of Securities, noted in 2004 the existence of "a steady stream of fraud and misconduct in the distribution and manipulation of shares of shell companies and the companies that combine with shell companies."[4]

Some steps have been taken to prevent this type of abuse. For example, the SEC adopted rules on June 29, 2005 designed to protect investors in the securities markets from fraud and abuse involving the use of shell companies, while allowing the use of shell companies for legitimate corporate structuring purposes.[5] The SEC's rules are disclosure-oriented

Shell Company Domestic Abuses

Pump and dump	Over invoicing
Credit card bust out	False invoicing
Fraud	

[4] "NASAA Wants All Merged Shell Companies to Provide Full Disclosure, Transparency," *M2 Financial Wire*, 06/28/2004.
[5] SEC Release Nos. 33-8587; 34-52038; International Series Release No. 1293; File No. S7-19-04, "Use of Form S-8, Form 8-K, and Form 20-F By Shell Companies," 70 FR 42233 (July 15, 2005).

and require the public reporting of information that would then be accessible through the Electronic Data Gathering, Analysis, and Retrieval system (EDGAR). The SEC acknowledged in its rulemaking that companies and their professional advisors often use shell companies for many legitimate corporate structuring purposes, such as certain change of domicile or business combination transactions.

Shell companies may play a role in common financial crime schemes such as the credit card bust-out, whereby credit is built up on cards using false identities, then phony transactions with cooperating businesses or shell companies are made and the phony charges are received as payments from the unsuspecting credit card companies. Referring to a case involving a foreign national who is suspected of providing bust-out proceeds to terror groups, FBI Intelligence Analyst Joseph Enright said, "one of the co-conspirators in the bust-out case linked to the New York case had an American identity under one name, with which he incorporated shell businesses and obtained checking accounts, and a completely different 'new name' under which he obtained a passport from his native country."[6] Additionally, the complicit businesses may change names, director names, and addresses on official documents to throw investigators off the track.

A technique commonly seen by corporate accountants involves an employee over-invoicing or creating false invoices and pocketing the difference. The director of a nutritional supplement company was convicted of money laundering in 2004. He had set up a shell company and was paying false invoices for the purchase of nutritional supplements. In addition, he received kickback payments from another nutritional supplement company in exchange for purchasing their products. His company was established by a service provider that also provided mail and phone forwarding for the shell company.[7]

The latter example indicates that the individuals or companies that create shell companies may play a significant role even after the shell is created and sold. In fact, a convenient and popular service combines formation with ongoing support.

One Delaware-based service provider provides formation services as well as mail forwarding services, telephone lines, e-mail accounts, and accounting services to file tax returns. A number of suspected shell companies created by this firm appear in Suspicious Activity Reports.

Forming and supporting small companies is neither difficult nor expensive, and requires no special skill other than understanding the laws in the various states. The majority of shell companies sold to foreign interests appear to differ significantly from those used in reverse acquisitions, for example, in that they appear to have been set up solely for purchase and were not "aged" or put on the shelf after some period of actual operation (though they, too, may not be used immediately). This type of shell appears to have few legitimate uses, and can fairly easily be employed to disguise ownership or movement of assets or to facilitate illicit activity.

A report by the U.S. General Accounting Office (now the Government Accountability Office) in 2000 provided information on another service provider whose business provided approximately 2,000 shell companies to clients based in Moscow, Russia. The report did not uncover the purpose of these companies, but did describe some interesting aspects of a phenomenon that appears to be continuing today on a large scale – the use of domestic shell companies to hide the ownership and purpose of billions of dollars in international wire transfers. This phenomenon has been drawing increasing attention both domestically and abroad due to the large amounts of money involved and the secretive nature of the companies and their transactions. The Financial Crimes Enforcement Network has previously examined the use of domestic shell companies in these transactions and has provided input to the Financial Action Task Force (FATF).

► Advertised Services for Shell Companies

Internet searches reveal that numerous service providers advertise services for shell companies, such as resident agent and mail forwarding services. Shell companies may also purchase corporate office service packages in order to establish a more significant local presence. Advertised prices for these packages, which often include a state business license, a local street address and an office that is staffed during business hours, a local telephone listing with a live receptionist, and 24-hour

[6] "Are bust-out schemes financing terror?," *Vision*, FBI New York, 04/07/2005.

[7] "Information issued by U.S. Attorney's Office for the Northern District of Texas on March 11: Former director of sports nutrition at Texas Tech University sentenced to 33 months in federal prison," *US Fed News*, 03/11/2005.

personalized voicemail, range from $900 to $1950 per year in the research sampling. In addition, service providers may offer assistance in opening local and foreign bank accounts for the shell company. For example, in the GAO report cited earlier, it was revealed that two service providers created 236 accounts at two U.S. banks which were the recipients of about $1.4 billion in wire transfers.

Service providers may also sell aged "shelf companies." Prices for these companies vary depending on the year and state of organization (older companies commanding higher prices), as well as factors such as whether the shelf company has an employee identification number (EIN), received a Paydex score, filed non-activity tax returns, previously had a bank account, or currently maintains a bank account. Advertisements by some service providers contend that the main advantage for purchasing a shelf company is to provide the appearance of longevity to the business, particularly for the purpose of meeting minimum age requirements when obtaining leases, credit, and bank loans.

In order to preserve a client's anonymity, some service providers promote a variety of nominee services including:

- **Nominee EIN**: Shell companies may obtain an EIN without providing the client's EIN on the application.
- **Nominee officers and directors**: Service providers may set up nominees for those offices in the shell company that appear on the public record in order to eliminate the client's name from secretary of state records. In addition, a client can retain ownership and operational control through confidential stock ownership or appointment to offices that do not appear on the public record (*e.g.*, vice president).
- **Nominee stockholders**: The client may use nominee stockholders to create an additional layer of privacy while maintaining control through an irrevocable proxy agreement.
- **Nominee bank signatory**: A nominee appointed as the company accountant accepts instructions from the client.

► Limited Liability Companies

Though there are other types of business entity available, a very common type formed and operated as a shell company is the limited liability company (LLC). In fact, the LLC makes an attractive vehicle for a shell company. Some LLCs can be owned or managed anonymously, and are therefore inherently vulnerable to abuse. Virtually anyone can own or manage an LLC, including foreign persons and other business entities. A *member* of an LLC is equivalent to a shareholder in a corporation. A *manager*, on the other hand, is equivalent to an executive officer or a member of the board of directors. An LLC may lack managers, in which case the members would manage the LLC. Some states do not require the names or addresses of members or managers. In some cases, only the names of managers and not members (owners) are reported.

According to the International Association of Commercial Administrators (IACA), an organization that solicits annual reporting from the states, of the states reporting, there were more than 4.9 million LLCs active or in good standing at the end of 2005 (See Figure 1).[8]

[8] Referenced figures and tables are located at the end of the report.

LLCs

Limited liability companies first became widely available in the U.S. in the early 1990s. The German version (GmbH, or *Gesellschaft mit beschränkter Haftung*) has been in existence since the late 1800s. The LLC is a hybrid form of business entity that can protect the owners effectively in the case of legal action. Like a corporation the LLC structure removes the members and managers from liability, and, like a partnership, it provides certain tax benefits. It is considered a "pass-through" arrangement because the individuals are taxed rather than the company (unless the company elects to be taxed as a corporation.). An LLC is easier to set up than a corporation and LLCs are subject to relatively few procedural requirements relating to the governance of the business entity.

As reported to IACA, the following five states had the most LLCs active or in good standing in 2005 (AK, IN, NM, PA, and WY did not report this statistic):

State	LLCs Active or in Good Standing (2005)
Delaware	333,565
California	325,738
Florida	293,845
New York	275,503
Michigan	274,940

Out of 35 states reporting (Michigan and Florida, among others, did not report this statistic), the top five states for revenue collected from LLC initial filings in 2005 were:

State	Revenue Collected in 2005 (initial filings)
Illinois	$13,639,250
Texas	$12,021,100
New York	$11,281,600
Delaware	$8,779,200
Massachusetts	$7,184,000

California was ninth with $4,901,680 collected. See Figure 2 for an example from Nevada of the various fees which contribute to the revenue generated by LLCs.

Illinois reported 138,256 LLCs active or in good standing in 2005. All of the above figures include both domestic and foreign LLCs. States use the term *domestic* to refer to business entities formed in their state. A *foreign* business entity is considered one formed in a state or jurisdiction other than the one to which it is applying for registration. A foreign LLC must file with the state in order to "do business" in that state. It is important to understand that companies owned by out-of-state or foreign persons or entities are formed as domestic LLCs unless they were originally formed in another jurisdiction. Therefore, newly created shell companies owned by such persons or entities will often fall into the domestic classification.

Reporting to IACA shows an increase for most states in the number of new LLC filings in the last five years (see Figure 3), with Florida posting the greatest percentage increase – 410.67% – from 2001 to 2005. Pennsylvania is next with 215.08%. For 2005, IACA reports show that Florida was the leader for new domestic LLCs (123,437 compared to the next highest by Delaware at 87,360) and the leader in total LLCs formed between 2001 and 2005 – 357,239. California was the leader in registration of foreign LLCs in 2005 (10,593 reported, compared to the next highest by Florida at 7,121).

► The Vulnerability of Certain States based on their Laws

Figures 4 through 8 illustrate the trends in LLC formation in four states – Delaware, Nevada, Oregon, and Wyoming – that are representative of those that have formation and reporting requirements which may be attractive to those persons seeking to hide illicit activity within the framework of shell companies. It is important to note that these same requirements also attract legitimate business activity. A comparative discussion of the formation of limited liability companies in these and other states follows.

► Limited Liability Company Requirements

Limited liability companies in Delaware, Nevada, Oregon, and Wyoming may be formed by one or more persons. See Table 1 for a comparison of the four states' initial formation requirements and fees. The certificate of formation required to form LLCs in these states must include the name of the LLC and the name and address of the registered agent and registered office. See Figure 9, Delaware's Certificate of Formation, for an example.

A critical element in the formation of a shell company to be used for illicit purposes is the lack of transparency regarding ownership. States whose laws do not require LLCs to report the identities of members or managers will be most attractive to persons seeking to form a shell company for illicit purposes. (However, even a requirement to identify a member or manager can be thwarted through the use of nominees or fictitious identities.)

The categories that follow are based on degrees of transparency assigned on the basis of FinCEN's preliminary understanding of each state's reporting requirements. The states in the first category offer the least transparency. All limited liability companies organized or "doing business" in a state must file one or more of the following documents – articles or a certificate of formation or organization, periodic reports, and an application for registration as a foreign entity. We have placed states in categories based on whether a limited liability company must report information in at least one of these documents. In addition, we have placed states in categories based on whether the limited liability company must report information on at least one person – and not all of them. To illustrate, if a state requires a limited liability company to report in a certificate of formation the identity of only one member and only one manager – and requires reporting of the information in no other document -- then the state will have been placed in the last category.

The statutes of a few states include language requiring the execution or signing of a document by a person whose identity the limited liability company need not report in the body of the document itself. For example, a statute may impose no requirement to report the identities of either members or managers. The statute may nevertheless indicate that "a member or manager must sign documents filed with the Secretary of State." Since the language is intended to ensure that the filing of a document is duly authorized – and not to ensure that the limited liability company includes information on members or managers – the language has no effect on the category in which the state would fall.

Fourteen states impose no requirement to report the identities of either members or managers. These states are listed below:

Arkansas	Mississippi
Colorado	Missouri
Delaware	New York
Indiana	Ohio
Iowa	Oklahoma
Maryland	Pennsylvania
Michigan	Virginia

Eight states and the District of Columbia require a limited liability company to report the identities of managers only. These jurisdictions do not require a limited liability company to report the identities of members, even when the limited liability company has no managers:

Massachusetts	Tennessee
North Carolina	Vermont
Rhode Island	Wisconsin
South Carolina	District of Columbia
South Dakota	

Twenty-four states require a limited liability company to report the identities of members, but only when the limited liability company lacks managers. These states are listed below:

California	Nebraska
Connecticut	Nevada
Florida	New Hampshire
Georgia	New Jersey
Hawaii	New Mexico
Idaho	North Dakota
Illinois	Oregon
Kentucky	Texas
Louisiana	Utah
Maine	Washington
Minnesota	West Virginia
Montana	Wyoming

The following four states are the only ones that require a limited liability company to report the identities of members regardless of the existence or number of managers:

Alabama	Arizona
Alaska	Kansas

Therefore, 47 jurisdictions in the U.S. exist in which ownership of an LLC may legally remain unreported, depending on how the LLC is structured. (And, as noted above, the conclusion does not address the potential for concealing identity through the use of nominees or similar mechanisms.)

The 14 states that impose no requirement to report the identities of either members or managers provide the least transparency. The following table identifies their ranking in terms of number of new LLCs formed in 2005 and the percentage increase (if available) from 2001 to 2005 according to reporting to IACA (also see Figure 3):

States with Lesser Transparency	Rank (of 47 reporting): New LLCs - 2005	% Increase in New LLCs 2001-2005
Delaware	2	102.13%
New York	5	111.87%
Michigan	8	86.28%
Colorado	9	133.37%
Ohio	11	92.77%
Virginia	13	136.08%
Maryland	15	106.81%
Missouri	16	N/A
Pennsylvania	19	215.08%
Oklahoma	30	N/A
Mississippi	32	N/A
Arkansas	35	107.29%
Iowa	37	109.20%
Indiana	N/A	N/A

Similarly, taking the average increase for each of the four groups of states yields the following comparison:

Comparison of states	
Level of Transparency (Least to Most)	**% Increase in New LLCs 2001-2005**
No Reporting of Managers or Members	120.09%
Reporting of Managers Only	112.00%
Reporting of Members When an LLC Lacks Managers	146.68%
Reporting of Managers and Members	138.75%
Average of all states reporting:	133.37%

- The average increase in new LLCs from 2001 to 2005 for the states with the least transparency was 120.09%.
- The states that provide the next level of transparency averaged a 112.00% increase from 2001 to 2005.
- The states that require information on members only when an LLC lacks managers had an average increase of 146.68%.
- The four states that provide the greatest level of transparency averaged an increase of 138.75%.
- The average increase in number of LLCs (2001-2005) for all states reporting to IACA was 133.37%.

In terms of percentage increase in new LLC filings there appears to be no definitive correlation between level of transparency and preference of a state for LLC formation. States with more transparency have exhibited slightly higher growth on average than states with less transparency, but there is much variation within each category. Other factors appear to account for the relative popularity of certain states over others.

Of the four states which are often recognized as being particularly appealing for the formation of shell companies (Oregon, Wyoming, Nevada, and Delaware)[9], only Delaware falls in the group offering the least transparency. The other three states fall in the group offering a moderate level of transparency.

A preliminary conclusion based on the above information suggests that having all states require LLCs to report the identities of members and managers would not significantly affect the number of LLCs formed or the relative balance among states. Therefore, it appears that the vulnerabilities of the states which provide less transparency could be reduced through requiring greater transparency without a major effect on revenue generated for those states. In contrast, the ensuing benefits to law enforcement and regulatory entities of greater transparency could prove significant.

[9] *See, e.g.*, Money Laundering Threat Assessment Working Group, "U.S. Money Laundering Threat Assessment," (Dec. 2005) at pp.47-50; U.S. Government Accountability Office Report No. GAO-06-376 to the Permanent Subcommittee on Investigations, U.S. Senate, "Company Formations: Minimal Ownership Information is Collected and Available" (April 2006).

Abuse of LLCs

The LLC can be used as a vehicle or tool in a wide range of illicit activity. The potential lack of transparency and ease of formation could make it useful for money laundering and other financial crime. Examples include:

Becs International LLC was a key company in a high profile case which broke in 1999 involving Russian money moved through the Bank of New York and a large network of shell companies.

Capital Consultants, LLC was at the center of an elaborate scheme to defraud benefit plan investors of hundreds of millions of dollars. Investigations started in 1993 and ended with the indictment of 11 individuals, seven of whom pled guilty and one of whom was convicted in a bench trial. Several shell companies were involved, including **Sterling Capital LLC**, **Brooks Financial LLC**, and **Beacon Financial LLC**. In a statement given to the Senate on June 9, 2005, Alan D. Lebowitz, Deputy Assistant Secretary for the Department of Labor's Employee Benefit Security Administration (EBSA) said, "The scheme was of great sophistication and had a veneer of respectability provided by the cooperation of so many professionals including attorneys, accountants, and investment advisors. EBSA's investigation uncovered a complex scheme to defraud investors through the unprecedented use of newly created shell companies, paper transactions, and false reports."

A lawyer in Oregon was sentenced to prison in February 2004 and forced to pay restitution of more than $400,000 for engineering several fraudulent loan schemes. He used a shell company to help defraud five different financial institutions.

Again, other factors may be at work in determining the preference of one state over another for the organization of a shell company. These might include considerations of convenience as well as availability. For illicit purposes, the services and advice of particular service providers may be another key factor.

There are additional issues concerning business activity conducted by LLC shells. While a shell company by definition has little or no assets, it may act as a conduit for the transfer of funds between third parties and members of the company. There are no requirements that the company report activity as a conduit. Many states do not consider the LLC to be "doing business" in the state simply because it maintains an account at a bank in that state. In that case, the LLC need not be registered with the state as a foreign business entity if it is not otherwise active there. Similarly, many states consider "isolated transactions" as falling outside the definition of "doing business" in the state. Therefore, an LLC conducting isolated transactions as a conduit may have no obligation to register as a foreign business entity. The LLC could organize in a state offering the least transparency and conduct activities in a number of other states without reporting the identities of members or managers.

There are additional ways to further obscure ownership and activity. For example, because an LLC can be owned or managed by one or more other business entities – a corporation, a limited partnership, a general partnership, a trust, or even another LLC – layers of ownership can be devised which make it highly unlikely that relations between various individuals and companies can be discerned, even if one or more of the beneficial owners are actually known or discovered. In Delaware and other states, an LLC serving as a member or manager for another LLC is not considered to be "doing business" in the state solely by reason of being a member or manager of the other LLC. An LLC serving as member or manager of another LLC could organize in a state offering the least transparency and conduct activities in a number of other states without reporting the identities of members or managers.

An additional benefit that applies equally to LLCs (or corporations) formed in any state is the air of legitimacy afforded foreign owners in operating a U.S.-based company. Further legitimacy may possibly be obtained by organizing in a state without an international reputation for privacy of ownership.

▶ Suspicious Activity Reporting

Research in the FinCEN Financial Database found 1,002 Suspicious Activity Reports (SARs) filed from 1996 through the beginning of 2005 which identify activity that appears to be related to shell companies. This is a sampling which almost certainly does not contain all of the SARs related to domestic shell company activity. The filing institution may not recognize the involvement of shell companies or may not indicate its suspicions clearly in the SAR. Preliminary analysis of SARs filed since this research was conducted indicates that financial institutions continue to file SARs on shell company activity. Much of the increase in the last several years may be attributable to heightened awareness of shell company "red flags" (see *The SAR Activity Review*, Issue 7, Aug. 2004, p. 7) as well as to agreements entered into by several major banks with their primary federal or state bank regulators to address deficiencies relating to compliance with applicable federal and state anti-money laundering laws, rules, and regulations.

These SARs reveal a wide variety of domestic and offshore financial center activity. Suspected shell company locations include the United States, the Cook Islands, Vanuatu, Bahamas, the United Kingdom, Panama, the Cayman Islands, Nigeria, and Antigua. 932 SARs identify activity involving suspected U.S.-based shell companies. 67 SARs identify activity primarily involving shell companies in typical offshore financial centers with some connection to a U.S. entity or financial institution. (38 of these SARs identify suspected shell banks in foreign locations such as Uruguay, the Cook Islands, St. Lucia, and St. Vincent/Grenadines.) The activities or location of the suspected shell companies in the SARs have some nexus with the United States. Because the SAR filers frequently do not or cannot provide information regarding the location of suspected shell companies (business location, mailing address, address of registered agent), the actual number of U.S.-based shell companies cannot be accurately determined. Many of the SARs identify multiple companies as possible shell companies.

Of the SARs describing recent domestic shell company activity in the United States, there are examples of a suspected Ponzi scheme, pump-and-dump stock fraud, telephone "cramming" by organized crime, possible money laundering by politically exposed persons, and various other suspected frauds and suspicious movements of money, particularly through wire transfers.

Foreign Abuse of U.S. Shell Companies

A review of SAR data on both a macro and micro scale indicates that suspected shell companies incorporated or organized in the United States have moved billions of dollars globally from accounts at banks in foreign countries, particularly those of the former Soviet Union, and predominantly the Russian Federation and Latvia. Most of these companies are LLCs and corporations.

Many of the U.S.-based suspected shell companies were observed to maintain banking relationships with Eastern European financial institutions, particularly in Russia and Latvia. Of the 1,002 SARs identified, 768 involved suspicious international wire transfer activity involving domestic shell companies which follow certain recurring patterns and share common characteristics. These SARs identify what appear to be 1,361 different suspect individuals and business entities, including 329 U.S.-based LLCs, as SAR suspects.[10] In addition, 504 of the SARs identify Russia and 449 identify Latvia as locations of activity in the narrative portion. See Figure 10 for a breakdown of countries frequently associated with activity in these SARs. The aggregate suspected violation amount reported by these SARs is nearly $18 billion.[11]

In contrast to the SARs identifying domestic or typical offshore center activity, these 768 SARs provide even less information on suspects owing to the lack of information provided in wire transfer communications and the anonymity provided by the use of shell companies.

The wire transfers described in many of these SARs originated at accounts in Russia or Latvia held by

[10] The number of truly unique subjects is probably slightly less due to alternate spellings, misspellings, incomplete identification, etc.
[11] As with the other SARs in this sampling, the actual total is somewhat less.

what appear to be U.S. shell companies, passed through the correspondent accounts of major U.S. banks or branches of foreign banks, usually in New York, and then were sent back overseas, often to a wide variety of beneficiaries in many locations. There are many variations of this basic flow. See Figure 11 for a model of the typical flow of funds in this pattern. Reporting of such activity has increased considerably since 1999 – see Figure 12.

Because this type of SAR is only filed if a U.S.-based bank or branch is involved in the wire transfer chain, it is conceivable that banks outside of the United States may be handling similar activity that is not being reported through the U.S. system.

