The dark side of Business – the misuse of corporate vehicles

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<td>AFM</td>
<td>Autorité des marchés financiers</td>
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<td>AML</td>
<td>anti-money laundering</td>
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<td>CDD</td>
<td>customer due diligence</td>
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<td>CFT</td>
<td>combating the financial terrorism</td>
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<td>FATF</td>
<td>Financial Action Task Force on Money Laundering</td>
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<td>FinCEN</td>
<td>US Financial Crimes Enforcement Network</td>
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<td>FIUs</td>
<td>Financial Intelligence Units</td>
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<td>international business corporations</td>
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<td>International Money Fund</td>
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<td>IOSCO</td>
<td>International Organization of Securities Commissions</td>
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<td>JV</td>
<td>joint venture</td>
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<td>KYC</td>
<td>Know Your Customer</td>
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<td>LLCs</td>
<td>limited liability companies</td>
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<td>LLPs</td>
<td>limited liability partnerships</td>
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<td>LPs</td>
<td>limited partnerships</td>
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<td>NCCTs</td>
<td>Non-Cooperative Countries or Territories</td>
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<td>OFCs</td>
<td>offshore financial centres</td>
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<td>SEC</td>
<td>Securities Exchange Commission</td>
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INTRODUCTION

The fundamental feature of every business is to provide profits for those who are investing their resources. Apart from loads of advantages and recognised input towards increasing wealth, that can be addressed to business in general, there is another side of the coin – the dark side. Here all the illegal acts regarding business activities are performed. The dark side has always disturbed the global financial world. Nevertheless, recent financial market difficulties and scandals showed that the dark side of businesses’ gains is much larger than estimated. In consequence, the main attention is now paid to the most vulnerable business forms, meaning corporate vehicles (including business entities and other legal arrangements). Although they are the core for the majority of commercial activities, in particular circumstances they may be used for or facilitate illegal actions. These include money laundering and terrorist financing, corruption, tax evasion, asset shifting, improper insider dealings and other criminal financial schemes.

In addition, it shall be noted that many agencies are supporting the claim that it is extremely difficult to precisely measure to what extent legal entities are misused for illicit purposes. For instance, in the European Union (EU) it has been concluded that nearly all economic crimes involve legal persons. The United Nations (UN) has also noted that "the principal forms of abuse of secrecy have shifted from individual bank accounts to corporate bank accounts and then to trusts 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".1 This current shift can be observed, due to the fact, that financial institutions have changed their policy towards the individual clients who are now extensively verified by banks before any contract is signed. In addition, many tax authorities have recognized that many individuals are using legal entities so as to hide their gains with the purpose of avoiding tax legal duties. In connection with such activities it is believed that not only criminals are involved in abovementioned schemes. Lawyers, accountants, auditors, brokers, notaries and other professionals who are directly or indirectly connected with business are taking part in money laundering, corruption, bribes and other financial schemes.

The problem of the misuse of corporate vehicles has furthermore been addressed more internationally, as the business activities, to large extent, are carried out transnational. The increase in the misuse of corporate vehicles has also resulted in the establishment of various international organisations that aim to combat this problem. These organisations also provide and publish their guidelines, recommendations and reports that try to present remedies to the abovementioned issues.

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This dissertation is made on the view that although corporate vehicles are serving legitimate purposes, they are nowadays also widely used in criminal activities as the features that they present attract the perpetrators.

In this respect two central questions can be identified. Firstly, what remedies shall be taken into account, in order to decrease the misuse of the corporate vehicles. Secondly, as the most suggested solution concerns the introduction of stricter disclosure regulations, the question arises whether such regulations can be a barrier for perpetrators.

The thesis proceeds as follows. The first chapter focuses on the corporate vehicles that are misused together with features that can be attractive for perpetrators. It also provides some examples of the misuse of corporate vehicles in order to illustrate how perpetrators exploit particular vehicles. Moreover, the first chapter brings forward the instruments that are recognised to facilitate the misuse of corporate vehicles and the matter of the beneficial ownership and control. The second chapter demonstrates the most complex issue of the misuse of corporate vehicles, meaning the money laundering that after the terrorist’s attacks on September 11, 2001 has initiated the world’s attention towards the abuses of business entities and other legal arrangements. Furthermore, it presents among other things the current typologies on money laundering. The focus of the third chapter is placed on international organisations and the legal framework that can be addressed to the misuse of corporate vehicles. The final chapter critically analyzes the suggested solutions and proposes some others that may facilitate the ongoing discussion.

The author is of the opinion that the current attention toward the misuse of the corporate vehicles is inevitable, as these business forms are constantly in use. However, there are some limitations that need to be stressed. First of all, although the literature on the topic is extensive, the essence of information is rather repetitive. Secondly, it shall be pointed out, that this thesis focuses mainly on the vehicles that were presented in the two most important reports - the Organisation for Economic Co-operation and Development (OECD) Report, *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*, from 2001 and The World Bank Report, *The Puppet Masters How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It*, from 2011, as theses organizations are internationally recognized for their input in combating illegal cross-border offences. Furthermore, in the authors view the vehicles presented in the abovementioned reports are the most complex, diverse and essential forms in the business world.
I. THE MISUSE OF BUSINESS FORMS