The following elements of suspicious activity in these SARs are cited repeatedly:

- Insufficient or no information available to positively identify originators or beneficiaries of wire transfers (using Internet, commercial database searches, or direct inquiries to a correspondent bank). The lack of identifying information on the transactors is one of the most frequently cited concerns
- U.S. company with Latvian or Russian bank account in U.S. dollars formed in U.S. state that does not require the reporting of information on ownership
- Foreign correspondent bank exceeds its client profile for wire transfers in a given time period or individual company exhibits unusually high amount of activity, sometimes in bursts inconsistent with normal business patterns
- Payments have no stated purpose, do not reference goods or services, or identify only a contract or invoice number
- Goods or services, if identified, do not match profile of company provided by correspondent bank or character of the financial activity; companies reference remarkably dissimilar goods and services in related wire transfers (for example, computers, footwear, steel, meat products, dairy products, sporting goods, lids, auto parts, film extruders, sugar, coolers, pet resins, tissue, furs, mining machinery, maintenance and support, tutoring, marketing); explanation given by foreign correspondent bank is inconsistent with observed wire activity
- Transacting businesses share the same address, provide only a registered agent's address, or other address inconsistencies
- Many or all of the wires are sent in large, round dollar, hundred dollar, or thousand dollar amounts
- Unusually large number and variety of beneficiaries receiving wires from one company
- Frequent involvement of high-risk offshore financial centers, especially as location of beneficiaries; sometimes many jurisdictions involved
- Use of nested correspondent banking situations in Russia or Latvia[12]
- Repeated SAR filings on same suspects (i.e., ongoing activity over a period of months)

Many additional suspect entities (business entities and individuals) are identified by name in the SAR narratives, which often contain what limited originator, beneficiary, and wire reference information may be available to the U.S.-based bank filing the SAR. Because in most cases the filing bank is simply a middle link in the wire transfer chain, there is little information on the originator and beneficiary entities – often just a company name with no other identifying information. Definitive identification of shell companies solely from wire transfer records is therefore rarely possible.

The owners of the companies involved in these transactions are very difficult or impossible to identify. However, it is possible that some identification may be made by correspondent banks, though this information is often considered by the filing institution to be insufficient proof that the transactions are legitimate.

The combination of correspondent banking and domestic shell companies provides an opportunity for foreign or domestic entities or individuals to move money via wire transfers or other methods without disclosing their true identities or the nature or

[12] "Nesting" refers to the use of a foreign bank's correspondent account with a U.S. bank by another foreign bank to gain access to the U.S. banking system.

purpose of the transactions. In effect, the domestic shell company could be a vehicle to launder money, move money derived from crime, or finance terrorist activities and groups, all completely anonymously. SAR information indicates that some U.S. banks have closed their correspondent accounts with foreign banks which did not provide adequate identification of the wire transactors or purpose of the wires.

Requests from Foreign FIUs

Case data suggests that foreign Financial Intelligence Units (FIUs) have an interest in U.S. companies that may be shells. For example, through the first half of 2005, 15% of research requests made to FinCEN from the Latvian FIU, 21% from the Bulgarian FIU, 25% from the Slovakian FIU, 33% from the Russian FIU, and 55% from the Ukrainian FIU identified an LLC as the primary subject.

Because of the lack of ownership information for these companies, U.S. banks holding correspondent accounts for foreign banks will have difficulty corroborating the foreign banks' claims that the foreign correspondent banks know their customers. In addition, law enforcement often is forced to investigate these companies through requests to Financial Intelligence Units (FIUs) in the appropriate countries. Despite these companies being formed in the United States, successful identification and research sometimes may be possible only through requests for investigative efforts overseas.

Various reports provide a further indication of the level of foreign concern about the abuse of U.S. shell companies. A lawsuit filed in Delaware's Chancery Court alleges that the Russian Izmailova "mafia" laundered millions of dollars through U.S. shell companies.[13] The *Wall Street Journal* reported that law enforcement agencies in Russia and 13 other countries made more than 100 requests to obtain subpoenas on Delaware companies in a four-year period ending in September 2004.[14]

[13] "Is Russian mob exploiting Del. law?; Chancery Court lawsuit claims criminals are using 'corporate veil' to launder money," *The News Journal* (Wilmington, DE), 11/26/2004.
[14] "Laundering queries focus on Delaware," *Wall Street Journal*, 09/30/2004.

A possible solution which tackles the problem at its root is to examine the laws and requirements which prevent law enforcement and regulatory authorities from conducting effective investigations into the ownership of business entities. Such steps as requiring company formation agents and similar service providers to obtain and maintain records of beneficial ownership for the companies they service could be considered. The information could then be made available at the request of government authorities under appropriate circumstances. In addition, greater transparency in reporting requirements under state law could reduce the value of business entities as vehicles for illicit activity.

► Steps Forward

FinCEN is undertaking three key initiatives, set forth below, to deal with the issues addressed in this report and to mitigate risks posed by shell companies,.

1. **Issue an advisory to alert financial institutions maintaining accounts for domestic non-publicly traded business entities about the particular risks associated with domestic shell companies.**

To assist U.S. financial institutions in identifying and mitigating potential risks associated with accounts maintained for shell companies, FinCEN is issuing, concurrent with this report, an advisory that highlights some indicators of money laundering and other financial crime involving such entities.

The advisory provides an overview of shell companies and agent and nominee service providers, describe some of the vulnerabilities posed by these business entities and service providers, describes indicators of money laundering, highlights published reports concerning shell companies, and outlines how to manage the risks of providing services to shell companies by reference to the provisions of the Business Entities (Domestic and Foreign) section of the FFIEC BSA/AML Examination Manual, dated July 28, 2006.[15]

[15] http://www.ffiec.gov/pdf/bsa_aml_examination_manual2006.pdf

2. Conduct outreach to state governments and appropriate trade groups.

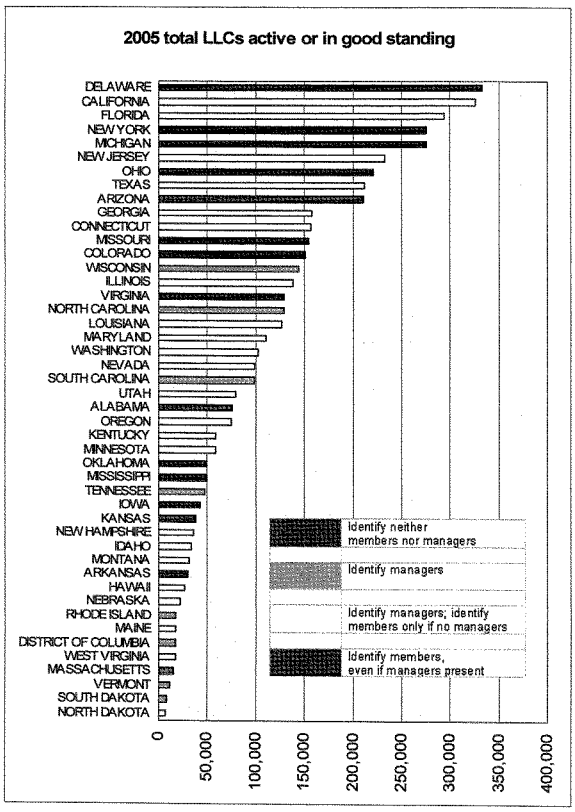
FinCEN continues its outreach to financial institutions, state governments and appropriate trade groups to explore ways to address vulnerabilities in the state incorporation process, particularly with respect to the lack of public disclosure and transparency regarding beneficial ownership of shell companies and similar entities. Positive experiences with Delaware on the issue of bearer shares lead us to believe that some states could be motivated to take prompt steps to remedy weaknesses in their statutory schemes. Other states may be less willing to take those steps.

3. Continue to study what role certain businesses specializing in the formation of business entities may play in addressing existing vulnerabilities.

FinCEN is continuing to collect information and studying how best to address the role of certain businesses specializing in the formation of business entities in its effort to reduce money laundering and related vulnerabilities in the financial system through the promotion of greater transparency.

Given their role in forming and supporting business entities, these service providers – which could include attorneys, trustees, and other intermediaries specializing in the business of providing services relating to the formation and support of business entities – are in a unique position to know and obtain information about beneficial owners, to determine whether these entities are to be used illicitly, and to recognize suspicious activity. They have information that can be critical to law enforcement, regulatory authorities, and other financial institutions in combating the use of shell companies to promote illicit finance. Moreover, they are in the best position – in the first instance – to discourage abuses by reducing the ability of the beneficial owners of these entities to operate anonymously (and, consequently, with relative impunity).

Figure 1



Source of data: International Association of Commercial Administrators (IACA), Annual Report of the Jurisdictions, 2006. AK, IN, NM, PA, and WY did not report this statistic.

Figure 2

DEAN HELLER
Secretary of State
202 North Carson Street
Carson City, Nevada 89701-4201
Phone: (775) 684 5708
Website: secretaryofstate.biz

Limited-Liability Company
Fee Schedule
Effective 10-1-05

LIMITED-LIABILITY COMPANY FEES: Pursuant to NRS 86 for both Domestic and Foreign Limited-Liability Companies.

Articles of Organization	$75.00
Registration of Foreign Limited-Liability Company	$75.00
Reinstatement Fee	$300.00
Certificate of Amendment	$175.00
Restated Articles	$175.00
Certificate of Correction	$175.00
Certificate of Termination (pursuant to NRS 86.226)	$175.00
Merger	$350.00
Termination Pursuant to NRS 92A	$350.00
Dissolution of Domestic Limited-Liability Company	$75.00
Dissolution of Foreign Limited-Liability Company	$75.00
Preclearance of any Document	$125.00
Articles of Conversion – contact office for fee information	
Articles of Domestication – contact office for fee information	
Revival of Limited-Liability Company – contact office for fee information	
24-Hour Expedite fee for above filings	**$125.00**
Change of Resident Agent/Address	$60.00
Resident Agent Name Change	$100.00
Resignation of Manager or Managing Member	$75.00
Resignation of Resident Agent (plus $1.00 for each additional entity listed)	$100.00
Name Reservation	$25.00
24-Hour Expedite fee for above filings	**$25.00**
Apostille	$20.00
Certificate of Good Standing	$50.00
Initial List of Managers or Members	$125.00
Annual or Amended List of Managers or Members	$125.00
24-Hour Expedite fee for above filings	**$75.00**
Certification of Documents – per certification	$30.00
Copies – per page	$2.00
Late Fee for List of Managers or Members	$75.00

2-Hour Expedite is available on all of the above filings at the fee of $500.00 per item.

1-Hour Expedite is available on all of the above filings at the fee of $1000.00 per item.

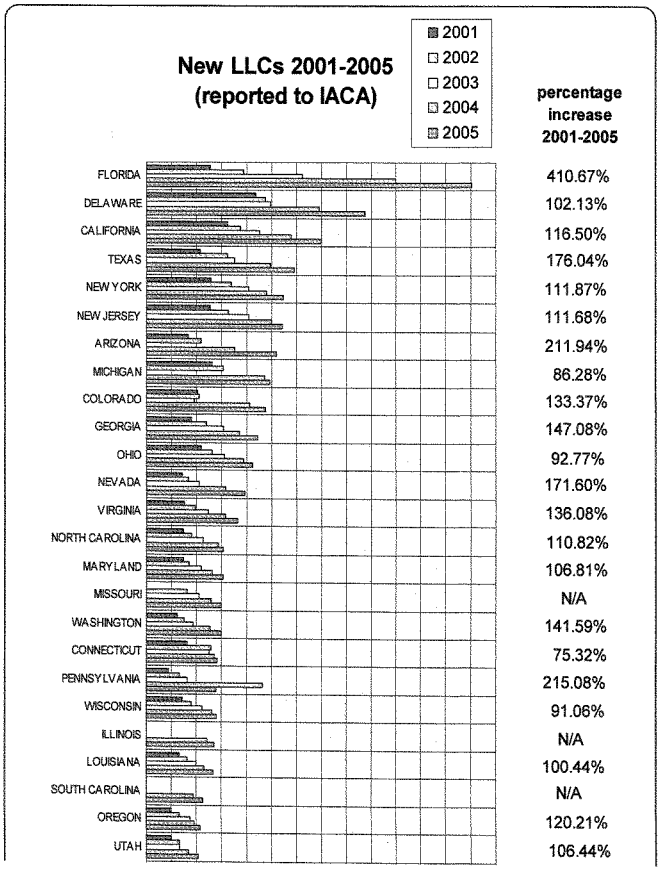
PLEASE NOTE: the expedite fee is in addition to the standard filing fee charged on each filing and/or order.

24-HOUR EXPEDITE TIME CONSTRAINTS:

Each filing submitted receives same day filing date and may be picked up within 24 hours. Filings to be mailed the next business day if received by 2:00 pm of receipt date and no later than the 2nd business day if received after 2:00 pm. Expedite period begins when filing or service request is received in this office in fileable form. The Secretary of State reserves the right to extend the expedite period in times of extreme volume, staff shortages, or equipment malfunction. These extensions are few and will rarely extend more than a few hours.

Nevada Secretary of State Form Fee Schedule-LLC 2005
Revised on: 08/20/05

Figure 3



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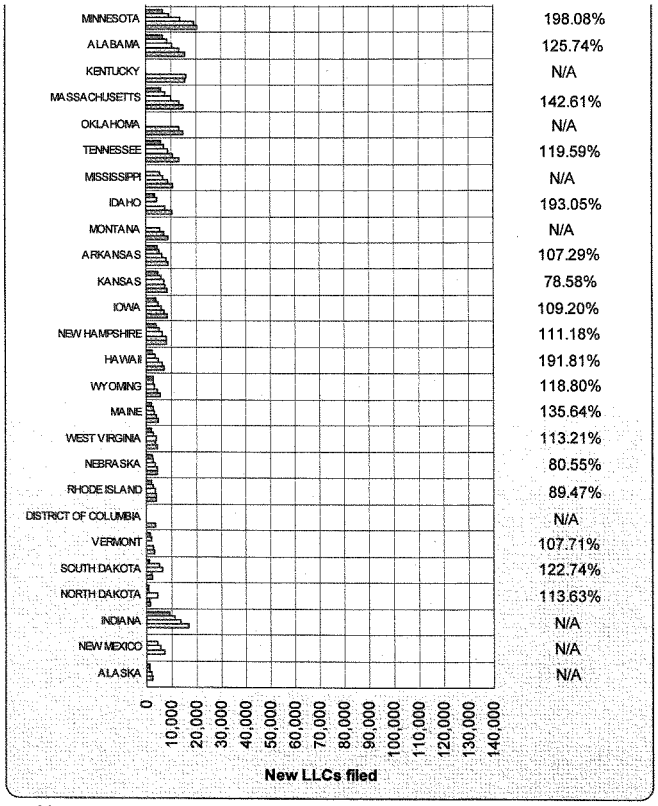


Source of data: International Association of Commercial Administrators (IACA), Annual Reports of the Jurisdictions covering 2001-2005 Missing data bars indicate the data was not reported to IACA for that year.

Figure 4

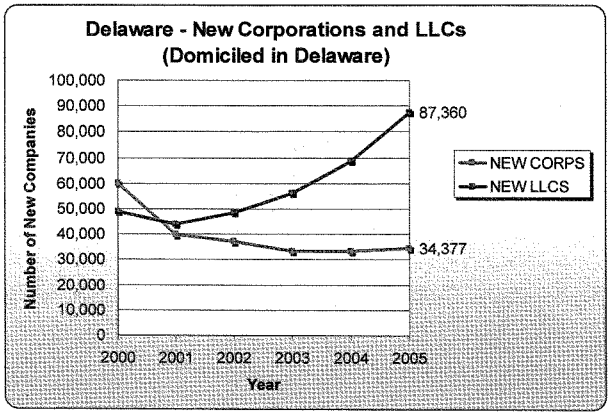
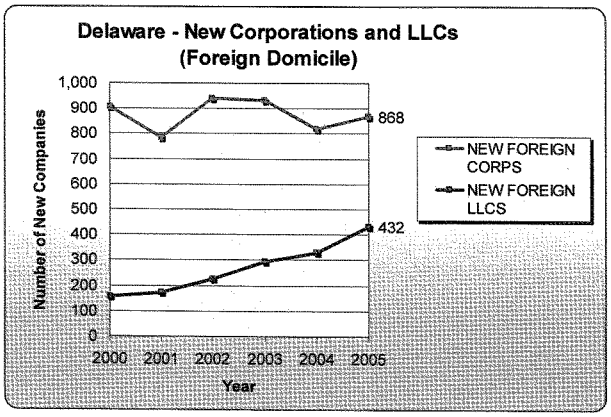


Figure 5



Source of data: Delaware Department of State (2000-2003), IACA Annual Reports of the Jurisdictions (2004-2005)

Figure 6

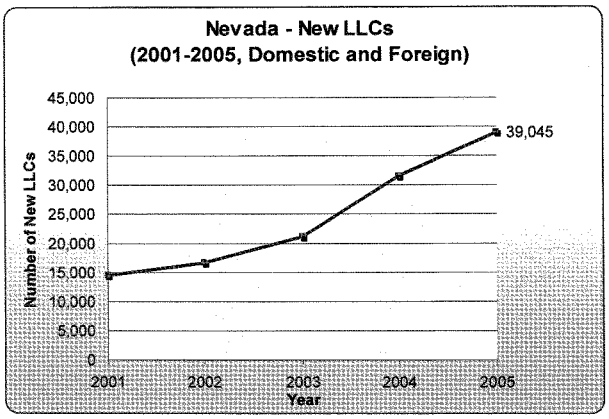
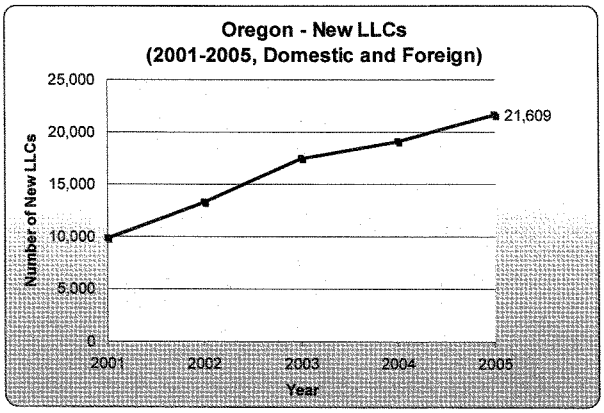
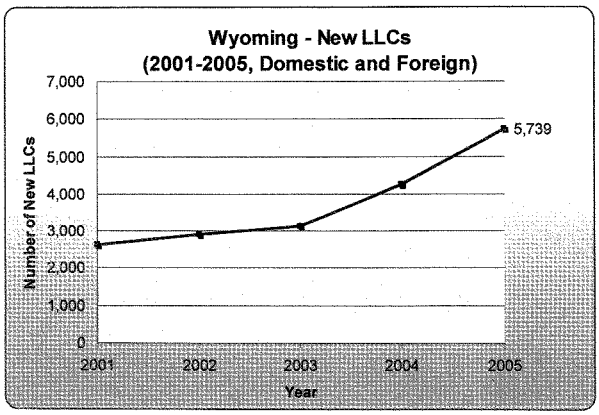


Figure 7



Source of data: IACA Annual Reports of the Jurisdictions, 2003-2006

Figure 8



Source of data: IACA Annual Reports of the Jurisdictions, 2003-2006

Table 1 – LLC formation requirements comparison

Requirements:	**Delaware**	**Nevada**	**Oregon**	**Wyoming**
Number of Organizers	One or more	One or more	One or more	One or more**
Name/Address of Registered Agent/Office	Yes	Yes	Yes	Yes
Name and Address of Members*	No	Yes	Yes***	Yes
Name/Address of Beneficial Owner(s)	No	No	No	No
Cost to File (2005)	$90 ($100 foreign)	$75**** ($75 foreign)	$50 ($50 foreign)	$100 ($100 foreign)

*Management by members is optional. To protect the identity of members, managers can assume management responsibility.
**One person may form the LLC, but it must have two or more members, unless it is a *flexible* LLC, in which a member may assign his/her interest to another person.
***The name of one member or manager is also required for a foreign LLC.
****This fee was lowered from $175 in 2003.

Figure 9

STATE *of* DELAWARE
LIMITED LIABILITY COMPANY
CERTIFICATE *of* FORMATION

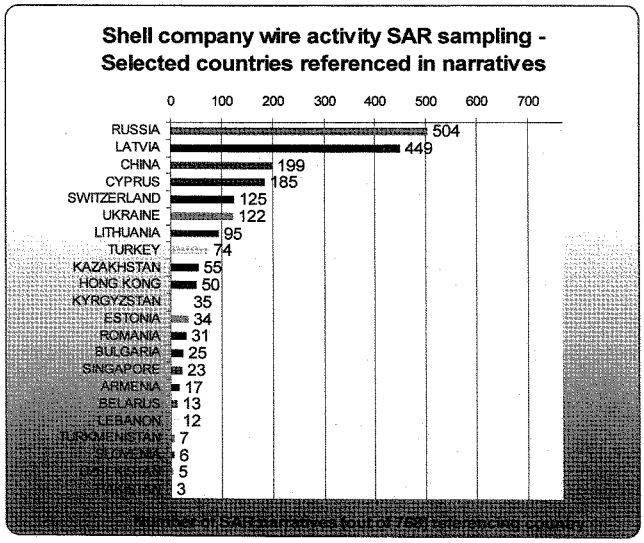
- **First:** The name of the limited liability company is _____
_____
- **Second:** The address of its registered office in the State of Delaware is _____
_____ in the City of _____. The name of its Registered agent at such address is _____
_____
- **Third:** (Use this paragraph only if the company is to have a specific effective date of dissolution: "The latest date on which the limited liability company is to dissolve is _____.")
- **Fourth:** (Insert any other matters the members determine to include herein.)
_____
_____
_____
_____
_____
_____

In Witness Whereof, the undersigned have executed this Certificate of Formation this _____ day of _____, 20_____.

By:_____
Authorized Person(s)

Name:_____
Typed or Printed

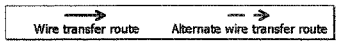
Figure 10

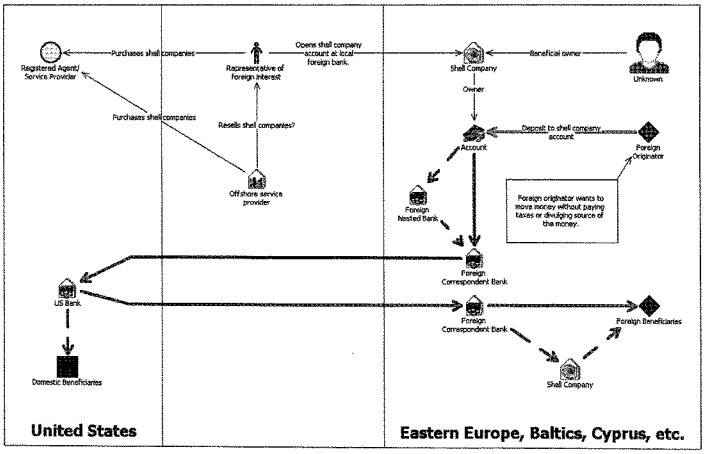


Note the frequency of occurrence for China, Cyprus, and Switzerland, which were often identified in the SARs as destinations of wire transfers from suspected shell companies formed in the United States that had opened accounts in Eastern Europe.

Figure 11

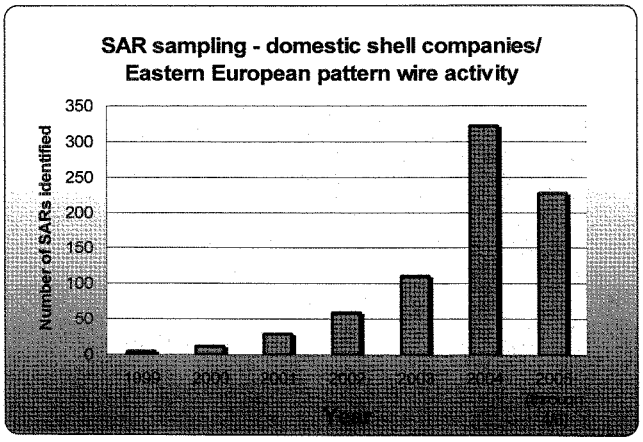
A general model of suspicious wire transfer activity involving domestic shell companies





The movement of money may vary. However, the flow typically described by the majority of SARs filed on this pattern of activity begins with a foreign account owned by a U.S.-based shell company, often in Russia or Latvia, is sent through the correspondent account of a major U.S. or U.S.-based bank, and goes back overseas to various individual and/or company beneficiaries. The domestic shell company can serve as originator or beneficiary. Additional intermediary banks are often involved.

Figure 12



The apparent increase does not necessarily indicate an increase in activity of the magnitude shown, but simply reflects an increase in filing of SARs on this type of activity and the increased ease of identifying activity as being related to domestic shell companies. More likely this is a graphic representation of the lack of reporting in earlier years, as many of the SARs are reviews of past activity filed after the fact. Regulatory and other actions involving ABN Amro Bank, NY and Union Bank of California, for example, have caused those banks to review their records and file more SARs on this activity. These two banks filed 290 of the 768 SARs (37.76%) in the Eastern European/U.S. shell pattern sub-group of the sampling. In addition, a lawsuit filed by a Hong Kong investment group against ABN Amro Bank alleged the bank allowed itself to be used by First Merchant Bank (based in the "Turkish Republic of Northern Cyprus") for money laundering. FinCEN issued a proposed rule regarding First Merchant Bank in August 2004: see http://www.fincen.gov/waisgate1.pdf and http://www.fincen.gov/311fmbextension.pdf.

Department of the Treasury
Financial Crimes Enforcement Network

Guidance

FIN-2006-G014
Issued: November 9, 2006
Subject: Potential Money Laundering Risks Related to Shell Companies

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This advisory is being issued to alert financial institutions to some of the potential money laundering risks associated with providing financial services to shell companies. Most shell companies are formed by individuals and businesses for legitimate reasons. However, these entities also have been used for illicit purposes.[1]

Lack of transparency in the formation and operation of shell companies may be a desired characteristic for certain legitimate business activity, but it is also a vulnerability that allows these companies to disguise their ownership and purpose. All financial institutions that are subject to the Bank Secrecy Act (BSA) should review their anti-money laundering programs to ensure that any money laundering risks are being assessed and managed appropriately.

This advisory is not intended to encourage financial institutions to discontinue business or refuse particular accounts or relationships with shell companies. Rather, the purpose of this advisory is to remind financial institutions of the importance of managing the potential risks associated with providing financial services to shell companies.

Shell Company Overview

The term "shell company," as used herein, refers to non-publicly traded corporations, limited liability companies (LLCs), and trusts that typically have no physical presence (other than a mailing address) and generate little to no independent economic value.[2] Most shell companies are formed by individuals and businesses for legitimate purposes,

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[1] Shell company activity has been a topic in three issues of the Financial Crimes Enforcement Network's *SAR Activity Review*.
(*See SAR Activity Review* Issue #1 (Oct. 2000) http://www.fincen.gov/sarreviewforweb.pdf; Issue #2 (June 2001) http://www.fincen.gov/sarreview2issue4web.pdf; and Issue #7 (Aug. 2004) http://www.fincen.gov/sarreviewissue7.pdf.
[2] U.S. Money Laundering Threat Assessment Working Group, *U.S. Money Laundering Threat Assessment* (December 2005), p. 47.

Permanent Subcommittee on Investigations
EXHIBIT #6

such as to hold stock or intangible assets of another business entity[3] or to facilitate domestic and cross-border currency and asset transfers and corporate mergers.

As noted in the 2005 U.S. Money Laundering Threat Assessment, shell companies have become common tools for money laundering and other financial crimes, primarily because they are easy and inexpensive to form and operate.

According to a survey conducted by the U.S. Government Accountability Office, there were approximately 8.9 million corporations and 3.8 million LLCs registered nationwide in 2004. Although the corporation historically has been the dominant business structure over other forms of business entity, the LLC has become increasingly popular. More LLCs were formed nationwide in 2004 (1,068,989) than corporations (869,693).[4]

Ownership and transactional information on these entities can be concealed from regulatory and law enforcement authorities. All states have laws governing the formation of limited liability companies; however, most states do not collect or otherwise require the disclosure to state governments of ownership information at the formation stage or thereafter.

Furthermore, there are several ways, consistent with state laws, in which organizers of shell companies may obscure company structure, ownership, and activities. For example, many states' laws permit corporations, general partnerships, trusts, and other business entities to own and manage LLCs. This statutory feature enables an individual or business to further conceal involvement in the activities of a shell LLC. Layers of ownership can be devised which make it highly unlikely that relationships among various individuals and companies can be discerned, even if one or more of the owners is actually known or discovered.

Agents and Nominee Incorporation Services

Agents, also known as intermediaries or nominee incorporation services (NIS), can play a central role in the creation and ongoing maintenance and support of shell companies. NIS firms are often used because they can legally and efficiently organize business entities in any state. Numerous agents and NIS firms advertise a wide range of services for shell companies, such as serving as a resident agent and providing mail-forwarding services. Organizers of shell companies also may purchase corporate office "service packages" in order to appear to have established a more significant local presence. These packages often include a state business license, a local street address, an office that is staffed during business hours, a local telephone listing with a receptionist, and 24-hour personalized voicemail.

---

[3] Companies that hold significant assets (for example, subsidiary company shares) but that are not engaged in active business operations would not be considered shell companies as described herein (although they may in practice be referred to as "shell holding companies").

[4] U.S. Government Accountability Office, *Company Formations – Minimal Ownership Information is Collected and Available*, GAO-06-376 (April 7, 2006).

International NIS firms have entered into marketing and customer referral arrangements with U.S. banks to offer financial services such as Internet banking and funds transfer capabilities to shell companies and foreign citizens. U.S. banks that participate in these arrangements may be assuming increased levels of money laundering risk.

Some agents and NIS firms also provide individuals and businesses in the United States and abroad a variety of nominee services that can be used to preserve a client's anonymity in connection with the formation and operation of shell companies. Such features, while legal, may be attractive to those seeking to launder funds or finance terrorism. These services include, for example:

- Nominee Officers and Directors: Incorporators provide the shell company with nominees for all offices that appear in public records.

- Nominee Stockholders: A beneficial owner may use nominee stockholders to further ensure privacy and anonymity while maintaining control through an irrevocable proxy agreement.

- Nominee Bank Signatory: A nominee appointed as the company fiduciary (such as a lawyer or accountant) can open bank accounts in the name of the shell company. The nominee accepts instructions from the beneficial owners and forwards these instructions to the bank without needing to disclose the names of the beneficial owners.

Banks can serve as formation agents and, when so acting, are subject to all BSA requirements, including suspicious activity reporting.

Potential Indicators of Money Laundering and Other Risk-Related Considerations

The use of shell companies provides an opportunity for foreign or domestic entities to move money by means of wire transfers or other methods, whether directly or through a correspondent banking relationship, without company owners having to disclose their true identities or the nature or purpose of transactions. A review of Suspicious Activity Report data reveals that shell companies in the United States have been used to move billions of dollars globally.[5]

Additionally, the following elements are cited repeatedly in Suspicious Activity Reports involving shell companies:

- An inability to obtain – whether through the Internet, commercial database searches, or direct inquiries to the foreign correspondent bank whose customer is the originator or the beneficiary of the transfer – information necessary to identify originators or beneficiaries of wire transfers.

[5] *See SAR Activity Review* #7 (Aug. 2004); http://www.fincen.gov/sarreviewissue7.pdf

- A foreign correspondent bank exceeds the anticipated volume projected in its client profile for wire transfers in a given time period, or an individual company exhibits a high amount of sporadic activity that is inconsistent with normal business patterns.

- Payments have no stated purpose, do not reference goods or services, or identify only a contract or invoice number.

- Goods or services of the company do not match the company's profile based on information previously provided to the financial institution.

- Transacting businesses share the same address, provide only a registered agent's address, or raise other address-related inconsistencies.

- An unusually large number and variety of beneficiaries receive wire transfers from one company.

- Frequent involvement of beneficiaries located in high-risk, offshore financial centers.

- Multiple high-value payments or transfers between shell companies with no apparent legitimate business purpose.

Managing the Risks of Providing Services to Shell Companies

Keeping in mind that most shell companies are created to serve legitimate business purposes, financial institutions should be aware of the unique characteristics of shell companies when providing them with financial services.

Providing services to shell companies involves varying degrees of risk, depending on the ownership structure, nature of the customer, the services provided, purpose of the account, the location of services, and other associated factors. The potential to abuse shell companies for illicit activity must be recognized, and financial institutions must be vigilant in monitoring such companies on an ongoing basis. Financial institutions are expected to assess the risks involved in each shell company relationship and take steps to ensure that the risks are appropriately and effectively identified and managed in accordance with their BSA obligations.

Accordingly, all financial institutions that are subject to the BSA should review their anti-money laundering and, as appropriate, suspicious activity reporting programs to ensure that internal policies, procedures, controls, systems and training programs are designed to prevent, detect, and report possible money laundering and other financial crime involving shell companies.[6] For guidance on managing the risks of providing services to shell

[6] An effective compliance program also should include screening shell companies for possible OFAC-related sanctions references, while also getting assurances from a shell company representative that the principals of the company have been screened as well. For guidance on complying with OFAC-related

companies, financial institutions should refer to the Business Entities (Domestic and Foreign) section of the FFIEC BSA/AML Examination Manual, dated July 28, 2006.[7]

As previously stated in SAR Activity Review # 7, if a financial institution discovers suspicious activities such as those listed above and knows, suspects or has reason to suspect the transactions involve the use of United States or foreign-based shell business entities to launder illicit funds or to enable the furtherance of a crime, the institution must file a Suspicious Activity Report in accordance with the suspicious activity reporting regulations and use the narrative to completely and sufficiently describe the suspicious conduct. The narrative should use the term "shell," as appropriate. The preparer should provide all required and relevant information about the conductor(s) and transactions, including, as applicable, the names and account numbers of all originators and beneficiaries of domestic and international wire transfers, the names and locations of shell entities involved in the transfers, and the names of and information regarding any registered agents or other third parties.[8]

We will continue to monitor and analyze the misuse of shell companies and similar business entities and may issue additional guidance in the future.

---

sanctions, financial institutions should refer to the Foreign Assets Control Regulations for the Financial Community available at: http://www.treas.gov/offices/enforcement/ofac/regulations/t11facbk.pdf.

[7] http://www.ffiec.gov/pdf/bsa_aml_examination_manual2006.pdf.

[8] http://www.fincen.gov/sarreviewissue7.pdf

EXHIBIT #7

wyomingcompany.com

Excerpts from website of a Wyoming based Company Formation Firm

Permanent Subcommittee on Investigations
EXHIBIT #7

MENU
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November 13, 2000

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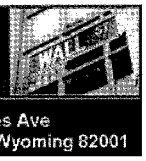


1-800-990-0433
Outside USA 1-307-632-3333
2710 Thomes Ave
Cheyenne, Wyoming 82001

Don't Gamble on Nevada!

Check out the advantages of incorporating in Wyoming:

- **No State Income Taxes**
- **No information collected to be shared with IRS**
- **Privacy allowed**
- **Shareholders are not listed with the state**
- **Best Asset Protection Laws**
- **Bearer Shares are allowed**
- **Nominee officers are legal**
- **Citizenship not required**
- **State tax not being considered**
- **Wyoming draws little attention**
- **No Nevada "Stigma"**
- **Lower Startup Costs**

Wyoming state fees are 50% less than Nevada's. And that's not including the "hidden" officer filing fees that you learn about only after you start your company there. Nevada will hit you with a $125 fee 30 days after you start your company! Wyoming does charge an officer filing fee, 12 months after you start your company. The cost? $50 and that's the second years total state fee! Oh, and no state business license is required in Wyoming either. Just another "little" $100 per year hidden fee that they don't like to talk about in Nevada. All this means is we can deliver a quality company package to you for much less than you would pay in Nevada.

- **NEW 2007 study shows Wyoming to be the most business-friendly, lowest tax state, of all 50 states!**

According to the new 2007 edition of the Tax Foundation's *State Business Tax Climate Index*, "Wyoming has the most business-friendly tax system of any state." Click here to see the report.

- **Asset Protection**

A Wyoming corporation or LLC offers its officers and directors a high degree of protection from lawsuits filed by disgruntled creditors or over zealous plaintiff attorneys. Doing business as a Wyoming Corporation can give you asset protection and business privacy. There is much information on this web site which outlines the benefits of using various types of structures.

The first LLC statutes in the United States were instituted in Wyoming in 1977. Since Wyoming has had limited liability companies available longer than any other state and has strong laws protecting members and managers of an LLC, we feel it is the state of choice for establishing LLC's.

- **Privacy**

Wyoming allows Bearer Shares, Nominee Officers and Lifetime Proxies. Attorneys and Accountants are often asked to provide an anonymous "company cover" for their clients. To do this you need to have possession of the "bearer share" stock certificate and appoint nominee officers and/or directors for the company. We can arrange this for you. See this section for the advantages of Lifetime Proxies, Nevada does not have them.

NEWS FLASH: As of June 1, 2005 Nevada requires the Social Security number, date of birth, resident addresses, and telephone numbers of all shareholders, partners, officers, managers and members of all companies formed in the state. See the Nevada Business Registration form that you would have to fill out here.

- **Freedom**

You can operate your Corporation and live anywhere in the world and you do not have to be a US citizen to incorporate in Wyoming. But in order to give substance to your operation you should know about our Office Service Contract and learn how use of this inexpensive option will give "presence" to your remote corporate operations. And if are not a US Citizen we have a whole section for you to read here.

- **No State Taxes**

There are no State taxes in Wyoming on corporations. If you choose to incorporate in Wyoming your company may not pay State taxes at all. Stop for a minute and think what you paid last year in your States income tax. If you are comparing Nevada and Wyoming, keep in mind that the Nevada State Legislature is being lobbied hard to install a corporate income tax. Don't gamble that this will not happen. Wyoming never has and never will have a state income tax on corporations. It is one of the only states with a budget surplus!

- **Easy to Move**

Wyoming has made it easy to move your existing corporation to Wyoming. Something you can not do in Nevada. That service is detailed here.

Special Easy to Use Corporate Structures

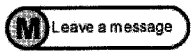
Wyoming has Close Corporations. These are special companies authorized by the Wyoming Legislature for small business owners. Less paperwork is required to keep them going. Few states have them. You can read about them here.

Wyoming now has Close LLC's. Less paperwork. Less time to manage. Perfect for a closely held family company. You can see the details here.

Wyoming Corporate Services, Inc. has been in business in Cheyenne Wyoming since 1998. We specialize in helping you incorporate in "tax free" Wyoming and have strategies to help you

lower your tax liability in your home state, increase your asset protection and give you back your privacy. We think that you will find the information you need, on this site, to help you make the decision to start your company in **Wyoming!**

Top



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Member of Better Business Bureau

Wyoming Corporate Services Inc.
1-800-990-0433
Outside USA 1-307-632-3333
2710 Thomes Ave
Cheyenne, Wyoming 82001

Who Should Incorporate

Whether you're a small business owner with no employees or with hundreds, there is no greater way to protect yourself and your personal assets from the threat of lawsuits than by incorporating. Incorporating is also a legal and simple way to cut your taxes, lower your audit risk, increase your privacy, build credit, raise capital and let you live the corporate lifestyle.

Roughly a million corporations are formed each year and the number is growing every year. Why? Because a corporation is a legal person created by state statute that can be used as a fall guy, a servant, a good friend or a decoy. A person whom you control... yet cannot be held accountable for its actions. Imagine the possibilities!

If you operate a business (even a home based or part-time business), contemplate starting a business, wish to protect your personal assets or are thinking about estate planning, establishing a corporation can provide a simple and inexpensive foundation.

Can you be sued?

The average man or woman in the United States today experiences five lawsuits in his or her lifetime. The odds are that one of these is a devastating lawsuit.

You can and must safely shelter your assets from lawsuits before a lawsuit strikes. The law deals quite harshly with those who seek last minute transfers of assets in an attempt to defraud creditors. What this means is that you must realize now that you can run into financial trouble. You must recognize and come to grips with your own vulnerability. When you get this reality under your skin, only then will you have the sense of urgency necessary to take action to protect yourself from the virtually inevitable.

Most of those who have assets to lose occasionally consider taking action to protect their assets and lower their taxes. The reminder may strike around tax time or when a lawsuit or other tragedy strikes. However, the consideration often fades when the danger subsides. Then the procrastinator is usually leveled with a financial blow that robs the individual of hard-earned resources. Do not let another day go by without establishing your own corporation or LLC.

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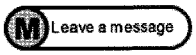
You should use a Wyoming Corporation to save your assets



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Why Wyoming is Better

The Wyoming Advantage

We believe that Wyoming is the best state in America in which to do business and we think we can make you a believer also. In a moment, we will examine the many benefits that Wyoming has but let's first take a look at what it **doesn't** have:

Wyoming doesn't have:

- **Personal income tax**
- **Corporate income tax**
- **Inventory tax**
- **Gross receipts tax**
- **Franchise tax**
- **Burdensome regulations**
- **Disclosure of shareholders**
- **Business or "per-capita" tax**
- **Excise tax**
- **Sales, property and inheritance taxes are among the lowest in America**

...AND CONSIDER THESE ADVANTAGES

- **Unlimited ability to issue stock**—Most states set a limit on the number of shares that you are authorized to issue; Not so in Wyoming! You may issue as many shares as you wish (without any additional costs or fees) by simply making the proper entries in your Articles of Incorporation. (We will take care of all that for you.) Unlimited shares may be of paramount importance to you in particular, if you ever contemplate taking your company public.

- **You can be everything in Wyoming**—Some states require that you have more than one person to serve as the various officers and directors of your corporation. Again, not so in Wyoming! One person can fill all of the required corporate positions giving you the ultimate in flexibility and control.

- **Enjoy anonymity and privacy in Wyoming**—The more information about you that appears in the public record the easier it is for you to become a target. Wyoming has **no** requirement for the names of shareholders to be filed with the state. It asks only for a simple "Annual Report" which requires disclosure of only those assets located **within the state of Wyoming** and the name of one person, usually the one who submits the report.

- **Restrictions and corporate formalities are at an absolute minimum in Wyoming**—If

you would like less "red tape", bureaucracy and restrictions in your business life Wyoming is the place for you!

- **Low annual fees**—The annual fees in Wyoming are based solely on the value of corporate assets **located within the state.** The minimum is $50 and a million dollars worth of assets **within the state of Wyoming** would cost you only $200. That's right, $200 in fees for every million dollars worth of assets that you keep within the state of Wyoming and **no fees for assets outside of the state.**

- **As an officer or director you cannot be held responsible for the debts of the corporation**—Wyoming law is quite strong in this respect and holds generally that as long as you did not intentionally break the law you are protected from claims against the corporation.

- **No minimum capitalization is required in Wyoming**—You can fund your corporation with one dollar, with a million dollars or the amount of your choice. And, while there are sound business reasons of avoiding "under capitalization" the point is that the choice is yours and you enjoy the ultimate in flexibility.

- **Your directors and/or shareholders meetings may be held anywhere in the world**—You are not required to hold meetings in Wyoming; indeed you need never set foot within the state. Wyoming is rich in history and breathtaking scenery but if your tastes run more to the Bahamas, Hawaii or, for that matter, the French Riviera the choice is yours.

- **Stock in your Wyoming corporation may be issued in exchange for "anything of value"**—You may use cash of course but also property, services or any valuable consideration at the total discretion of the board of directors which you'll remember can be one person (you?).

- **Maximum anonymity can be yours**—Make no mistake; we're not suggesting that you need to be "secretive" and certainly not that you do anything improper. Nevertheless, in today's overly litigious society it is a fact of business and personal life that the only thing necessary to involve you in a lawsuit is the perception by someone else that you have assets...you've heard it called the "deep pocket theory." Many business people have found it advantageous to maintain financial privacy simply to avoid looking like a good litigation "target." In Wyoming you may use "nominee officers/directors" meaning that anyone you designate can appear on the public record in your stead offering you valuable financial privacy. Furthermore, you may also be interested in using nominee or "third party" shareholders who can be the owners of record of the stock which you control. Ask us how to explain the endless possibilities for privacy using the foregoing two strategies.

- **Lifetime proxy**—John D. Rockefeller was the first individual to acquire a personal net worth of one billion dollars. When asked late in life how he accomplished such a feat he is reported to have shared with a young interviewer that his simple secret was to "own nothing and control everything." That is indeed wonderful advice for a host of reasons (consider, no one can take from you that which you do not own) but it is sometimes more easily said than done. By allowing another person or entity to own shares you can use proxies to maintain complete control. The problem is that most state laws require proxies to expire and be subsequently renewed every six or seven years. If the "legal owner" declined to renew your proxy you could be literally be left with nothing and no recourse. That is hardly a scenario that makes us feel secure nor is it one that we would recommend to you. However realize that Wyoming allows for lifetime proxies thereby protecting you from any such problem arising.

- **If you already have a corporation** —Once again Wyoming offers unparalleled flexibility. By filing a few simple forms (we will handle it for you start to finish) your existing corporation can become a bona fide Wyoming Corporation. Wait; it gets even better! Your existing corporation can retain its original incorporation date after becoming a Wyoming corporation. Anyone examining the Wyoming public record will see a corporation dating back as far as your current corporation does. You can promptly become a Wyoming Corporation without losing the many benefits of the longevity and continuity of operation.

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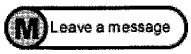

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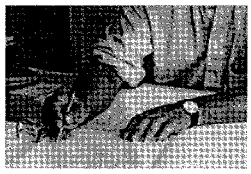

Wyoming vs Nevada vs Delaware

Where You Should Incorporate

Delaware - Nevada-vs-Wyoming - Side By Side Comparison - Why Wyoming

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We hope the foregoing review of business entities has been helpful and given you some ideas. All of them have a place, many can be used in conjunction with one another, but by far our favorite is the corporation. Corporations have become the quintessential form of doing business throughout the world for more than a century. Just the simple act of incorporating in your home state can protect your personal assets, reduce taxes and provide a universe of "fringe benefits" such as retirement plans, deferred compensation, annuities, life insurance, and medical reimbursement plans just to name a very few. Moreover, many of these benefits may be tax deductible to the corporation and tax-free to the employee (that would be you). So what state should you incorporate in?

Exploding the Delaware Myth

You may have heard that Delaware is the "incorporation capital" of America. It's true! More than 60% of Fortune 500 companies are incorporated in Delaware. If you own a Fortune 500 company (and for your sake we hope you do) then by all means you should strongly consider incorporating in Delaware. However, if you are a small or medium sized business that is more concerned with tax benefits, flexibility, privacy and a minimum of bureaucracy and "red tape" then Wyoming is the clear choice for you.

You see, Delaware has an excellent body of corporate case law spanning 110 years regarding such matters as management/shareholder issues and mergers/acquisitions. That's precisely why the Fortune 500 are drawn to the state of Delaware. Delaware laws tend to be "pro-management" when it comes to minority shareholder disputes. Huge public companies have literally hundreds of such disputes pending in the courts on any given day. So if you are managing a Fortune 500 company, Delaware's case law offers many insights into what you can and cannot do, and what

the likely consequences may be. Unfortunately, Delaware also has corporate income tax, personal income tax, a state franchise tax, reporting requirements and regulations compelling disclosure of substantial amounts of information resulting in far less privacy for you. We are always surprised at how many otherwise knowledgeable professionals advise their small business/ entrepreneur clients to incorporate in Delaware. Well intentioned though it may be; it is not sound advice.

Perhaps you're one of those who received such advice and have incorporated your business in Delaware. It's not to late! Refer to the preceding section and you will see that we can easily "move" your corporation to Wyoming while preserving the original incorporation date.

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Nevada vs Wyoming

Perhaps you're one of those who have read all the web sites that promote incorporating your business in Nevada. The reasons given usually are:

1. Nevada does not share information with the IRS.

Wyoming Answer: Nevada makes the IRS mad. Wyoming does share information with the IRS, but only the information given by companies with real assets inside the state. So you have the best of both worlds, the IRS is not targeting you because you are in a non friendly state (like they may in Nevada), and yet there is no information that is shared because most businesses do not have real assets inside the state of Wyoming.

2. Nevada allows bearer shares.

Wyoming Answer: Nevada's law does not say anything about bearer shares. Wyoming's law allows them.

3. Nevada has privacy.

Wyoming Answer: Go to the Secretary of State of Nevada's web site and type in a person's last name and/or first name. You will see a list of all companies that person is a part of in Nevada. Go to the Secretary of State of Wyoming's web site and you will find that the only way to search on a company is by company name. You can not search using a person's name.

4. No taxes in Nevada.

Wyoming Answer: No state income taxes on people or companies in Wyoming either. **And** Wyoming is not considering any. Nevada is.

There are more comparisons in the chart below.

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A Side by Side Comparison of Wyoming and Nevada and Delaware

Benefits	Nevada	Wyoming	Delaware
No state corporate income tax	●	●	
No tax on corporate shares	●	●	●
No franchise tax	●	●	
Minimal annual fees		●	
One-person corporation is allowed	●	●	●
Stockholders are not revealed to the State	●	●	●
No annual report is required until the anniversary of the incorporation date		●	
Unlimited stock is allowed, of any par value		●	●
Bearer stock can be used	●	●	
Nominee shareholders are allowed	●	●	
Share certificates are not required		●	
Minimal initial filing fees		●	
No minimum capital requirements	●	●	●
Meetings may be held anywhere	●	●	●
Officers, directors, employees and agents are statutorily indemnified	●	●	
Continuance procedure (allows Wyoming to adopt a corporation formed in another state)		●	
Doesn't collect corporate income tax information to share with the IRS	●	●	

Why Wyoming

As you can see from the above list, Wyoming has advantages that Nevada does not have.

Also, with the changes that Nevada has made to their laws, in 2001 and in 2003, Wyoming has become the best state in the nation to incorporate in.

If you are comparing price, Wyoming is about 35% less to incorporate in than Nevada.

Another thing that they will not tell you about Nevada. The state is running a deficit and the Nevada State Legislature has been trying to pass a corporate income tax and it came within a few votes of passing a tax last year. It is thought that they will pass some sort of business tax this year.

Wyoming is not considering any business income tax and does not need it. Wyoming has a budget surplus in 2003! Don't gamble on Nevada passing a law that could cost you taxes after you incorporate there.

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Do you need a Nominee?

A **nominee** is used when you want to increase your privacy, decrease your visibility, or have someone do something that you can not do. We can provide a nominee for the following situations:

1. Nominee for tax id number for the company. Some people want to keep their names off all the governmental records possible. Or others who are not in the US want someone else to file for the number to save time. The nominee files for the company tax id number using their social security number. We can normally have the company tax id number for you in 1 working day. Go here for pricing.

2. Nominee for Public Record. If you wish to keep your name off the Internet, so that it is easy to discern that you are involved with a company, then this is the service for you. The nominee signs the incorporation papers and becomes the officer of record for the company. After the paperwork is returned from the state, the nominee resigns from the company and you appoint another officer, most likely yourself. The name listed on the Internet is still the nominee's name and that stays that way until the next year's list of officers must be filed. At that time if you wish for the nominee's name to remain on the public record, the nominee again signs the paperwork for the list of officers and then resigns again. The cost is reoccurring each year you wish the nominee to sign. Go here for pricing.

3. Full Time Nominee Service. This service is designed for those that absolutely do not want their name to be associated with a company. The nominee is not only the officer of record but is the only one who signs documents for the company. The nominee will sign all corporate documents, except those that are not lawful or that bring personal liability to the nominee. There is a yearly charge for the nominee service. You also must sign a nominee agreement, which protects the nominee if there is wrong doing. Tax returns are not signed for by the nominee. Go here for pricing.

4. Attorney Privilege Services with Full Time Nominee. There are varying degrees of privacy offered with the above nominee services. If you want the best privacy there is in the USA, then this is the service for you. We provide an attorney who serves between the beneficial client and the nominee. With the attorney in place, there is an attorney client privilege, which still allows the client to communicate instructions via a password to the nominee, but all nominee connections are handled through the attorney. This allows the nominee to respond to questions by referring to the attorney and the attorney can then invoke the client privilege. Here is the pricing.

5. Aged Companies. An aged company, more than one (1) year old, comes with a Public Record nominee until the due date of it's officer registration. Other nominee services can also be added to these aged companies. Please call us if you are in need of these services. Here is a list of

aged companies with prices for the company only.

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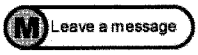

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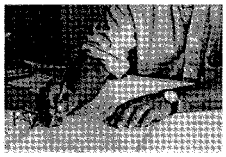

Aged Companies

Here is a list of the companies that we currently have for sale.

This list changes without notice and is the largest inventory of Wyoming aged shelf corporations on the net. These are companies that we formed and put on the shelf, they have not been used by anyone. They come with Certificates Of Good Standing from the state, Certified Articles of Incorporation from the state, the corporate kit which includes 20 pre-printed stock certificates, corporate seal, suggested meetings minutes and one year of Registered Agent Services. All state fees are paid through the renewal date of the company. If you need other services see our other services here.

These companies can be registered in any other state as a foreign company doing business in that state, if you need an aged company in your home state.

If you are looking for a Publicly Traded company go here.

Unless otherwise noted, the aged company does not have an EIN issued yet.

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Wyoming Shelf Corporations		
Name of Company	Cost	Inc. Date
Other aged companies available and not listed	ask us	back to 1996
Ashe Lake Incorporated	$6995	9/4/96
Long Pine Resources, Inc.	$6995	9/4/96
Konexis Inc **(with aged EIN and 3 year old aged bank account.)**	$5995	8/2003
Double Horseshoe Ranch	$1995	2/2004
Inn Systems (Statutory Trust)	$1995	3/2004
Executive Management Services Inc.	$1895	4/2004
Future Imports Ltd	$1895	4/2004
Home Development Inc.	$1895	5/2004
U.S. Trading Group Ltd.	$1895	5/2004
Round Mountain Enterprises Inc.	$1895	6/2004
Shadow Properties, Inc.	$1895	6/2004
Sentry Medical Corporation	$1895	6/2004
Sterling Distribution, Inc.	$1895	6/2004
US Import Export Ltd.	$1895	6/2004

Alpine Development, Inc.	$1895	6/2004
Legend Distribution, Inc.	$1895	6/2004
Brookstone Financial, Inc.*	$1895	6/2004
Sole Financial LLC	$1895	6/2004
Wyoming Capital Group LLC	$1895	6/2004
Frontier Holdings Group LLC	$1895	6/2004
Cheyenne Leasing Corporation	$1795	7/2004
Apple Capital Corporation	$1795	7/2004
Life Resources LLC	$1795	7/2004
Champion Management, Inc.	$1795	7/2004
Bluegrass Properties, LLC	$1795	7/2004
Summit Travel Company	$1595	8/2004
Golden Acquisitions LLC	$1595	8/2004
Future Resources LLC	$1595	8/2004
Financial Management LLC	$1595	8/2004
Midas Trucking Corp.	$1595	8/2004
Local Enterprises Inc.	$1595	8/2004
Elite Transportation Systems, Ltd	$1595	8/2004
Campbell River Enterprises, Inc.	$1495	9/2004
Wells Home Mortgage, Inc.	$1495	9/2004
Alpine Marketing Group, Inc.	$1495	9/2004
British Investments LLC	$1495	9/2004
Bush & Associates LLC	$1495	9/2004
Morning Star Real Estate LLC	$1495	9/2004
Royal Holdings LLC	$1495	9/2004
Christian Investments LLC	$1495	9/2004
Great Wall Enterprises Inc	$1495	9/2004
New Age Financial LLC	$1495	10/2004
Once In A Blue Moon LLC	$1495	10/2004
The United Foundation **(a non profit company)**	$1495	10/2004
The Courage Under Fire Foundation **(a non profit company)**	$1495	10/2004
Entertainment, Inc.	$1495	10/2004
Wharton Financial Inc	$1495	11/2004
Lucky Star Industries, Inc.	$1495	11/2004
First Class Travel, Inc.	$1395	12/2004
Cascade Property Management, Inc.	$1395	12/2004
Homestreet Mortgage Corporation	$1395	12/2004
Sterling Resources LLC	$1395	12/2004
National Capital Management LLC	$1395	12/2004
United Financial Services LLC	$1395	12/2004
Bistro Enterprises LLC	$1395	12/2004
AB Supply LLC	$1395	12/2004
B of A Financial Group, Inc.	$1095	4/2005
Impact Advertising Corporation	$1095	4/2005
Oakwood Resources Corp.	$1095	4/2005
Fairview Holdings Ltd.	$1095	4/2005
Infinity Acceptance Corporation	$1095	4/2005

Main Street Mortgage Corp.	$1095	4/2005
Technology Services LLC	$1095	4/2005
Resources United LLC	$1095	4/2005
Round Mountain Mortgage LLC	$1095	4/2005
Cowboy Trading Company	$1095	6/2005
Aspen Investments LLC	$1095	6/2005
Good Financial Services Inc.	$1095	7/2005
Morris & Hamilton Consulting LLC*	$1095	7/2005
Jetscape Media	$1095	7/2005
Frontier Consulting Group Ltd.	$1095	8/2005
Maverick Funding Corp.	$1095	8/2005
Merritt Financial Services, LLC	$1095	8/2005
Sierra Technical Services LLC	$1095	8/2005
Orchard Technologies Corporation	$1095	8/2005
BVI Corporation	$995	9/2005
Surf Corp.	$995	9/2005
Solutions International, Inc. *	$995	9/2005
Impact Systems Ltd.	$995	9/2005
Prime Systems Inc.	$995	9/2005
Mutual Funding Inc.	$995	9/2005
Premier Services LLC	$995	9/2005
Capital Enterprises LLC	$995	9/2005
Castle Enterprises Group LLC	$995	9/2005
The Strategy Group LLC	$995	9/2005
US Healthcard Inc.	$995	9/2005
National Marketing Specialists, Inc.	$995	10/2005
Advanced Security Group, Inc.	$995	10/2005
Beverly Hills Management Corp.	$995	10/2005
Aspen Valley Real Estate, Inc.	$995	10/2005
ICT Investments LLC *	$995	10/2005
Riverside Consulting LLC	$995	10/2005
Superior Building Services Corp.	$995	10/2005
Rockin Ventures LLC	$995	11/2005
Harmony Technologies Inc	$995	11/2005
Jolly Enterprises Inc	$995	11/2005
Guardian Company, Inc.	$995	11/2005
Corner Company Inc	$995	11/2005
Unique Services Corporation	$995	12/2005
Advanced Marketing Solutions Inc.	$995	12/2005
Superior Resource Management Inc.	$995	12/2005
Quality Solutions Ltd..	$995	12/2005
Advanced Imaging Inc.	$995	12/2005
Creative Marketing Inc.	$995	12/2005
Customized Solutions Inc.	$995	12/2005
Economic Research Group Inc.	$995	12/2005
Alternative Business Services, Inc.	$995	12/2005
Quality Financial Corporation	$995	12/2005
Economic Development Group Inc.	$995	12/2005
Transwestern Services Corp.	$995	12/2005

Casper Financial Holdings, LLC	$995	12/2005
Southern Wyoming Resources, LLC.	$995	12/2005
Fine Edge Corporation	$795	1/2006
Western Range Corporation	$795	1/2006
Miracle Financial LLC	$795	1/2006
States West Financial, Inc.	$695	2/2006
Real West Enterprises, Inc.	$795	2/2006
Corner Resources, Inc.	$795	2/2006
Country Home Solutions, LLC	$795	2/2006
Quick Draw Properties, LLC	$795	2/2006
Trans Atlantic Cargo Inc.	$795	3/2006
Daylight Financial Group, Inc.	$795	3/2006
Hilight Properties, Inc.	$795	3/2006
Mountain Woods Management, Inc.	$795	3/2006
Silver Moon Investments, Inc.	$795	3/2006
Triton Steel Buildings LLC	$695	4/2006
Broke Back Mountain, Inc.	$695	4/2006
Mid-America Business Services, Inc.	$695	4/2006
Diversified Financial Investment Group	$695	4/2006
Monumental Development Corp.	$695	4/2006
Magnum Marketing Association	$695	4/2006
Investors, Inc.	$695	5/2006
Frontline Oil & Gas Corporation.	$695	5/2006
United Property Investors, LLC	$695	5/2006
Continental Business Advisors, Inc.	$595	6/2006
International Marketing Consultants, Inc.	$595	6/2006
Mid-Western Energy Corporation	$595	6/2006
Wyoming Oil & Gas Exploration	$595	6/2006
International Resources, Inc.	$595	6/2006
Continental Financial Services Inc.	$595	6/2006
Vista Marketing, Inc * **(with EIN Number)**	$895	6/2006
Continental Enterprises, LLC	$595	6/2006
Arrowhead Investments, LLC	$595	6/2006
Project Greenway **(with EIN number)**	$895	6/2006
International Benefits Corporation	$595	7/2006
International Broker Network, Inc.	$595	7/2006
International Business Resources, Inc. **(with EIN Number)**	$895	7/2006
International Business Technologies, Inc.	$595	7/2006
Tri-State Leasing Corporation	$595	7/2006
Global Lending Solution, Inc.	$595	7/2006
Corporate Financial Services, Inc. **(with EIN Number)**	$895	7/2006
Foreign Investment & Funding, Inc.	$595	7/2006
International Development & Investment Corporation	$595	7/2006
Mutual Investment Properties, Inc.**(with EIN Number)**	$895	7/2006
International Commodity Brokers, LLC	$595	7/2006
Columbia Gorge, LLC	$595	7/2006
Century City Capital Inc. **(with EIN number)**	$895	7/2006
Investigative Resources, Inc.	$595	8/2006
Fundamental Technology Corporation	$595	8/2006

Security & Investment Research, Inc.	$595	8/2006
Wyoming Financial Advisory Company	$595	8/2006
State Street Securities, Inc.	$595	8/2006
FundingCorp **(with EIN Number)**	$895	8/2006
State Street Finance, Inc.	$595	8/2006
Traveling Health Enterprises Inc.	$595	8/2006
Elite Technologies, Inc.**(with EIN Number)**	$895	8/2006
Prime Holdings Corp.	$595	9/2006
Alpine Services, Inc. **(with EIN Number)**	$895	9/2006
Tools, Inc.	$595	9/2006
Choice Mortgage Corporation	$595	9/2006
Capital Mortgage, Inc. **(CLOSE CORP)**	$595	9/2006
Advanced Business Solutions, Inc. **(with EIN number)**	$895	9/2006
Network Solutions, Inc. **(CLOSE CORP)**	$595	9/2006
Institute for Corporate Research	$595	9/2006
Business Data Systems, Inc. **(CLOSE CORP)**	$595	9/2006
Corporate Consulting Corp. **(CLOSE CORP)**	$595	9/2006
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Ridgeview, LLC **(CLOSE LLC)**	$595	9/2006
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New Century Holdings, LLC	$595	10/2006
Midland Mortgage Corp	$595	10/2006
Mid-America Credit Services, Inc.	$595	10/2006
Asset Management Advisors Inc.	$595	10/2006
Virtual Investment Corp	$595	10/2006
New Age Investments, Inc.	$595	10/2006
Informative Financial Advisors LLC	$595	10/2006
The Firm Inc	$595	10/2006
Creative Designs, Inc.	$595	10/2006
Prime Marketing Solutions LLC	$595	10/2006
Kingston Mortgage, LLC	$595	10/2006
Research Tools, Inc.	$595	10/2006
Search Systems Inc.	$595	10/2006
Information Services, Inc.	$595	10/2006
Informative Solutions LLC	$595	10/2006
New Beginnings Corp.	$595	10/2006
Barefoot Contessa LLC	$595	10/2006
Streamline Films Ltd.	$595	10/2006
U.S. Corporate Services, Inc.	$595	10/2006

Aged corporations are guaranteed to be clear of any debts or liabilities. The name of the company can be changed for a fee of $100 and the date of the incorporation will remain the same.

You may need an aged corporation for the following reasons:

- To have a company ready to use today.
- Corporate image is enhanced with age.
- Building corporate credit is easier with age.
- Other companies will do business with an older company before a brand new one.
- Establishing a history for your business.

- Bidding contracts at times require a certain age to your corporation.
- Obtaining bank loans is easier when you can show you have history, the age is what matters most.
- Obtaining corporate credit cards and leases. For example, Gateway computers lease only to corporations 6 months old or more.

*Kit

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November 13, 2000

Free Evaluation

BBB Online Reliability Program
Member of Better Business Bureau

Wyoming Corporate Services Inc.

1-800-990-0433
Outside USA 1-307-632-3333

2710 Thomes Ave
Cheyenne, Wyoming 82001

Not a US Citizen? How Wyoming works for International Citizens

If you are not located in the US or are not a US Citizen and need a US company, we can establish one for you. All that is needed is your contact information, the name that you want to use for your company, and payment.

You do not have to be a US citizen to own or be a part owner of a C-Corporation or LLC. The only limitation is that you can not start an S-Corporation.

Since most companies will also need a Tax ID number (EIN) then you might also want to use our Nominee Tax ID services, which will speed up the process of getting a number for your company. (This service can only be used with a C-Corporation.)

We can have the company established and the tax number issued within 7 working days. The costs are the same for you as they are for anyone else, except for the cost of shipping you the kit via International FedEx service so that you can get the package from us in a timely manner.

If you need a bank account in the US you must either come to the US so that the bank can verify your ID or use our Full Time Nominee services. The banks will not open an account without positive verification of your ID, in person. We can direct you to banks that will open an account for you and tell you what they will require.

All of the services and prices mentioned on this page, are explained in detail on the page linked here.

Please note, we can not establish companies for you if you are from Cuba, Iran, North Korea, Sudan, Western Balkans, Burma, Liberia, Zimbabwe or if you name appears on the OFAC list of Blocked persons or companies. That list can be accessed from this link:

http://www.treas.gov/offices/enforcement/ofac/sdn/t11sdn.pdf

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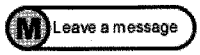

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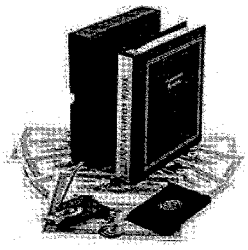

Our Prices

New Wyoming C- Corporation, S-Corporation or Close Corporation Package

Our Wyoming Incorporation service has everything you'll need to start your new company. No other service is as rich in usable features at this price.

Includes:

- One full year of registered agent services
- All State filing fees
- Corporate name check
- Wyoming Certificate of Incorporation and Good Standing
- Certified Articles of Incorporation
- All paperwork filed with the State, including By-Laws
- Corporate Forms
- Engraved corporate hand-press seal with pouch
- Deluxe corporate binder with corporate name embossed that includes:
  - Certified copy of Articles of Incorporation
  - 20 Pre-Printed Stock Certificates
  - Corporate By-Laws
- Minutes of first Board of Directors
- Over a dozen commonly used resolutions
- Stock Transfer Register
- Application and instructions for Employer Identification Number (SS-4 Form)

$495.00 one time charge. There are no other fees or charges.

How Long It Takes: About 5 working days to get the papers back from the State and another 3 to 4 days to mail the kit to you.

Click here to go to Order Form

New Wyoming LLC Package

Our Wyoming LLC package has everything you'll need to start your new LLC.

Includes:

- One full year of registered agent services
- All State filing fees

- LLC name check
- Wyoming Certificate of Good Standing
- Certified Articles of Organization
- All paperwork filed with the State
- Organizational Forms
- Engraved hand-press company seal with pouch
- Deluxe corporate binder with company name embossed that includes:
  - Certified copy of Articles of Organization
  - 20 Pre-Printed Membership Certificates
  - Membership Agreement
- Minutes of first Members Meeting
- Over a dozen commonly used resolutions
- Membership Transfer Register
- Application and instructions for Employer Identification Number (SS-4 Form)

$495.00 one time charge, there are no other fees or charges.

How Long It Takes: About 6 working days to get the papers back from the State and another 3 to 4 days to mail the kit to you.

Click here to go to Order Form

Move Your Current Corporation to Wyoming

We will process all the State paperwork needed to move your existing US corporation to Wyoming, retaining your original incorporation date, but placing your company in "no state tax" Wyoming. First years Registered Agent service is included. (You must be current with your existing state and provide a Certificate of Good Standing and certified Articles of Incorporation, both issued within the past 30 days.)

$595.00 one time charge

Click here to go to Order Form

Wyoming Non-Profit Corporation

Certified Articles of Incorporation, Certificate of Good Standing, Corporate book, corporate seal, 20 pre-printed stock certificates, first years Registered Agent service is included. (Filing of the Federal 501-C is not included.)

$495.00 one time charge

Click here to go to Order Form

Registered Agent Services

Wyoming laws require that all corporations maintain a registered agent within Wyoming's borders, with a live person there available for service Monday through Friday 8:00am to 5:00pm. The duty of the registered agent is to accept service of legal documents and notifications from the state or other entities. As your registered agent, we will accept all legal documents on behalf of your corporation and forward them to you. This is not a regular mail forwarding service.

Also included in this service is the forwarding of all governmental mail to you from the Federal and State governments. Most other companies do not provide this service.

(Registered agent service is automatically included in the basic Corporation and LLC packages for the first year.)

$135.00 per year for each year thereafter if paid via Auto-Debit/credit card.
$185.00 if billed.

Click here to go to Order Form

Federal Tax Identification Number Application

All new corporations must obtain a federal tax identification number. We will forward the appropriate forms for you to sign. (Your Social Security Number Required.) This is included in the new incorporation and LLC packages.

Free with New Incorporation and LLC Packages

Apostille

A company that is planning to open a bank account in Europe and other countries most likely will need an Apostille. The cost for any document that needs this service is $50.00 per Apostille.

Click here to go to Order Form

Nominee Tax Identification Number

**No Social Security Number Required
All new corporations must obtain a federal tax identification number. Normally you must provide a social security number to obtain the tax id. But using this plan the Nominee will provide their social security number, allowing you to maintain your privacy. **This service is not available for LLC's which are taxed as an individual or for S-Corporations.**

$300.00 One Time Charge

Click here to go to Order Form

Bank Account

Most corporations need a new bank account. You can choose to have this bank account in the state where you are located or in Wyoming. If you choose Wyoming and want a national bank, the only national banks we have in Wyoming, that will allow long distance applications, are Wells Fargo and Bank of the West. To get an account opened, in Cheyenne, you will need to be positively identified and have the paperwork notarized, at a branch near you. We will send you the appropriate forms to sign, explain what you need to do with the branch in your area, coordinate this with the branch here, walk the papers into the bank in Cheyenne, and then mail you the finished paperwork and banking information. **NOTE: If you are turned down for any reason, the fee we change is not refundable. If you are on ChexSystems the bank will turn you down.**

$395.00 One Time Charge

Click here to go to Order Form

Mail Forwarding and Virtual Office Address

Using this option gives you a virtual corporate address and presence in Wyoming. Any mail sent to your Wyoming address will be forwarded to you. The total postage to you can not exceed $4.05 per mailing for our flat rate service. Your company is assigned a separate suite number, at a real physical address.

Inside the USA Flat Rate Mail Forwarding/Physical Address

$150.00 per year Quarterly Mail Forwarding
$250.00 per year Monthly Mail
$350.00 per year Twice Monthly Mail
$450.00 per year Weekly Mail
$550.00 per year Twice Weekly Mail*
$650.00 per year Daily Mail*

*postage not included in daily and twice weekly mail services

Outside the USA

$250.00 per year Monthly plus postage with a $200.00 minimum postage deposit to start

Click here to go to Order Form

Phone Service voice mail only auto message forwarding

A dedicated phone line is answered by machine only. Messages are taken for your corporation and sent to you automatically via-email wav file attachment. (phone is not listed in information. This can be added for $10 per month, paid yearly in advance)

$250.00 per year

Click here to go to Order Form

Live Phone Answering Service

A dedicated phone line is answered in the name of your Wyoming structure by a live receptionist. Messages are taken for your corporation and sent to you via-email or phone. (phone is not listed in information. This can be added for $10 per month, paid yearly in advance)

$800.00 per year

Click here to go to Order Form

Full Office Presence

If you need an Corporate Presence in Wyoming we will provide that service. Mailing address, mail forwarding, separate phone in the company name, phone number can be listed in yellow pages for an added fee, phone answered in the company name by a live person, fax number with forwarding, and use of an office when you visit.

$1350.00 per year

Click here to go to Order Form

Officer Nominee For Public Record Only

Each state has a web site that can be searched to find out who the officers and directors of a company are. So the first thing attorneys do when filing a lawsuit is to conduct an asset search from one end of the country to the other. The extra cost for this service will pay for itself many times over when a lawyer from a potential lawsuit tries an asset search with your name and finds nothing linking you to the company in the public records. This privacy service provides your corporation with a nominee officer and director to keep your name off state public records. After the public records are filed the nominee resigns and you become the officer of the company, but this change is not required to be reported to the state until the next years filing. At that time you can elect to use the nominee again. We recommend that all of our clients use this service, unless they wish to project a high profile image.

Public Record Nominee $400.00 ($300.00 if purchased with company)

Click here to go to Order Form

Full Time Nominee Officer/Director

This privacy service provides your corporation with nominee officers and directors to keep your name off both public state records and other paperwork that the corporation needs to file during the year. Consider this service an essential rock-solid fortress between your assets and potential lawsuits. Owners of Wyoming corporations need not be listed on state records, only the President, Secretary, Treasurer, and Directors do. Therefore, you become the corporation's Vice President - the one person not listed on state records. This service allows you full control and complete privacy. By having contracted directors and officers represent those positions on public files, your relationship with the corporation remains totally private.

Full Time Nominee $1500.00 a year. There are certain limitations regarding personal liability.

Click here to go to Order Form

Attorney Privilege Full Time Nominee Services

Using this service we provide an attorney who serves between the beneficial client (you) and the nominee. With the attorney in place, there is an attorney client privilege invoked, which still allows the client to communicate instructions via a password to the nominee, but all nominee connections are handled through the attorney. This allows the nominee to respond to questions by referring to the attorney and the attorney can then invoke the client privilege. You pay the attorney for all services. There is no connection with you and the corporation. The attorney's name will appear on the public record as the director. The nominee signs everything for the corporation, that does not have a personal liability, including agreements and corporate documents.

Price per year $2500.00

Click here to go to Order Form

Aged (Shelf) Corporations

If the need of an aged, established corporation is important to you, Wyoming Corporate Services has a limited number of previously formed, unused corporations. Aged corporations come with all the features of our Classic Incorporation Package, and are guaranteed to be clear of any debts or liabilities. You may need an aged corporation for the following reasons:
Corporate Image Building, Corporate Credit, Working With Other Companies, Establishing a History, Bidding Contracts, Obtaining Bank Loans, Obtaining Corporate Credit Cards, Obtaining Privacy.

Price Based On Age Of Corporation

Click here to see the list we have

Click here to go to Order Form

OFFICE PACKAGES

Wyoming Corporate Starter Package

The Corporate Starter Incorporation Package adds a new dimension to the "Basic Incorporation Package", providing an additional service that most corporations should have.

Includes:

- Everything that is included with our Basic Corporation Package
- Plus physical address with corporate mail forwarded monthly

$695.00 for Corporations and LLC's

Click here to go to Order Form

Wyoming Virtual Office Package with Phone

This package is designed to cover most of the initial things needed if you need a virtual office presence. The features included are:

- Everything that is included in the Basic Corporate or LLC Package, plus
- Phone number, answered by machine with messages sent via email attachment
- Physical address with mail forwarding service monthly

$895.00 for Corporations and LLC's

Click here to go to Order Form

Full Wyoming Office Presence Package

This package is designed to cover most of the things needed if you need a full office presence. The features included are:

- Everything that is included in the Basic Corporate or LLC Package, plus
- Phone number answered by a live operator in your company name
- Mail Forwarding service weekly
- Physical Address in Wyoming
- Fax number with forwarding
- Use of an office when you visit
- If Yellow page listing of phone is needed add $30 per month.

$1745.00 for Corporations and LLC's

Click here to go to Order Form

PRIVACY PACKAGES

Basic Privacy and Asset Protection Package

The Basic Privacy and Asset Protection package offers privacy from the start. This package adds Nominee Officer Services, and nominee EIN service which gives you confidentiality.

Includes:

- Everything that is included with our Basic incorporation service, plus
- Nominee Federal Tax I.D. Number
- Public Record Nominee Officer and Director

$995.00 (not available for LLC's)

Click here to go to Order Form

Privacy and Asset Protection with Office Package

The Privacy and Asset Protection package offers Nominee Officer Services, Nominee EIN service, virtual office services.

Includes:

- Everything that is included with our Basic incorporation service, plus

- Physical Address with monthly Corporate Mail Forwarding
- Public Record Nominee Officer and Director
- Nominee Federal Tax I.D. Number
- Phone with voice mail only and messages forwarded via email attachment

$1495.00 (not available for LLC's)

Click here to go to Order Form

Full Executive Privacy Office Package

This includes everything in the Privacy and Asset Protection Package but adds the corporate phone service, answered by a live operator in the corporate name and weekly mail forwarding.

- Nominee Federal Tax I.D. Number
- Corporate Mail Forwarding and Physical Address Package, weekly forwarding
- Public Record Nominee Officer and Director
- Phone number answered in company name by a live person
- Plus everything that is included with our Basic incorporation service

$2195.00 (not available for LLC's)

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We accept MasterCard, Visa, American Express, Discover, Checks, and Wire Transfers.

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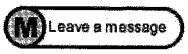

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EXHIBIT #8

nevadafirst.com

Excerpts from website of a Nevada based Company Formation Firm

Permanent Subcommittee on Investigations
EXHIBIT #8

Nevada First Holdings, Inc.

Welcome Letter / Site Map / **Login to Account**

LIVE SUPPORT Online - Click here **(8-5 M-F PDT)**

Call 1-800-767-9262 (8 - 5 pdt) or on weekends/after hours 1-866-881-0073 (until 7pm pdt)

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- What's right for you?
- FAQ
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- Pricing / Order Forms
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- Support Services
- Contact Us

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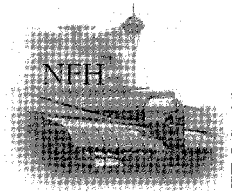
Email: Join

13 Years



Incorporation Services

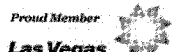
Nevada First Holdings offers a unique combination of professional services including filing Incorporation, Partnerships, LLCs, and Trusts; special services such as Setting up Bank Accounts with Office Presence or providing Director or Trustee Services, and financial services that include preparation of tax filings and contractual agreements. Our Services are designed to meet the needs of clients from all over the globe. Nevada First Holdings has enjoyed success providing our clients with specialized planning for asset protection and privacy by assisting our clients with management consulting in the income tax-free state of Nevada. We can answer your questions: Why incorporate in Nevada? What's so good about tax-free Nevada? What are the reasons for choosing an LLC over corporation? No question goes unanswered.

Main Advantages to Incorporating in Nevada

For small and medium size businesses, Nevada is now the preferred jurisdiction in which to incorporate. Incorporating in Nevada gives access to a series of fiscal and legal benefits. Asset protection and tax exposure reduction are the two primary reasons that people choose to incorporate in Nevada. Domicile is critical. Domicile means "primary resident", not to be confused with "resident agent". Without a corporate address, most of the Nevada benefits are lost (see Office Presence).

Tax Advantages

The first main consideration when deciding whether to incorporate in Nevada is the effect on tax exposure. Nevada offers corporations outstanding fiscal advantages. Nevada has no business income tax, corporate shares taxes, state corporation tax, franchise tax, or inheritance tax. Furthermore, corporations do not have to file state tax returns and share information is held private.



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Asset Privacy
One advantage of Nevada incorporation is that it provides owners with beneficial and unparalleled asset privacy. Nevada's reporting and disclosure obligations are lighter than in any other state.

Flexibility
In Nevada the shareholders of a standard corporation may consist of any number of individuals of any nationality, and/or any number of Corporations. Shareholders' identities are protected in Nevada. Any individual or Manager, as a Director or Officer in a Nevada Corporation, is protected from personal liability for acts committed on behalf of the Corporation, by the Corporation.

Nevada First Holdings Inc.

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Dear Sir or Madam:

Welcome to Nevada First Holdings Inc.'s (**NFH's**) website. From our home page, you will be able to navigate through topics of information on the services we provide. Coming soon, our new interactive Web Database will allow clients to log in to see their current entity status along with the option to order many new services (i.e. living trusts, trusts, wills etc.).

NFH offers a unique combination of professional services ranging from domestic Incorporation, Partnerships/LLCs, Business Trusts, and Director Services. We also offer complete Office Suite/Identity services which include telephone service, financial services to include the opening of business checking accounts and Duns and Bradstreet ratings. We provide our clients, as needed, detailed explanations of structural organization that will minimize their tax exposure. After we prepare the articles of incorporation we can assist with the company's by-laws and shareholder/board of director initial minutes and/or operational contractual agreements. Our services are designed to meet the needs of our clients from all over the globe. **NFH** was established in 1993 in Las Vegas, and has since enjoyed success providing our clients with specialized planning for asset protection and privacy through domestic incorporation and financial services in the income tax-free state of Nevada.

The information provided will guide you through the process of domestic incorporation and furnish you with instructions for operating your business entity. Please refer to the home page or the links on the left for the appropriate subject of interest. To establish your Nevada business entity, go to the appropriate order form page.

NFH's combination of services is second to none. Our ability to offer clients advice and guidance through the assistance of professionals with expertise in the areas of tax planning and corporate legal services assures that your goals will be achieved in a timely and affordable manner. We are always available to discuss the particulars of your individual circumstances and to offer our advice. We advise all prospective clients to be aware of incorporation companies that are new, do not operate in Nevada, or do not give their address or complete pricing in advance. We also recommend checking Better Business Bureau, Chamber of Commerce and Nevada Resident Agents Association (you may access these by clicking on their logos

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on the left).

Please feel free to call or come by our offices so we may further assist you with your needs and accomplish your goals. All correspondence, both written and oral, will be held in strictest confidence. We promise only professional consultation-without commissioned salesmen.

Respectfully,

Wayne Andre
Director Client Services

Nevada First

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13 Years

Proud Member
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The Voice of Business

Dear Friends,

Confused? You see "Incorporate for $100" advertised everywhere! Our Incorporation service fee begins at $100, but what does that mean? The basic fee should not be the cornerstone for your research. Instead NFH is dedicated to providing useful and pertinent information. For example, never do a foreign filing! (this is paying double for no reason) When should you use an LLC or a Corporation? Simple, Corporations are preferred for operating business and/or holding companies (such as company assets), while LLCs are good for pass through income and holding assets such as real property. Corporations are better for privacy and have superior tax benefits. C corporations are best when there are expenses, operating cost and operating purchases, S corporations for businesses with limited operating expenses or to carry forward losses. Double taxation only exists when there is unmanageable sudden gain income. S corporations offer dividend income and this limits federal taxation. Read these examples and see if they help.

As for our pricing, we believe our prices cannot be met apple for apple. For example, we charge a basic fee of $675 for a LLC or $595 for a Corporation, which includes everything required to establish either properly completed in one day. However, we will prepare and file either an LLC or a Corporation for $200 which includes our fees, the state fees and S/H. However, this is "bare bones", and it will take six weeks and does not include resident agent or a kit which includes operational guidance such as the LLC operating agreement. We suggest you read further.

Example for a Local Business: Joe's Pizza in New York, NY is an operating business and should incorporate in NY (and probably should file a 2553 "S" with IRS). If Joe's Pizza ends up owning the building and equipment, these assets should be owned by a separate holding entity, preferably a "C" corporation in Nevada. If Joe's Pizza gets sued and loses the lawsuit, the assets are protected in the holding entity. Remember, an operating company should never hold assets.

Example for Regional Business: ACME Consulting/web hosting does business nationally. This company should incorporate and be domiciled in Nevada. Without a proper "Domicile" (domicile means "place of residence") the Nevada advantages are lost. Incorporating alone does not domicile a business (articles of incorporation are like a birth certificate and have nothing to do with the company's residence), nor does having a resident agent (resident agent means "legal address for service") does not domicile a business. A business, when domiciled in Nevada, is headquartered here with branch offices elsewhere (foreign registration is not normally required). When shipment is made from a different state than the headquarters, it is advised that the Nevada corporation file a corporation in the state where shipment is made (for proper sales tax purposes). Never should a Nevada entity file as a foreign corporation in another state (new filing fees are the same as foreign fees).

Example for Real Estate business: ACME Real Estate Developer/Property Management places each property in an LLC.

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The Manager (Property Management/Developer) is incorporated as a C corporation, and the investors are the members. See chart with explanation.

For more details on specific pricing on our services, see our order forms, or call and let's talk. Remember, there are no commissioned salesmen at NFH. To place an order, see Complete Corporate Business Package Order Form or Complete LLC Business Package Order Form or LLC with a Business Corp Package plus a Trust Package order form or go to List of Order Forms.

We can assist you in the proper organizational structure, as needed. Please take a look at our site and the services we offer, then call, e-mail or stop by and visit. Appointments are not required-but it's a good idea to call to make sure there isn't a line in the waiting room! The coffee is always fresh and complementary!

We look forward to hearing from you,

Wayne Andre

Director Client Services

Nevada First

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The Voice of Business

These pages are under constant construction and will be updated regularly to help assist you in whatever questions you may have regarding Corporate definitions and our services. Please see Corporation Definitions and Attributes, for defined subject matter.

1. **What are the benefits of incorporation?**
2. **Does incorporation require extensive paperwork?**
3. **Why should I incorporate in Nevada?**
4. **What is a Registered Agent and what services does one provide?**
5. **Why do I need office identity or a telephone number in Nevada?**
6. **What are the annual filing requirements of a Nevada corporation?**
7. **How many directors and officers are required to form a corporation?**
8. **Who owns and controls the corporation?**
9. **What is a 'C' corporation?**
10. **What is a 'S' corporation?**

What are the benefits of incorporation?

Incorporation provides many benefits to business owners. One of the primary benefits is asset protection. As owners of a corporation, shareholders' liability is limited to the amount invested or capitalized to organize the corporation. For example, creditors of your corporation must generally satisfy their claims by seizing assets of the corporation rather than the personal assets of the shareholders. In contrast, as a sole proprietor or partner in a general partnership, you are financially responsible for all liabilities of the business, and your personal assets are subject to seizure or lien by creditors.

Those persons desiring to conduct general trading activity, real estate development, or other business ventures may choose incorporation as an effective investment vehicle for such activity. Incorporation provides the structure to take advantage of generally accepted accounting principles to reduce tax exposure.

Incorporation also provides a method to retain anonymity as a business owner since shareholders of a corporation are not generally publicly registered. Furthermore, incorporation provides a greater opportunity to raise capital for the business through issuance of stock (certain restrictions apply).

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Does incorporation require extensive paperwork?

No. When electing to utilize our Incorporation services, we undertake preparation of the Articles of Incorporation, Acceptance of Resident Agent, List of Officers, and any necessary records and resolutions to maintain compliance with the State of Nevada. Our professional services may also be utilized to obtain the federal tax identification number to establish corporate bank accounts. The Purchase Order forms contain all of the information necessary to

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establish your entity in the State of Nevada. We can also assist with establishing a limited partnership, limited liability company, or offshore corporation.

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Why should I incorporate in Nevada?

There are numerous advantages to incorporating in the State of Nevada. Probably the most compelling reason to choose Nevada is that it imposes no state income taxes or annual financial returns. Also, the Secretary of State only requires minimal annual reporting; which is limited to submitting the name (s) and address(es) of the person(s) holding the position of Officer or Director. (As your Resident Agent we provide assistance to ensure annual compliance.) Additionally, the Nevada Revised Statutes do not impose restrictions on the place, time, or frequency of stockholders' or directors' meetings. Another important factor when choosing the jurisdiction in which you wish to incorporate is the anonymity protection afforded to the shareholders. Nevada does not require the name(s) and address(es) of the shareholder(s) to be publicly filed.

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What is a Resident Agent and what services does one provide?

The term 'Resident Agent' means the agent (natural person or legal entity) appointed by the corporation, limited partnership, or limited liability company upon whom process or a notice or demand authorized by law to be served upon the corporation may be served. The Nevada Revised Statutes require that corporations, and other such legal entities, retain the services of a Resident Agent who must have a street address for the service of process. The street address of the Resident Agent is the registered office of the corporation in the State of Nevada.

Nevada Revised Statutes (78.105) further requires that a corporation must keep a copy of the following records at its registered office: (a) a copy certified by the Secretary of State of its Articles of Incorporation, and all amendments thereto; (b) a copy certified by an officer of the corporation of its bylaws and all amendments thereto; and (c) a stock ledger or a duplicate stock ledger, revised annually, containing the names, alphabetically arranged, of all persons who are stockholders of the corporation, showing their place of residence (if known) and the number of shares held by them respectively. In lieu of the stock ledger, the corporation may keep a statement setting out the name of the custodian of the stock ledger or duplicate stock ledger, and the present and complete post office address, including street and number, if any, where the stock ledger or duplicate stock ledger is kept. Please contact Nevada First Holdings, Inc. for information regarding records maintenance for Limited Partnerships or Limited Liability Companies.

As your Registered Agent, we strive to ensure that your corporation, limited partnership, or limited liability company remains in compliance with the annual provisions as set forth by the State of Nevada. You may contact us with any questions regarding the operation of your corporation. Resident agent does not provide a legitimate address for the business in Nevada see Office Identity for an explanation

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Why do I need Office Identity or a telephone number in Nevada?

Why have an office identity? Let's begin with "Domicile" which means "Primary Residence." Confusion begins with the "Articles of Incorporation." In simple terms, this is a birth certificate, which of course has nothing to do with residence. Then the term "Resident Agent," which is defined as "agent for accepting legal service." This also has nothing to with the residence of the business. The residence of an individual or an entity is based upon their paper trail which proves their address (i.e. utility bills, bank account, IRS address, etc.) A Post Office Box or PMB is not a legitimate address. Resident agents who forward official mail are not a legitimate address. Only at a company designated with the correct business licenses at the location's facilities and with U.S. Post "mail drop" designation may a specific address designation be issued for a legitimate address. See Office Identity for more information.

What are the annual filing requirements of a Nevada corporation?

Nevada corporations must file an annual List of Officers with the Secretary of State setting forth the name(s) and address(es) of the person(s) holdings the offices of President, Secretary, and Treasurer as well as those serving on the Board of Directors. (The names of the shareholders are not subject to public registration.) Limited Partnerships and Limited Liability Companies have similar annual reporting requirements.

The State of Nevada does not impose income taxes, and as such, an annual financial return is not required. The State does now require the registration of a Nevada Business License and pay a minimum of $100, NFH offers the service of registering this license on a one time basis for $50.00. Corporations must, however, file an annual federal tax return (IRS Form 1120) with the US Department of Treasury. Limited Partnerships and Limited Liability Companies have similar requirements, please contact Nevada First Holdings Inc. for further details.

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How many directors and officers are required to form a corporation?

Nevada Revised Statutes require at least one natural person to serve as director of the corporation. The same person may hold the offices of President, Secretary, and Treasurer and may be the only person appointed to the Board of Directors. The name(s) and address(es) of the person(s) holding said offices or appointed to the Board of Directors must be filed with the Secretary of State annually. The Officers and Board of Directors are appointed by the shareholders of the corporation. The shareholders ultimately decide the course of action of the corporation.

If you desire to retain a higher level of anonymity, you may wish to utilize our Director Services. Nevada First Holdings Inc. will provide your corporate entity with an Officer to serve in the positions as required by the Nevada Revised Statutes. The name and address of the Director will be filed annually with the State of Nevada on behalf of the corporation. Additionally, the Director will be utilized to obtain the tax identification number for your corporate entity. When submitting the application for a tax identification number to the US Department of Treasury, the President of the corporation must provide their name and social security number (or proof of foreign status). While you may elect to use the Director Services, you will remain responsible for the daily operation of the corporation. This is generally substantiated through resolution (Appointment of Operating Officer) or power of attorney.

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Who owns and controls the corporation?

The corporation is owned by the shareholders, who may be domestic or foreign natural persons or legal entities. In general, since the shareholders appoint the Officers and Directors, the corporation is controlled by the shareholders. The name(s) and address(es) of the shareholder(s) are officially recorded in the stock ledger which is typically maintained by the Resident Agent or an Appointed Custodian.

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What is a 'C' corporation?

The "C-Corporation" designation merely refers to a standard, general-for-profit, state-formed corporation. To be formed, an Incorporator must file Articles of Incorporation and pay the requisite state fees and prepaid taxes with the appropriate state agency (usually, the Secretary of State – Corporations Division).

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What is a 'S' corporation?

A S corporation is a standard C Corporation that has had an S filing form completed to the IRS. There are several reasons for filing an S corporation, double taxation normally is not one of them! For more read Corporate definitions and attributes.

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TAX COMPLIANCE AND THE CORPORATE SHIELD

The two main reason for using LLCs are 1. For titling of Real Property (and other assets) (see chart below) or for companies with unmanageable income or income with limited operating cost. A business organized for purposes other than banking or insurance may within the previously defined purposes find it advantageous to establish itself as a Limited Liability Company rather than as a corporation. A Limited Liability Company (LLC) is a hybrid between a corporation and a limited partnership. Members are afforded the limited liability of corporate shareholders and the pass through tax advantages of a partnership without the restrictions imposed on limited partnerships and Subchapter S corporations. Management and ownership may be structured in any fashion as specified in the Operating Agreement, thereby allowing for total flexibility in income distribution. In addition, the Operating Agreement is not required to be publicly filed, maintaining confidentiality of the ownership structure.

The principal issue when forming an LLC will be whether pass-through taxation is desirable; if not, the LLC can be structured to be taxed as a corporation. The LLC can be organized with two or more members. Members may be any person or legal entity, domestic or foreign, who own an interest in the company. Members have no liability of NRS in Nevada, Chapter 86, for the debts, obligations or liabilities of the company to any third parties, whether any such debts, obligations or liabilities arise out of contract, tort or otherwise, solely by reason of being members of an LLC. An LLC requires no general partner, so all of the members have the same limited liability, regardless of ownership interest.

ADVANTAGES OF FORMING AS AN LLC

- LLCs may operate with a single Manager, Real property recorded in an LLC has tremendous benefits see Chart with explanation.
- Unlike a Limited Partnership, a Limited Liability Company is not required to declare a general partner. The manager of a Limited Liability Company does not have to maintain a one percent interest in the entity; therefore the personal assets of the manager can not be attached by a creditor seeking payment of a Limited Liability Company debt. Furthermore, no member of a Limited Liability Company may be held fully liable for any debts of the company.
- LLCs can allocate specifically any distribution of income, gain, deduction, or loss among its members. Stockholders of corporations organized under Subchapter S of the IRS guidelines are limited to distributing interest among its shareholders in

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proportion to holdings of capital.

- The entity may have any number of stockholders, unlike a sub S corporation that is restricted to a maximum of 35 investors. In addition, corporations, partnerships, certain kinds of trust, and non-resident alien individuals are restricted from being shareholders of a sub S corporation. LLCs are not subject to these restrictions.
- LLC operating costs are inherently lower than those of a sub S corporation.
- Whereas a general partner may not be removed by members of the Limited Partnership, an LLC is not required to declare a general partner. Managers designated by members of an LLC may be subject to removal if desired.

BUSINESSES WHICH BENEFIT MOST FROM BECOMING AN LLC

Companies that are closely held entities not to be traded publicly in the near term may benefit from organizing as an LLC. See Charts Business activities which typically benefit from organizing as an LLC include:

- **Real Estate Developers** - Members may contract debt (acquire loans) on behalf of the LLC. Once the property is acquired, any income, gain, deduction, or loss may be specifically allocated among the Members. This combination of provisions essentially allows for the transfer of capital gains from one member to another.
- **Corporate Joint Venture** - Rather than using wholly owned subsidiaries to establish a general partnership joint venture, corporations may form an LLC that will provide the same amount of limited liability as well as pass-through taxation.
- **Subsidiaries of Sub S Corporations** - A sub S corporation may not own more than 80% of an LLC subsidiary corporation; however, a sub S corporation may form a wholly owned subsidiary LLC. Owning the subsidiary LLC would allow the parent S corporation to expand its resource base.
- **Venture Capital Vehicle** - LLCs allow considerable opportunities for investment of company capital into income-generating ventures since the potential number of investors are unlimited. Venture profitability can be enhanced further when members are structured as offshore corporations. This not only allows for reduction in tax exposure, but also a greater level of asset protection and scrutiny. Bahamas Incorporation Services are available through Nevada First Holdings, Inc. Please call for additional information.
- **Small or Family Businesses** - LLCs are ideal for small or family-operated businesses. There is total flexibility for structuring management and ownership, and members avoid double taxation.

ORGANIZATIONAL DIFFERENCES AMONG THE STATES

There are four important distinctions among the States:

- **Dissolution Date** - California must specify a dissolution date, which may be at any point in time. Neither Nevada nor Delaware may specify a period of duration greater than 30 years. Wyoming has no limit, and may designate "perpetual" as a period of duration if so desired.
- **Cash Contribution Disclosure** - Organizing in Wyoming requires disclosure of the total amount of cash contributed to the

company as well as the total cash value of property contributed to the company at the time of formation. Nevada and California have no such requirement.

- **Freedom of Contract** - Delaware will only provide rules for matters on which the Members of the LLC have failed to agree as per the Operating Agreement. This contractual flexibility as defined by Delaware Corporate Statutory Law is superior to that of any other state.

- **State Taxation** - Nevada and Wyoming do not have a State income tax; California levies an annual franchise tax of $800.00; Wyoming levies an annual State tax on LLCs of $100.00; Nevada requires an annual List of Officers or Members filing, fee $100.00; Delaware levies an annual franchise tax of $30.00.

TAX AND OPERATING DIRECTION

Limited Liability Companies are taxed as a "pass-through" entity, unless otherwise structured in the organizational documents. Please see page 2 under the heading "Tax and Operating Direction" for a more detailed explanation.

Nevada First Holdings Inc

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Nevada First Holdings (NFH) offers the service of providing our clients assistance with opening business checking/trading accounts. Currently there are at least three regional/national banks which allow signers that live out of the state of Nevada. Fortunately, NFH may assist its clients with two of these banks (Wells Fargo and WAMU). Also, NFH may assist with opening trading/checking account with several major trading companies (that provide checking) and/or with the discount traders. We also have associations with several local Nevada banks.

We herein will attempt to explain each bank's requirements to open accounts in Las Vegas, Nevada. It must be understood that the banks change their requirements periodically on a rather subjective basis. The new standards are theoretically based upon the Patriot Act. The issue for the banks is two fold, the Act generally makes the bank responsible to know their customer and the banks are financially responsible for their customers actions. Therefore, policies have been sent down to branch managers that leave them somewhat without reasonable options, for example both Wells Fargo and BofA will not accept Canadian signers without SSN or TIN. All new customers must identity themselves with proper identification and provide either a SSN or TIN or W-8 (NFH will assist). Please review the following:

Wells Fargo: (23 states) New customers or customers with existing accounts do not have to appear at a Wells Fargo branch. The first step is completion of Authorized for Information in Connection with Business Account Application and provide two types of ID. All arrangements are completed by NFH; then the client will then be contacted by a Wells Fargo representative to open their business account.

International signers; Wells Fargo will no longer accept signers without SSN or TIN.

Washington Mutual (13 states) East Coast to West Coast (see map) offers many benefits. New customers may open business accounts by presenting themselves with identification at their local branch. All arrangements are completed by NFH. Find A Location

International signers, WAMU will accept International signers by appearing at any US Branch with correct Identification and completing a W-8, All arrangements are completed by NFH.

Bank of America: (38 states) BofA will open business accounts in Nevada when the signer(s) appear at a Branch locally in Nevada.

International Signers; Bank of America will open business accounts when signers present SSN or TIN and appear at a branch Locally in Nevada.

Trading Firms: Require new customers to complete the application forms titled New Account Application (with addendums) plus standard identification, SSN or TIN or EIN (provided by NFH) and signed W-8, Branch appearance not required, bank letter of reference and proper utility bill may be required. When checking services are required, these trading companies have minimal

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deposit requirements which are substantially larger than normal bank requirements.

Scottrade: Similar to above.

To use the services of NFH to open a business checking/trading account. NFH has certain requirements. The client must have or wish to file a Nevada entity with NFH as the resident agent and use NFH's Office Identify service. To order our business package see Complete Corporate Business Package or Complete LLC Package. To order an account for an existing existing entity, see Bank Account for existing entities.

For additional assistance please feel free to call or e-mail the Director of Client Services, see Contacts.

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The Office Identity program is provided for clients who require a legitimate business address in Las Vegas, Nevada. Rather than a mail drop or a PO Box service, NFH offers genuine office suite services that includes an address with a distinct suite number, individualized mail forwarding, corporate telephone number (shared) that includes reception service, routine copier and facsimile service and a full service conference room availability are included in the basic Office Identity program.. Expanded fulfillment services are available. See explanation below of why your corporation requires office identity.

Why office identity? Lets begin with "Domicile" which means "Primary Residence". Confusion begins with the "Articles of Incorporation". In simple terms this is a birth certificate, which of course has nothing to do with a residence. Then the term "Resident Agent", the term should be "agent for accepting legal service". The term Resident., also has nothing to with the residence of the business. The residence of an individual or an entity is based upon their paper trail which proves their address i.e., utility bills, bank account, IRS address, etc. A Post Office Box or PMB is not a legitimate address. Resident agents who forward official mail are not a legitimate address. Only at a company designated with the correct business licenses at the locations facilities and with U.S. Post "mail drop" designation may a specific address designation be issued for a legitimate address.

Individual telephone service. This service is available for those clients who realize the importance of their business credibility. Clients with Office Identity may wish to have their own listed business telephone line. Corporate credit can not be issued without telephone confirmation. State revenue officers confirming a company's existence simply dial 411 to see if a company exists. Our service offers complete reception answering (no charge for answering service), voice mail and voice mail messaging so a client is notified in real time of voice mail messages. For the link to these services see Office Identity Services.

The flexibility of our office identity department allows NFH to deliver to each client a tailored package suitable for their business activities. Please contact our offices so we may explain in detail how our Office Identity Program can satisfy your business requirements. You may also sign up on line by registering at Office Identity Services.

13 Years

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What is a director/manager? The term is meant to imply that a client or clients who are the majority shareholders or majority member certificate holders, have nominated Nevada First Holdings to appoint a Director or Managing Member and oversee that the Director/Manager completes their responsibilities. At NFH we are proud to offer Professional Director/Manager Services. It is important to understand that Directors/Managers have a responsibility to the shareholders/certificate holders that all legal responsibilities of the managers of the business have been reported annually and that their responsibilities according to the By-Laws/Operating Agreement have been satisfied.

Why should shareholder(s)/certificate holder(s) appoint Director(s)/Manager(s), especially when shareholder(s)/certificate holder(s) might be part of the management team? Simply put, in the event of lawsuits against an entity it is common that when a manager also appears as a Director, the manager could also be named in the lawsuit. In Nevada Shareholders/Certificate holders are held privately, however, directors/managers are public on the internet. The key to asset protection is privacy. These services provide the ultimate form of continuance of this American principal.

NFH provides Director/Manager services for their clients per the following terms:

1. Office Identity and Resident Agent services must be provided by Nevada First Holdings, Inc.

2. The Annual fee is $250.00

3. Additional fees for Director/Manager Activities, are $35 for the signing and forwarding of a group of documents required to be signed by the shareholders. The Director/Manager fee for all other services required by the shareholders is $65 per hour. Legal review is $125 per hour.

4. The company General Manager is required to provide the Director/Manager with an annual report to include the company has performed all functions legally per the By-Laws/Operating Agreement, and that all taxes have been paid and a copy of the first page of the corporations 1120/1540 corporate/ partner tax returns will be presented in advance of presentation to IRS.

DIRECTOR SERVICES (Corp) CONTRACT

SCHEDULE A
(Successors & Assigns)

MANAGER (LLC) CONTRACT

SCHEDULE A
(Successors & Assigns)

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www.Nevadafirst.com

Incorporate in Nevada!
NFH was established in 1993 in Las Vegas, and has since enjoyed success providing our clients with specialized planning for asset protection and privacy through domestic incorporation and financial services in the income tax-free state of Nevada.

<<< Incorporation & Support Services In Las Vegas Since 1993

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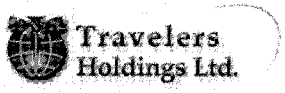
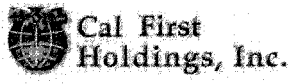
www.Travelersgroup.com

THM's professional staff offers the expertise and guidance to assist clients successfully establish and operate their companies and financial accounts in the ***Bahamas***. THM is Also available to assist you in your private banking and offshore investing needs.



Incorporation & Banking Services In Nassau Since 1992 >>>



www.calfirstholdings.com

California is *now* the preferred jurisdiction in which to incorporate. Incorporating in California gives access to a series of fiscal and legal benefits. Asset Protection and tax exposure reduction are the two primary reasons that people choose to incorporate in California.

<<< Incorporation & Support Services In California Since 1996

www.ICINV.com

ICI was formed in 1991 specializing in Corporate Consulting including public shell preparation, financing and preparation of business plans.

International Credit Investments, Inc.

Nevada First Business Suites.

www.NVFST.com

Virtual Business Office Suites
Nevada First Business Suites offers a complete Las Vegas City corporate identity Package with business and virtual office support services.

<<< Incorporation & Support Services In Las Vegas Since 1993

www.LasVegasRE.com

Las Vegas Real Estate has been created for the purpose of representing commercial properties in the metro Las Vegas area and to facilitate 1031 exchange properties in our area.

Las Vegas Real Estate

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Nevada First Holdings provides this service for a fee of $100 annually (guaranteed to never change), please read the description that follows then the explanation of how to register NFH as your resident agent.

The term 'Resident Agent' means the agent (natural person or legal entity) appointed by the corporation, limited partnership, or limited liability company upon whom process or a notice or demand authorized by law to be served upon the corporation may be served. The Nevada Revised Statutes require that corporations, and other such legal entities, retain the services of a Resident Agent who must have a street address for the service of process. The street address of the Resident Agent is the registered office of the corporation in the State of Nevada.

Nevada Revised Statutes (78.105) further requires that a corporation must keep a copy of the following records at its registered office: (a) a copy certified by the Secretary of State of its Articles of Incorporation, and all amendments thereto; (b) a copy certified by an officer of the corporation of its bylaws and all amendments thereto; and (c) a stock ledger or a duplicate stock ledger, revised annually, containing the names, alphabetically arranged, of all persons who are stockholders of the corporation, showing their place of residence, if known, and the number of shares held by them respectively. In lieu of the stock ledger, the corporation may keep a statement setting out the name of the custodian of the stock ledger or duplicate stock ledger, and the present and complete post office address, including street and number, if any, where the stock ledger or duplicate stock ledger is kept. Please contact Nevada First Holdings, Inc. for information regarding records maintenance for Limited Partnerships or Limited Liability Companies.

As your Registered Agent, we strive to ensure that your corporation, limited partnership, or limited liability company remains in compliance with the annual provisions as set forth by the State of Nevada.

The term Resident Agent does not mean an entity has a legitimate business address in Nevada this is called "Domicile" see Office Identity for an explanation.

When NFH files an entity for a client this service is automatically provided. However, you may wish to change your Resident Agent or file your entity yourself. In either case go to this link Support Services complete the form and check the appropriate fields, then submit the form and we will contact you immediately.

Respectfully,

Dr. Conner O'Shea

Operations
Manager

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We must begin with the first rule for "why Nevada" granted we offer privacy with no state income tax, but there is a hitch the word is "domicile" or if you do not set your corporation up correctly you are wasting your time buying a Nevada entity, see Here for a complete explanation of services available and why.

Previously formed companies are known by a number of terms: i.e. Shelf or shell (usually refers to publicly traded) or aged or seasoned companies, corporations, limited liability companies or partnerships or combinations of terms. Irrespective of the term, a shelf companies offers unique opportunities. Perhaps the leading reason for acquiring an aged entity in general is credibility. An answer to the most common question, yes you may merge your history with an aged entity.

Business relationships are frequently influenced by the length of time a company has been in existence. This is often true when establishing financial and client/vendor relationships. See NFH's heading above "*Since 1993*".

The fact that NFH's Shelf Entities have never or had limited operation, that all stock or member shares remain intact, gives intrinsic value to that entity. The limited existence of shelf companies should, therefore, not be unexpected. NFH's shelf companies date from 1994 to 2005. Most of these entities have Federal EIN numbers and have or had business checking accounts. Note it is no longer possible to take over and existing bank account. Therefore, a new account is opened with a reference to the existing account.

The age and not the name of the Shelf Company should be of primary importance as a name change can be readily accomplished along with a "Certificate of Good Standing" which is issued by the Secretary of State and includes the new name with the original date. **NFH's pricing structure is complete**. Which means the corporate status with the Secretary of State is current to include Director filings, Resident Agent service, EIN, Office Identity and the conversion or opening of a bank account as required. There are additional services which may be required. However, our pricing is not complex. Pricing begins with corporations see Basic Corporate or the Complete Business Package or LLCs see Basic LLC or Complete Business Package. Then, add $250 under a half year, or $500 per year. A complete list of additional service pricing are on the links above. We also provide a list of companies available, note "*" after the entity name indicates special features exist that increases its value and purchase price, also NFH does not provide the complete entity name so that the integrity is preserved, see Shelf List.

We offer substantial consulting in completing the proper merging and organization of a shelf company. NFH also offers continued support in establishing credit for the corporation, periodical financial analysis and corporate tax returns, these programs are customized to meet each clients specific needs.

Please feel free to contact us for further information.

Respectfully,

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Wayne Andre
Director Client Services
702-732-7570, ext. 1009

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Shelf Corporations - *Name of entity protected to preserve integrity of the company.*

[Pricing = $500 p/yr + applicable business package & optional services]

No.	Name of Entity	Type of Entity	Date of Entity	SOS Status	EIN	D & B	Bank Acct	NFH Status
1	Happy...	Corp	7/24/1992	PRV	NI-...		No Acct	
2	Karma...	Corp	8/10/1992	PRV	NI-...		No Acct	
3	Down ...	Corp	12/31/1992	PRV	NI-...		No Acct	
4	Cross...	Corp	3/25/1994	PRV	88-...		B of A	New - 10/2006
5	Train...	Corp	8/3/1994	PRV	88-...		B of A	
6	Timol...	Corp	8/8/1994	PRV	88-...		B of A	
7	JHB...	Corp	9/28/1994	PRV	88-...		B of A	
8	Impex...	Corp	10/17/1994	CL	88-...		No Acct	
9	Magnu...	Corp	10/17/1994	CL	88-...		No Acct	
10	InetA...	Corp	5/17/1995	PRV	88-...		B of A	
11	MCST,...	Corp	7/12/1995	PRV	88-...		B of A	
12	Unity...	Corp	7/17/1995	PRV	20-...		B of A	
13	1st I...	Corp	5/8/1996	CL	20-...		No Acct	
14	Distr...	Corp	8/22/1996	PRV	77-...			
15	AAA S...	Corp	10/29/1996	PRV	77-...		No Acct	
16	Water...	Corp	12/31/1996	CL	86-...		B of A	
17	Hedma...	Corp	2/14/1997	CL	77-...		Wells	
18	Groun...	Corp	3/18/1997	CL	13-...		No Acct	
19	Tamar...	LLC	3/24/1997	CL	77-...	Yes		
20	Trane...	Corp	4/7/1997	CL	77-...			
21	Airge...	Corp	5/2/1997	CL	88-...	Yes	No Acct	
22	Panor...	Corp	5/21/1997	PRV	NI-...		No Acct	
23	Sourc...	Corp	5/23/1997	CL	NI-...		No Acct	
24	Savoy...	Corp	10/29/1997	PRV	77-...		No Acct	
25	Plymo...	LP	10/30/1997	PRV	77-...			
26	Baraj...	Corp	12/23/1997	CL	20-...		No Acct	
27	Sante...	Corp	5/6/1998	PRV	NI-...		No Acct	
28	On Ho...	Corp	12/11/1998	CL	88-...		B of A	
29	L.E.A...	Corp	1/5/1999	CL	20-...		No Acct	

30	Herit...	Corp	1/8/1999	CL	20-...		No Acct	
31	Sky-R...	Corp	2/18/1999	CL	88-...		No Acct	
32	Provi...	Corp	4/12/1999	CL	88-...		None	
33	Globa...	Corp	5/28/1999	CL	88-...	Yes	No Acct	
34	Custo...	Corp	6/8/1999	CL	NI-...		No Acct	
35	CBWJ ...	LLC	7/27/1999	PRV	88-...		B of A	
36	Duxpl...	Corp	8/5/1999	CL	20-...		No Acct	
37	Nevad...	Corp	8/20/1999	CL	88-...		B of A	
38	World...	Corp	8/20/1999	CL	88-...		B of A	
39	ABC H...	LLC	9/2/1999	PRV	88-...	Yes	B of A	
40	Capit...	Corp	10/26/1999	PRV	88-...		B of A	
41	Big L...	LLC	12/29/1999	CL	88-...	Yes	B of A	
42	Point...	Corp	1/26/2000		88-...	Yes	B of A	New - 9/2006
43	First...	LLC	1/28/2000	CL	88-...	Yes	No Acct	
44	JLF R...	Corp	2/3/2000	CL	88-...		B of A	New - 9/2006
45	Chari...	Corp	2/8/2000	CL	88-...	Yes	B of A	New - 9/2006
46	Debt ...	Corp	2/8/2000	CL	88-...		No Acct	
47	Web G...	Corp	2/8/2000	CL	88-...		B of A	
48	JRC E...	Corp	2/11/2000	CL	88-...		B of A	
49	FairW...	LLC	3/1/2000	CL	NI-...		No Acct	
50	Rainb...	Corp	4/3/2000	CL	88-...	Yes		
51	Virtu...	Corp	4/25/2000	PRV	88-...	Yes	No Acct	
52	MPC A...	Corp	5/10/2000	CL	88-...		No Acct	
53	Gyron...	Corp	6/21/2000	CL	88-...	Yes	B of A	
54	Excav...	LLC	6/26/2000	CL	88-...		B of A	
55	Obliv...	Corp	6/30/2000	CL	88-...	Yes	B of A	
56	Sierr...	Corp	7/10/2000	CL	88-...		No Acct	
57	Desig...	Corp	7/13/2000	CL	88-...	Yes	B of A	
58	Distr...	LLC	7/19/2000	CL	NI-...		No Acct	
59	Glast...	Corp	7/27/2000	PRV	20-...	Yes	No Acct	
60	Maxim...	Corp	7/28/2000	CL	88-...		No Acct	
61	PI Tr...	LLC	8/14/2000	CL	88-...		B of A	
62	Disco...	Corp	9/6/2000	CL	88-...		No Acct	
63	Nos P...	Corp	9/20/2000	CL	88-...	Yes		
64	UG Wa...	Corp	10/5/2000	CL	88-...	Yes	B of A	
65	Crown...	Corp	4/4/2001	CL	88-...			
66	Premi...	Corp	7/11/2001		88-...			New - 9/2006
67	JPG, ...	Corp	7/17/2001	CL	88-...		No Acct	
68	Clear...	LLC	7/20/2001	CL	20-...		No Acct	
69	Alder...	LLC	9/19/2001	CL	03-...			
70	Winth...	LLC	11/8/2001	CL	NI-...		No Acct	
71	1240,...	Corp	12/20/2001	CL	-...		No Acct	
72	NeoCh...	LLC	3/13/2002	CL	41-...		B of A	
73	ABC a...	Corp	3/20/2002	CL	41-...		No Acct	
74	Quail...	Corp	3/20/2002	CL	41-...		No Acct	
75	Jami,...	Corp	6/13/2002	CL	68-...		B of A	
76	YK Ma...	Corp	8/13/2002	CL	42-...		B of A	

77	Starl...	Corp	7/16/2003	CL	20-...		Wells	New - 9/2006
78	NSI T...	LLC	9/17/2003	CL	54-...		B of A	
79	Eclec...	Corp	5/24/2004	CL	20-...	Yes		
80	Rosem...	LLC	8/16/2004	CL	20-...		No Acct	
81	Commu...	LLC	9/16/2004		-...		No Acct	New - 9/2006
82	Healt...	Corp	10/5/2004	CL	20-...		No Acct	
83	MedTa...	Corp	11/4/2004	CL	20-...		Wells	
84	Lacy ...	Corp	11/18/2004	CL	20-...		Wells	
85	Firew...	Corp	11/22/2004	CL	20-...			
86	Inter...	Corp	12/17/2004	CL	20-...		No Acct	
87	Moonb...	LLC	3/15/2005	CL	20-...		Wells	
88	Compa...	Corp	5/9/2005	CL	20-...		No Acct	
89	Hurri...	LLC	9/21/2005		-...		No Acct	New - 9/2006
90	Stoug...	Corp	9/23/2005		-...		No Acct	New - 9/2006
91	Ameri...	Corp	12/14/2005	CL	-...		No Acct	
92	Ameri...	Corp	12/16/2005	CL	20-...		No Acct	
93	Axium...	Corp	12/16/2005	CL	20-...		No Acct	
94	Land ...	LLC	12/16/2005	CL	-...		No Acct	
95	Prope...	LLC	12/16/2005	CL	-...		No Acct	
96	The P...	Corp	12/16/2005	CL	-...		No Acct	
97	The T...	Corp	12/16/2005	CL	-...		No Acct	
98	MALEX...	LLC	1/31/2006	CL	-...		No Acct	
99	NOAB,...	Corp	2/13/2006	CL	20-...		No Acct	
100	Ameri...	Corp	2/28/2006	CL	-...		No Acct	
101	Vieir...	Corp	2/28/2006	CL	20-...		B of A	
102	My By...	Corp	3/1/2006	CL	20-...		No Acct	
103	Domin...	Corp	5/10/2006	CL	20-...		No Acct	
104	Premi...	Corp	7/11/2006	CL	88-...		No Acct	New - 9/2006
105	After...	Corp	9/15/2006	CL	20-...		No Acct	New - 9/2006

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SHELF PRICING EXPLANATION

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Director Client Services

702-732-7570, ext. 1009

or

Conner O'Shea
Shelf Manager
702-732-7570, ext. 1011

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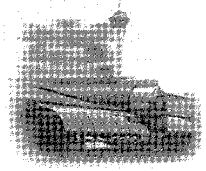

>Directions<

The Telephone Service program You may forward your telephone number or we provide an individual private business telephone number, with a telephone listing. Reception answering service (no charge) , voice mail and message forwarding to the number or pager of your choice. These services are available for a flat monthly fee of **$49.95.** To order Telephone Service and for more details go to www.TelephoneService.com or call 702-990-0495.

TESTIMONIALS

The office identity program is provided for clients who desire to establish a physical Las Vegas, Nevada residence for their entity, rather than a mail drop or a PO Box service. NFBS offers genuine office suite services that includes an address with a distinct suite number, individualized mail forwarding, corporate telephone number (shared) that includes reception service, routine copier and facsimile service and full service conference room availability.

The flexibility of our office identity department allows each client to create a tailored package suitable for their business needs. Please contact our office for details on how our Office Identity Program can satisfy your business requirements. To order office identity and for more details go to www.OfficeIdentity.com or call.

Conner O'Shea

Manager
702-990-0495

revised September 2006

1425
visits in 2006

Country Comparison Chart

HOME
PRODUCTS
STRATEGIES
ABOUT US

JURISDICTIONS
PRICES & COMPARISON
ANGUILLA
BAHAMAS
BELIZE
BRITISH VIRGIN ISLANDS
CAYMAN ISLANDS
DELAWARE
SEYCHELLES
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PANAMA
SAMOA
HONG KONG
ORDER NOW

BANKING
SHIP REGISTRATION

GLOSSARY

TERMS & CONDITIONS

Incorporate in Delaware or Nevada for top-notch privacy and lowest taxes possible within the limitations of U.S. law. Nevada and Deleware have the benefits of pro-business legislation and a long history as a tax haven. Incorporate in Nevada, Delaware or any other U.S. state at some of the best rates available anywhere. Just email us to get started. (Note: if you are not a U.S. resident we can assist you step-by-step in obtaining the EIN you will need for doing business or opening a bank account in the U.S.)

	Seychelles	British Virgin Islands	Samoa	Anguilla	Nevada (USA)	Delaware (USA)	Cayman Islands	Belize	Bahamas	Panama	Hong Kong
Offshore Inc Rating	★★★★★	★★★★★	★★★★★	★★★★	★★★★★	★★★★	★★★★	★★★★	★★★	★★★	★★★★★
Type of company	IBC	BC	International	IBC	Corporation	Corporation	Exempt	IBC	IBC	Ltd	Ltd.
Common or Civil Law Jurisdiction	Common	Common	Common	Common	Common	Common	Common	Common	Common	Civil	Common
Shelf Company Availability	Yes	Yes	Yes	Yes	No	No	No	No	No	No	No
Minimum annual government fee	US$ 110	US$ 350	US$ 300	US$ 200	US$ 175	US$ 35	US$ 580	US$ 100	US$ 350	US$ 300	HK$2705
Annual return required	No	No	No	No	Yes	Yes	Yes	No	No	No	Yes
Taxation on foreign profits	None	None	None	None	U.S. Govt., Taxes Only	U.S. Govt., Taxes Only	None	None	None	None	None
Disclosure of beneficial ownership	No	Only To Registered Agent	Only To Registered Agent	No	No	No	Only To Registered Agent	Only To Registered Agent	Only To Registered Agent	No	Yes
Bearer shares permitted	Yes	Yes	Yes	Yes	Yes	No	No	Yes	No	Yes	No
Standard minimum paid up capital	US$ 1	US$ 1	US$ 1	US$ 1	US$ 0	US$ 0	US$ 1	US$ 1	US$ 5,000	US$ 0	HK$ 1
Standard authorised share capital	US$ 100,000	50,000 shares	US$ 1,000,000	US$ 50,000	US$ 75,000	N/A	US$ 50,000	US$ 5,000 in US$1 shares	US$ 50,000	500 NPV Shares	HK$10,000
Permitted currencies of capital	Any	Any	Any	Any	US$	US$	Any	Any	Any	US$	Any
Minimum number of shareholders	1	1	1	1	1	1	1	1	1	1	1
Minimum number of Directors	1	1	1	1	1	1	1	1	1	3	1
Corporate directors / managers permitted	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes
Local directors / managers required	No	No	No	No	No	No	No	No	No	No	No
Registered Office / Agent	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Our Money Back Guarantee
If we accept you as a banking client and are unable to assist you to successfully open a bank account, we will return our full Bank Introduction fee (net of any shipping charges) to you.

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Merchant Accounts.
If you will be doing business on the Internet it is usually important that you be able to accept payment via credit card. This is often troublesome at the very least. However we have arranged with WorldPay to provide you with everything you need to start doing business overthe Internet.

Permanent Subcommittee on Investigations
EXHIBIT #9

	Seychelles	British Virgin Islands	Samoa	Anguilla	Nevada (USA)	Delaware (USA)	Cayman Islands	Belize	Bahamas	Panama	Hong Kong
Company secretary required	No	No	Yes - Anyone	No	Yes - Anyone	Yes - Anyone	No	No	No	No	Yes - Professional
Company seal required	No	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes
Public record of directors / managers	No	No	No	No	No	Yes	Yes	No	Yes	Yes	Yes
Public record of members	No	No	No	No	No	No	No	No	No	No	Yes
Location of directors / managers meetings	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere
Location of members meetings	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere	Anywhere
Telephone board / managers meetings permitted	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Audit Required	No	No	No	No	No	No	No	No	No	No	Yes

Prices (in Euros) (including first year government fees & registered office, excluding courier charge to your office.)

	Seychelles	British Virgin Islands	Samoa	Anguilla	Nevada (USA)	Delaware (USA)	Cayman Islands	Belize	Bahamas	Panama	Hong Kong
Simple Incorporation	730	860	790	730	530	510	2040	700	920	1130	1690
Incorporation with Isle of Man, Jersey or Seychelles Bank Account	1340	1470	1400	1340	1130	1120	2650	1310	1530	1730	2300
Incorporation with Swiss Trading Account	1260	1390	1320	1260	1050	1040	2570	1230	1450	1650	2200
Incorporation with USA Account	1340	1390	1400	1340	1130	1120	2650	1310	1530	1730	2300

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Annual Fees starting second year (Euros)

	Seychelles	British Virgin Islands	Samoa	Anguilla	Nevada (USA)	Delaware (USA)	Cayman Islands	Belize	Bahamas	Panama	Hong Kong
Annual Tax / License Fees100	90	280	240	160	140 list filing fee due 30 days after incorporation	Delaware Franchise Tax§	470	80*	280	240	310
Normal Local Annual Fees**	380	290	280	320	240	240	690	280	360	280	410
Normal Total Annual Cost from Second Year	450	570	530	490	380	240	1160	360	640	520	720

* IBC's with Authorized Capital of US$50,000 or less. Contact us if you wish to capitalize at a higher level.
**Normal annual fees include government fees and registered office. Does not include nominee directors and shareholders or other optional items. You will be invoiced well in advance for the charges so that you will not need to worry about being delinquent.
§ Minimum of $35 for up to 3,000 shares up to a maximum of $165,000 for an unlimited number of shares.

Other Services (Euros) *Excludes courier fees where applicable*

	Seychelles	British Virgin Islands	Samoa	Anguilla	Nevada	Delaware	Cayman Islands	Belize	Bahamas	Panama	Hong Kong

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There is no flag more respected or advantageous when sailing the oceans than the British Flag, but registering your vessel under the British Flag isn't straightforward unless you are a British citizen. We can offer you ship registration packages for any vessel that you've purchased (or will purchase) at a reasonable cost - - without your having to leave your home port.

Costs
There are many variables, so it is impossible to quote exactly, but in general the costs will range from as little as $2,600 plus shipping for a new registration or $1,500 for a change of ownership. We've provided a page with quite a bit more information that should give you a better idea of what the costs will be and what you need to supply. If it doesn't answer your questions, just send us an email.

International Offshore Banking
Not all banks are the same. The major concerns you need to have are safety, convenience and privacy. Achieving all three is a significant challenge and you can spend a great deal of time searching for a bank that will provide you with all three. Since each jurisdiction has different reserve requirements and insurance requirements as well as different levels of oversight, it is hard to know what the best options are. We provide you with a choice of banks in several jurisdictions (Switzerland, Isle of Man, Jersey, Antigua & Vanuatu), all of which provide you with the ability to manage your account via the Internet for maximum convenience. All of these jurisdictions have strong privacy laws and a history of protecting their clients. We will introduce you to the bank that you feel best fits your needs and help you through the often complex process of opening an account. Click here for further information.

[redacted]

Apostille (per document at time of incorporation)	230	540	630	450	230	230	600	280	740	280	60
Nominee Director	450	450	450	450	450	450	450	450	450	450	450
Nominee Shareholder	170	170	170	170	170	170	170	170	170	170	170

Top

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RESPONSE TO SUPPLEMENTAL QUESTION FOR THE RECORD SUBMITTED BY SENATOR CARL LEVIN

to

STUART G. NASH

Associate Deputy Attorney General
and
Director
Organized Crime Drug Enforcement Task Force
U.S. Department of Justice

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

HEARING ON

"FAILURE TO IDENTIFY COMPANY OWNERS IMPEDES LAW ENFORCEMENT"

November 14, 2006

1. **In June 2006, the Financial Action Task Force (FATF) on Money Laundering issued a report, *The Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America,* which found that the United States fails to obtain beneficial ownership information for corporations and trusts formed within the United States and determined that the United States is out of compliance with the FATF recommendations requiring the collection of such information. Please provide the Subcommittee with a list of actions that will be taken by your agency to help bring the United States into compliance with the FATF recommendation, together with a timeline during 2007 and 2008 identifying key milestones necessary to accomplish this objective.**

Response:

As the Committee is aware, the United States must provide a succinct update to the FATF plenary in June, 2008 describing the actions it has taken or is taking to address the factors underlying the non-compliant ranking and the partially compliant ranking which the United States also received on core Recommendation 5 regarding customer due diligence (of which identification of beneficial owners is a significant part). In advance of this 2008 deadline, which includes all of 2007 and the first half of 2008, the Department of Justice intends to continue to

Permanent Subcommittee on Investigations
EXHIBIT #10

work closely with the Department of the Treasury and federal regulators to increase transparency in the U.S. financial system and ultimately correct the deficiencies identified in the FATF Report.

As we testified in November, 2006, any abuse of the corporate formation process in this country and any negative impact this abuse may have on our law enforcement efforts here and abroad are continuing concerns of the Department. The Department of Justice will continue to enhance its ability to meet the challenges posed by criminal abuses in the corporate formation process through greater coordination of efforts throughout the Department of Justice, and with our colleagues including the Department of the Treasury, the Securities and Exchange Commission, the Internal Revenue Service, and with the Secretaries of State and Attorneys General of affected states, as well as with our international law enforcement partners. Additionally, we will join the Department of the Treasury in its outreach efforts to the states and the private sector to enhance their understanding of the difficulties faced by law enforcement because of the lack of beneficial corporate ownership information.

As a member of the inter-agency working group created to address this issue, the Department will continue to gather information from our investigations and use that information to improve our investigative techniques in cases involving shell corporations. Further, we will make appropriate information available to our colleagues in the Department of the Treasury so that they can more effectively analyze and evaluate regulatory and other measures to address the role of certain businesses specializing in the formation of business entities. We recognize any contemplated regulatory approach will have to address difficult issues regarding the roles of banks and financial institutions, the states and the roles of attorneys, trustees, and other intermediaries engaged in the business of providing corporate formation services.

The use of U.S. shell corporations by criminals operating in foreign jurisdictions is many magnitudes more difficult to investigate and prosecute than those crimes occurring domestically. To more effectively address this issue, we will continue to work with our international law enforcement partners and foreign counterparts to develop more innovative ways to expedite the sharing of information and to jointly investigate and prosecute those criminals who exploit the weaknesses in our corporate formation process.

It is the Department's priority to address this issue in a manner that recognizes the important state interests at stake, but ensures that law enforcement has adequate and timely information on the beneficial ownership and control of legal entities used to facilitate crime. We look forward to working closely with the Congress in addressing this problem.

RESPONSES TO SUPPLEMENTAL QUESTION FOR THE RECORD
SUBMITTED BY

SENATOR CARL LEVIN

to

K. STEVEN BURGESS

Director of Examinations, Small Business/Self Employed Division
Internal Revenue Service

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
FAILURE TO IDENTIFY COMPANY OWNERS IMPEDES LAW ENFORCEMENT
November 14, 2006

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   RESPONSE: The IRS is participating in a newly formed inter-agency working group to examine the various issues and deficiencies cited in the report. This group was formed by the Department of the Treasury's office dealing with Terrorist Financing and Financial Crimes (TFFC).

   As was discussed at the hearing, the regulation of corporate formation is a function of state law. Imposing any Federal requirement to collect beneficial ownership information on state chartered corporations raises significant issues and should only be done carefully and with the understanding that any information collected generally cannot be shared with the other Federal agencies, such as the FBI or the Department of Homeland Security, and with our treaty partners. As discussed in my response to Question 2, the IRS may not be the appropriate agency to gather the information if the goal is to be able to share it with others.

   The IRS is continuing to work with the states to help them better understand the problems associated with the lack of beneficial corporate ownership information. In March, IRS representatives will speak to the Nevada Resident Agents Association, the organization representing promoters of corporate registrations in that state.

Permanent Subcommittee on Investigations
EXHIBIT #11

In my written testimony, I indicated that the IRS has formed an Issue Management Team (IMT) to look at the overall issue of access to beneficial ownership information. The IMT is a team of specialists in this area that will first attempt to determine the size of the problem. The IMT will then look at possible solutions which potentially could include legislative proposals. The IRS has used IMTs successfully in the past to deal with other complex compliance issues. The IMT has already met and has developed an action plan to move forward on this issue.

2. **At the hearing, you testified that the IRS is considering changing the form used to obtain an Employer Identification Number (EIN) to require beneficial ownership information from the entity seeking the EIN. Please confirm that the IRS plans to make this change to the EIN form, describe the process for doing so, and provide a timeline with key milestones during 2007 for making this change.**

   RESPONSE: As I testified at the hearing, it has been suggested by others that we add a line to the application (Form SS-4) that must be completed prior to the issuance of an Employee Identification Number (EIN). Currently, Form SS-4 requires the name and tax identification number (such as the Social Security number) of the principal officer if the business is a corporation, or general partner if it is a partnership, or owner if it is an entity that is regarded as separate from its owner (disregarded entity), such as a single member LLC. Theoretically, the additional line would ask for the name of the beneficial owner(s) of the corporation seeking the EIN.

   However, as I also mentioned, this solution is not as easy as it sounds. At this point, we are not confident that taking this approach would adequately address the issue of beneficial ownership. Some companies do not request or need EINs. For example, a single member LLC with no employees would not need an EIN. In addition, some EINs become inactive after a certain period, dropping off the IRS database. For example, U.S. shell companies being used in foreign criminal activity are sometimes inactive in the United States. In addition, ownership information on LLCs owned by foreign individuals or entities would only be available if the LLC obtained an EIN for income that was subject to tax in the United States.

   In addition, the IRS is not always notified when the ownership changes. In the instance of bearer shares, beneficial ownership changes each time the shares are passed from one person to another.

   There is also an issue relating to the IRS' inability to share data with other Federal agencies. As part of the administration of federal tax laws, IRS investigators can use IRS data in their investigations of tax and related statutes, but access by other federal and state law enforcement is restricted by 26 U.S.C. § 6103. For example, in order for other federal law

enforcement officials to access IRS information provided by taxpayers (or their representatives) a federal court must issue an ex parte order. The agency requesting the information must show that it is engaged in preparation for a judicial, administrative or grand jury proceeding to enforce a federal criminal statute or that the investigation may result in such a proceeding.

For these reasons, we have not yet made the decision to revise the form. However, we will continue to examine the issue in light of new developments that would make the information collected valuable in terms of identifying beneficial ownership of shell corporations that seek to avoid their Federal tax liability.

#

RESPONSES TO SUPPLEMENTAL QUESTIONS FOR THE RECORD
SUBMITTED BY
SENATOR CARL LEVIN
to
JAMAL EL-HINDI
Associate Director for Regulatory Policy and Programs
Financial Crimes Enforcement Network

PERMANENT SUBCOMMITTEE ON INVESTIGTIONS
HEARING ON
FAILURE TO IDENTIFY COMPANY OWNERS IMPEDES LAW ENFORCEMENT
November 14, 2006

1. In June 2006, the Financial Action Task Force (FATF) on Money Laundering issued a report, *The Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America,* which found that the United States fails to obtain beneficial ownership information for corporations and trusts formed within the United States and determined that the United States is out of compliance with the FATF recommendation requiring the collection of such information. Please provide the Subcommittee with a list of actions that will be taken by your agency to help bring the United States into compliance with the FATF recommendation, together with a timeline during 2007 and 2008 identifying key milestones necessary to accomplish this objective.

With respect to the FATF Mutual Evaluation Report, the U.S. delegation asserted that the United States combines a risk-based approach with effective supervision and a robust approach to enforcement, in applying specific elements of the FATF recommendation to the financial sector. We also asserted that the risk-based approach applied by the United States to anti-money laundering and customer due diligence requirements is consistent with and substantially in compliance with the FATF recommendation. Financial institutions generally are required by regulation to have in place adequate anti-money laundering programs that include suspicious activity reporting. To comply with this requirement, financial institutions are required to identify beneficial owners where the risks warrant doing so. In addition, an institution's customer identification program must address situations where, based on its risk assessment of a non-individual account, the institution will "obtain information about individuals with authority or control over such account... in order to verify identity." *See, e.g.*, 31 CFR 103.121(b)(2)(ii)(C) for banks. Moreover, United States regulators have brought enforcement actions against financial institutions for failure to identify beneficial owners. *See, e.g., In re Banco De Chile* (February 1, 2005); *In re Riggs Bank* (May 13, 2004); *In re State Bank of India* (November 13, 2001).

Notwithstanding the above, FinCEN's main goal in administering the Bank Secrecy Act is to increase transparency in the U.S. financial system. The lack of

Permanent Subcommittee on Investigations
EXHIBIT #12

transparency in the legal entity formation process, the absence of ownership disclosure requirements and the ease of formation of legal entities make these corporate vehicles attractive to financial criminals to launder money or conduct illicit financial activity. This, in turn, poses vulnerabilities to the financial system, both domestically and internationally. That is why finding a way to address the misuse of legal entities in the context of the BSA has been and continues to be a priority for the U.S. Department of the Treasury and for FinCEN.

As outlined in our testimony, FinCEN is undertaking three key initiatives to deal with and mitigate the risks associated with misuse of legal entities.

1. FinCEN prepared an internal report in 2005 on the role of domestic shell companies (and particularly limited liability companies) in financial crime and money laundering. An updated version of this report was publicly released in November 2006, along with an advisory to financial institutions highlighting indicators of money laundering and other financial crime involving shell companies, and emphasizing the importance of identifying, assessing, and managing the potential risks associated with providing financial services to such entities. The advisory also describes identified abuses by foreign criminals of domestic shell companies. The advisory consolidates existing guidance and does not represent a change in regulatory approach.[1]

2. In 2007, FinCEN will continue its outreach efforts and communication with state governments, corporate service providers and associated trade groups to explore possible solutions that would address vulnerabilities in the state incorporation process, particularly the lack of public disclosure and transparency regarding beneficial ownership of shell companies and similar entities. These outreach events are being conducted in coordination with the Office of Foreign Assets Control (OFAC) to better illustrate a variety of concerns that arise from the lack of transparency and highlight the combination of actions that can be taken by the two agencies.
3. Lastly, FinCEN will continue to collect information and analyze the role of certain businesses specializing in the formation of business entities. Given their role in forming and directly supporting business entities, corporate service providers -- which could include attorneys, trustees, and other intermediaries engaged in the business of providing services relating to the formation and support of business entities -- are in a

[1] See, "Business Entities (Domestic and Foreign"), FFIEC BSA/AML Examination Manual (July 28, 2006). Shell company activities have also been a topic in three issues of FinCEN's *SAR Activity Review*. (See *SAR Activity Review* Issue #1 (October 2000), Issue #2 (June 2001) and Issue #7 (August 2004).)

unique position to know and receive information about beneficial owners and recognize suspicious activity involving business entities.

2. At the hearing, you testified that FinCEN is considering a "regulatory approach" in which it would use its authority under the Bank Secrecy Act (BSA) to address certain aspects of the current U.S. failure to obtain corporate ownership information. In a separate briefing, FinCEN told the Subcommittee staff that it is considering issuing a proposed rule to designate certain company formation agents as "financial institutions" under the BSA and require them to implement an anti-money laundering program and report suspicious activity to law enforcement. Please confirm that FinCEN plans to issue this proposed rulemaking for corporate formation agents and, if so, provide a timeline with key milestones during 2007 for doing so.

The third step of our strategy to deal with and mitigate the risks associated with misuse of legal entities involves pulling together information from state regulators, industry and law enforcement to study how best to address the role of certain businesses specializing in the formation of business entities. Any decision on whether a regulatory approach would reasonably achieve the desired transparency will be informed by the outreach currently being conducted. Further, any contemplated regulatory approach would have to address difficult issues regarding the role of the states and the role of attorneys, trustees, and other intermediaries engaged in the business of providing services relating to the formation and support of business entities.

STATE OF DELAWARE
DEPARTMENT OF STATE

HARRIET SMITH WINDSOR, ED. D.
SECRETARY OF STATE

January 5, 2007

VIA U.S. MAIL & EMAIL (mary_robertson@hsgac.senate.gov)

Ms. Mary Robertson
Chief Clerk
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
199 Russell State Office Building
Washington, D.C. 20510

Dear Ms. Robertson:

Thank you for your letter of December 7, 2006 requesting responses to supplemental questions for the record submitted by Senator Carl Levin for the Subcommittee hearing that occurred on November 14, 2006. Below please find my responses:

1. *The U.S. Treasury Department's Office of Foreign Asset Control (OFAC) maintains a list of terrorists and drug traffickers with which no one in the United States is allowed to do business. Please describe any measures that are required to be taken within your state to ensure that the state is not forming a corporation or limited liability company (LLC) for a prohibited person on the OFAC list.*

   The Delaware Division of Corporations hosts regular educational programs that are attended by dozens of businesses and individuals working in the company formation industry. The State has invited OFAC and Financial Crimes Enforcement Network (FinCEN) officials to speak during such programs in order to educate members of the industry about their obligations under federal anti-money laundering statutes. On October 14, 2004, Ms. Erin Ghelber, of OFAC's Compliance Programs Division presented at the Division's Annual Executive Strategic Planning Conference in Rehoboth, Delaware. On February 1, 2005, Mr. Gerard LiVigni of OFAC's Compliance Programs Division and Ms. Anna Fotias, Senior Regulatory Specialist in the Office of Regulatory Policy of the Financial Crimes Enforcement Network (FinCEN) presented additional information on OFAC and FinCEN programs at the Division's Quarterly User Meeting.

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Permanent Subcommittee on Investigations
EXHIBIT #13

CARVEL STATE OFFICE BUILDING
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WILMINGTON, DE 19801
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The State encourages company registration businesses to use a website at http://www.state.de.us/corp/foragentsonly.shtml which includes hyperlinks to "Anti-money Laundering Information". The website includes a link to an OFAC pamphlet entitled "Foreign Assets Control Regulations for the Corporate Registration Industry." OFAC does not mandate what type of compliance program a U.S. organization should have. The State is aware of at least one company formation business that has experimented with using so-called "interdiction software" in response to such educational efforts.

New legislation that took effect January 1, 2007 allows the Secretary of State to seek to enjoin a registered agent or its officers, directors or managing agent(s) from doing business as a registered agent in the State upon conviction of a felony or any crime which includes an element of dishonesty or fraud or involves moral turpitude. It is believed that a conviction under any of the Acts administered and enforced by OFAC would qualify as such a crime. Therefore, this new legislation should assist OFAC in its efforts to encourage and enforce compliance.

2. *During the hearing, a Massachusetts representative testified that Massachusetts law requires that company records, including a list of names and addresses of company owners, be kept at a location physically within the Commonwealth. After the hearing, Massachusetts clarified that this requirement applies only to companies whose principal place of business is located within the state, and not those whose principal place of business is located elsewhere.*

    a. *Of the corporations and LLCs formed in your state, about how many have their principal place of business within the state and how many outside of the state?*

    Of the 687,000 corporations and LLC's that have their legal home in Delaware, fewer than ten percent have a principal place of business within the State.

    b. *Does your state require that company information be updated on a regular basis? Please explain.*

    Yes. Every corporation and LLC in the State is required to provide to their registered agent and update from time to time as necessary the name, business address and business phone number of a natural person who is an officer, director, employee, or designated agent of the company, who is deemed the company's communication contact. In addition, corporations are required to file an annual franchise tax report with the State by March 1st of each year which includes, among other things, a list of then current directors. Limited liability companies are not required to file an annual report to the State.

Corporations are required by statute and case law to maintain current lists of their stockholders. Section 219 of the Delaware General Corporation Law requires that the list of stockholders be made available at the site of the corporation's annual meeting for at least ten days before, and during, the meeting. Similarly, Section 220 requires corporations to make their list of stockholders available for inspection by stockholders. The Delaware Supreme Court in Rainbow Navigation, Inc. v. Pan Ocean Navigation, Inc., 535 A.2d 1357,1359 (Del. 1987) stated: "the statutorily guaranteed right to examine the stock ledger cannot be frustrated by nonfeasance. We find it implicit in Sections 219 and 220 that Delaware corporations have an affirmative duty to maintain a stock ledger."

Limited liability companies are also required by statute to maintain current lists of managers and members. Section 18-305(a)(3) of the Delaware Limited Liability Company Act requires Delaware limited liability companies to make available to members "a current list of the name and last known business, residence or mailing address of each member and manager".

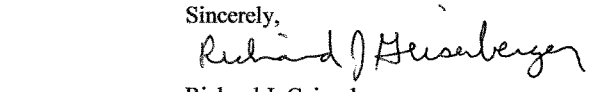
Delaware corporations and LLCs are required by Delaware law to maintain in the State of Delaware a registered agent for service of process, and the Delaware courts have ruled that such entities can be effectively subpoenaed by delivery of the subpoena to their registered agent. See, e.g., Kolyba Corp. v. Banque Nationale deParis, 316 A.2d 585, 588 (Del. Ch. 1973).

3. *Does your state have any plans to amend its laws with respect to the identification of beneficial owners of a company formed within the state? If so, please explain.*

   The State has no immediate plans to further amend its laws on this matter. We look forward to a continuing dialogue with the Subcommittee, federal agencies and others to develop solutions that take into account the many practical considerations discussed in our written testimony of November 14, 2006.

If you have any questions or would like additional information, please contact me at 302-739-4111 or via email at rick.geisenberger@state.de.us.

Sincerely,



Richard J. Geisenberger
Assistant Secretary of State
State of Delaware

RESPONSES TO SUPPLEMENTAL QUESTION FOR THE RECORD
SUBMITTED BY

SENATOR CARL LEVIN

to

SCOTT W. ANDERSON

Deputy Secretary of State for Commercial Recordings
Office of the Secretary of State, State of Nevada

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
FAILURE TO IDENTIFY COMPANY OWNERS IMPEDES LAW ENFORCEMENT
November 14, 2006

1. **The U.S. Treasury Department's Office of Foreign Assets Control (OFAC) maintains a list of terrorists and drug traffickers with which no one in the United States is allowed to do business. Please describe any measures that are required to be taken within your state to ensure that the state is not forming a corporation or limited liability company (LLC) for a prohibited person on the OFAC list.**

   RESPONSE: As with most state filing offices, The Nevada Secretary of State does not routinely or non-routinely compare the information received in the documents filed in the office against the U.S. Treasury Department's Office of Foreign Assets Control (OFAC) List or any other list. To my knowledge there are only two states that have compared organizational information to any watch list. Both states noted that this comparison was on a "non-routine" basis, post filing and that no matches were found. One state attempted comparisons on an experimental basis to determine if it was possible and it was not, even after additional attempts.

   There is uncertainty as to which list(s) would be used for such comparison and in the case of a match, what the procedure would be in reporting such a match. A number of questions were raised in conjunction with a search. These questions include, but are not limited to:

   - How detailed a search must be conducted?
   - What if there is a partial match?
   - What if there is a variation, abbreviation, nickname or misspelling?
   - What if there is a match, but that person is not the same person that is on the list?
   - If there is a match, does the process stop until there has been an investigation?
   - Who would be responsible for such an investigation?
   - Is there a disadvantage for the states that compare to watch lists?
   - Who must bear the costs for state system modifications for such searches?
   - Is there a list that is regularly updated in a format that is easily implemented in a variety of state systems?
   - Does this search requirement create a barrier to commerce?
   - re state filing offices bound by this requirement?

Permanent Subcommittee on Investigations
EXHIBIT #14

2. **During the hearing, a Massachusetts representative testified that Massachusetts law requires that company records, including a list of names and addresses of company owners, be kept at a location physically within the Commonwealth. After the hearing, Massachusetts clarified that this requirement applies only to companies whose principal place of business is located within the state, and not to those whose principal place of business is located elsewhere.**

   (a) **Of the corporations and LLCs formed in your state, about how many have their principal place of business within the state and how many outside of the state?**

   RESPONSE: It is uncertain how many corporations or LLCs formed in Nevada have their principal place of business in Nevada or outside Nevada. The Nevada Revised Statutes do not require disclosure of the location of the principal place of business in the organizational documents filed in the office of the Secretary of State. The Nevada Revised Statutes require the physical location of a Resident Agent in the State of Nevada where legal process may be served.

   (b) **Does your state require that company information be updated on a regular basis? Please explain.**

   RESPONSE: Business entities organized pursuant to the Nevada Revised Statutes and that are filed in the office of the Secretary of State are required to file an annual list updating the officer and directors/managers or managing members. Changes to Resident Agent information are generally required to be filed within 30 days of the change. Business entities may update company information at any time between annual filing due dates by filing an amendment to organizational documents or by filing an amended list of officers/managers/managing members. The Secretary of State must rely on the entities to properly update their information. Additionally, many entities choose not to update their information as required. When this occurs, the entity is placed in default, revoked or permanently revoked until such a time that it provides the required information and pays all related fees and penalties.

3. **Does your state have any plans to amend its laws with respect to the identification of beneficial owners of a company formed within the state? If so, please explain.**

   RESPONSE: As previously stated in hearing testimony, the beneficial ownership information issue is being discussed. Requiring beneficial ownership information as part of the public record in some states, when there may not be such requirement in other states, would put states requiring such information at a disadvantage. These states would be at risk of losing entities to less restrictive states. An option that has been discussed is that such information be maintained by the resident agent and made available to law enforcement only as part of an investigation and not be considered public record.

#

The Commonwealth of Massachusetts
William Francis Galvin, Secretary of the Commonwealth

Laurie Flynn
Chief Legal Counsel

January 3, 2007

VIA U.S. MAIL AND EMAIL (Mary_Robertson@hsgac.senate.gov)

Honorable Norm Coleman, Chairman
Honorable Carl Levin, Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Government Affairs
United States Senate

Re: The collection of Beneficial Ownership Information for Non-publicly Traded Corporations and Limited Liability Companies

Honorable Chairman and Committee Members:

Enclosed please find my response to the supplemental questions for the record submitted by Senator Carl Levin. I hope my response will be helpful to the Committee. I look forward to continuing to work with the Subcommittee to address the issue of the collection of beneficial ownership information for non-publicly traded corporations and limited liability companies.

Respectfully,

Laurie Flynn

Laurie Flynn

Permanent Subcommittee on Investigations
EXHIBIT #15

Supplemental Response to Question for the Record
Submitted by Senator Carl Levin

1. The U.S. Treasury Department's Office of Foreign Asset Control (OFAC) maintains a list of terrorists and drug traffickers with which no one in the United States is allowed to do business. Please describe any measures that are required to be taken within your state to insure that the state is not forming a corporation or limited liability company for a prohibited person on the OFAC list.

Massachusetts offered to make our database available to the U.S. Treasury Department and, upon receipt of a complaint that a person on the list was a participant in a domestic corporation or limited liability company, would hold an administrative hearing to dissolve or cancel the entity. Additionally, I have asked the Task Force on the Revisions of the Massachusetts Business Corporation Law to consider the possibility of legislation requiring the filer on organizing and annual filings to verify that they have checked the list and at the time of filing, no participant in the enterprise is a prohibited person. I suspect that the Task Force will reject the proposal because it will place an undue burden on business entity formation in Massachusetts. Such legislation would likely be effective only if required federally.

2. During the hearing, you testified that Massachusetts law requires that company records, including a list of names and addresses of company owners, be kept at a location physically within the Commonwealth. After the hearing, you clarified that this requirement applies only to companies whose principal place of business is located within the state, and not to those whose principal place of business is located elsewhere.

   (a) Of the corporations and LLC's formed in your state, about how many have their principal place of business within the state and how many outside of the state?

All domestic limited liability companies must maintain the list of members at an office in the Commonwealth. With regard to domestic business corporations, approximately 818 out of 182,061 list a principal office address outside of Massachusetts.

(b) Does your state require that company information be updated on a regular basis? Please explain.

A corporation is required to update information regarding its principal office location on its annual report. It may also change such information during the interim by filing a statement of supplemental change.

3. Does your state have any plans to amend its laws with respect to the identification of beneficial owners of a company formed within the state? If so, please explain.

Yes. Massachusetts will file legislation in the 2007 legislative session to require that all limited partnership and limited liability companies make available the list of partners and/or members to the state secretary within two business days if such information is required in the public interest. The purpose of the legislation is to reduce the time within which the list must be provided and to broaden the reason for the request from "investigatory and or enforcement reasons" to "any time the information is required in the public interest."

With regard to domestic corporations, the legislation will require that shareholder lists be maintained in the commonwealth and be made available to the state secretary within two business days if such information is required in the public interest.

A copy of the proposed legislation is attached for your convenience.

DRAFT

Section 1. Section 5 of Chapter 109 of the General Laws, as appearing in the 2002 Official Edition, is hereby amended by striking clause (c) and inserting in place thereof:

(c) the current list of names and addresses of the limited partners shall be made available to the secretary of state within two business days of receipt of a written request by said secretary stating that such information is required in the public interest. The state secretary may restrict further disclosure of such information to such terms and conditions as in his judgment the public interest may require.

Section 2. Section 9 of Chapter 156C of the General Laws, as appearing in the 2002 Official Edition, is hereby amended by striking clause (c) and inserting in place thereof:

(c) the current list of names and addresses of the members shall be made available to the secretary of state within two business days of receipt of a written request by said secretary stating that such information is required in the public interest. The state secretary may restrict further disclosure of such information to such terms and conditions as in his judgment the public interest may require.

Section 3. Section 16.01 Chapter 156D of the General Laws, as appearing in the 2002 Official Edition, is hereby amended by striking subsection (c).

Section 4. Section 16.01 of Chapter 156D, as so appearing, is hereby amended by adding the following:

(8) a record of its shareholders, in a form that permits preparation of a list of the names and addresses of all shareholders, in alphabetical order, by class of shares showing the number and class of shares held by each. The record shall be made available to the state secretary within two business days of receipt of a written request by said secretary stating that such information is required in the public interest. The state secretary may restrict further disclosure of such information to such terms and conditions as in his judgment the public interest may require.

RESPONSES TO SUPPLEMENTAL QUESTION FOR THE RECORD
SUBMITTED BY

SENATOR CARL LEVIN

to

ALAIN DAMAIS

Executive Secretary
Financial Action Task Force (FATF)

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
HEARING ON
FAILURE TO IDENTIFY COMPANY OWNERS IMPEDES LAW ENFORCEMENT
November 14, 2006

Your June 2006 report, *The Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America,* found that the United States fails to obtain beneficial ownership information for U.S. corporations and trusts and determined that the United States is out of compliance with the FATF recommendation requiring the collection of such information.

1. **Please provide the Subcommittee with a list of countries which, according to FATF's best information, currently comply with the FATF recommendation regarding the identification of beneficial owners of corporations and trusts formed within their borders.**

2. **Please describe, from your perspective, the process and timing that the United States should follow to correct the deficiency on beneficial ownership by 2008.**

[RESPONSES ATTACHED]

#

Permanent Subcommittee on Investigations
EXHIBIT #16

Financial Action Task Force ♦ Groupe d'action financière

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THE EXECUTIVE SECRETARY

24 January 2007

Mr. Norm Coleman
Chairman
Permanent Subcommittee on Investigation
United States Senate
Washington, DC 20510-6250
USA

&

Mr. Carl Levin
Ranking Minority Member
Permanent Subcommittee on Investigation
United States Senate
Washington, DC 20510-6250
USA

Ref: 20070124-AD

Dear Mr. Coleman and Mr. Levin,

Thank you for your letter of 7 December 2006 inviting me to answer two follow-up questions, from Senator Carl Levin, on our previous exchanges. I am deeply sorry to have passed the deadline of 5 January 2007 and am providing you with my answers with some delay. I hope you could accept my sincere apologies.

Regarding the first question, among the twelve FATF member countries which have been assessed so far in the third round of mutual evaluations (as you know about 6 FATF countries are assessed each year), the compliance results with respect to FATF Recommendation 33, on access to beneficial ownership information of corporation, are as follows:

- 1 country was found fully compliant (Italy);
- 2 countries were found largely compliant (Australia and Norway);
- 7 countries were found partially compliant (Belgium, Denmark, Iceland, Ireland, Portugal, Spain and Sweden); and,
- 2 countries were found non-compliant (Switzerland and the United States).

With respect to Recommendation 34, on access to beneficiary information of trust and other similar legal arrangements, the compliance results of the 6 countries in which trust can be formed (these kind of legal arrangements can not be formed within the borders of the 6 other countries assessed) are as follows:

- 5 countries were found partially compliant (Australia, Denmark, Ireland, Italy and Portugal);
- 1 country was found non-compliant (United States).

Regarding the second question, on the process and timing that the United States should follow to correct the deficiency on beneficial ownership by 2008, it has been suggested in the mutual evaluation report that "the U.S. authorities undertake a comprehensive review to determine ways in which adequate and accurate information on beneficial ownership may be available on a timely basis to law enforcement authorities for [privately owned] companies". This recommendation of the assessment team is still valid, and I support it. Also, as emphasized by the mutual evaluation report, "it is important that this information be available across all states as uniformly as possible" and "it is further recommended that the federal government seek to work with the states to devise procedures which should be adopted by all individual states to avoid the risk of arbitrage between jurisdictions". It is important that the comprehensive review be finalized as soon as possible, for instance in the first half of 2007, so that the Federal and/or State legislative measures necessary to correct present deficiencies can be elaborated and adopted in time for the follow up report that the United States delegation will present to the FATF Plenary in June 2008.

I remain available to provide you with any additional assistance or information you may need.

Yours sincerely,

Alain Damais
FATF Executive Secretary