When speaking about corporate entities it shall be noted that these vehicles are legal forms of the business that are established to conduct commercial activities and to hold assets. They are nowadays the most important forms which are widely used for national and international market transactions. As corporate vehicles have become necessary for the global economic system, they have also become exposed for illicit activities and abuses. International organizations recognize the misuse of the corporate vehicles for many illegal practices.² The most typical examples can be associated with the activities such as money laundering, corruption, hiding and shielding assets from creditors and other claimants, such as spouses, heirs, and tax authorities.³ As a consequence, the preferable entities are those which enable to hide an identity of the owner and successfully keep assets out of the reach of creditors and other claimants. The entities that are used, for example in bankruptcy cases, to shift the individuals assets are mainly shell companies and trusts established in other favourable jurisdictions (also called tax heavens), where it is very difficult to gain any information and enforce confiscation.⁴

It shall be stated that any jurisdiction, that possess regulations permitting effectively to conceal the ultimate identity behind a corporate veil and at the same time has provisions that restrain authorities from obtaining and sharing information on ownership and control for regulatory/supervisory and law enforcement purposes, may be a target of the misuse of such business forms.⁵ Those jurisdictions permit corporate entities incorporated under their laws to use various instruments to prevent the beneficial ownership and control from being revealed and identified. In some cases, such jurisdictions are observed to protect anonymity by introducing strict bank and corporate secrecy laws that prohibit company registrars, financial institutions, lawyers, accountants, and others, from disclosing any information regarding beneficial ownership and control to regulatory/supervisory and law enforcement authorities, under the threat of civil and criminal sanctions.⁶

The Organisation for Economic Co-operation and Development (OECD) emphasized in one of its reports that the offshore jurisdictions offer immense secrecy for corporate entities generating an conducive environment for possible misuse of the corporate vehicles. Such secrecy relies on the provisions that do not enable confidential information to be given to national and

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³ Ibidem; p. 35.
⁴ Ibidem.
⁵ Ibidem; p. 9.
⁶ Ibidem.
international authorities. In addition, shell companies that can be established in such offshore centres (OFCs) are at risk of being used for illegal purposes as the jurisdiction regulations have weak supervisory agencies and there are exemptions from periodic reports. Although the offshore jurisdictions may be seen as potential criminal heavens, a number of them have developed specific and sophisticated provisions used for obtaining and sharing information concerning beneficial ownership and control that aim to prevent the misuse of business forms.

I.1. Types of Misused Corporate Vehicles

Until the 20th century, most business or commercial activities were commenced by sole proprietorships or partnerships. Although, they are still considerable elements of the 21st century economy, many new types of business forms have been introduced or evolved from existed ones. All of legal constructions, that are able to conduct commercial activities, can be generally addressed to the term corporate vehicles. This expression relate both to legal arrangements and legal persons in the Financial Action Task Force on Money Laundering (FATF) terms and in the

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7 Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 18.
8 Offshore finance centres are “countries or jurisdictions with financial centres that contain financial institutions that deal primarily with non-residents and/or in foreign currency on a scale out of proportion to the size of the host economy. Non-resident-owned or -controlled institutions play a significant role within the centre. The institutions in the centre may well gain from tax benefits not available to those outside the centre.”; http://stats.oecd.org/glossary/detail.asp?ID=5988; (27.06.2012)
9 Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 18.
10 A sole proprietorship (also known as sole trader or a proprietorship) is a commercial formation under which “an individual is conducting economic activity, such as providing a service or product to a purchaser for remuneration, or investing to generate income, without the need to create a formal entity structure or to engage in legal arrangements such as a trust. A sole proprietorship represents the simplest way of conducting business—the individual has no formal registration requirements or filing fees, does not need to create an operating agreement or to be held accountable to anyone, and files taxes as a part of personal duties”; [In:] E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; The Puppet Masters. How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It: The World Bank; 2011; p. 159.
12 “Legal arrangements refers to denote trusts or other similar legal arrangements, together with fiducie, treuhand and fideicommis”; [In:] E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; The Puppet Masters...; op. cit.; p. 165.
13 “Legal person refers to bodies corporate, foundations, Anstalten, partnerships, or associations, or any similar forms that can establish a permanent customer relationship with a financial institution or otherwise own property”; [In:] Ibidem.
last years has been used by other international organizations such as the OECD and the World Bank.\textsuperscript{14}

There can be observed one major distinction between the two mentioned stipulations. Whilst the legal person is able to engage commercially and hold on its own rights and obligations, a legal arrangement is rather a relationship between different people of purely contractual nature. Moreover, the latter one has the indispensable feature that one person holds the legal title while another holds a beneficial title.\textsuperscript{15}

Not all types of corporate entities are preferable for illicit purposes. Those who are used dominantly, present certain characteristics which attract perpetrators such as anonymity and secrecy that conceal the ultimate ownership and control. Furthermore, in great number of cases perpetrators use different entities established in various jurisdictions so as to prevent attempts to identify owners and controllers of these vehicles.\textsuperscript{16} Below the most misused corporate vehicles are presented.

\textbf{I.1.1. Companies}

All over the world jurisdictions offer diverse types and forms of business forms and legal arrangements both for domestic and foreign individuals. Companies were initially foreseen with the aim of protecting investors and creditors. The legal separation of the individual from the assets vested to a company was a solution to accomplish this protection.\textsuperscript{17} However, as from the 21\textsuperscript{st} century, there has been observed that such a separation of assets from the individual has been abused for illicit purposes. According to reports conducted \textit{inter alia} by OECD, FATF and World Bank companies are the most considerably misused vehicles.\textsuperscript{18}

The basic legal entity that occurs all over the world is a corporation. It possesses a separate legal personality that permits it to operate and conduct business activities such as investments, financial transactions and employment. Furthermore, company maintain a separate legal

\begin{flushright}
\textsuperscript{14} E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; \textit{The Puppet Masters}..., op. cit.; p. 166.
\textsuperscript{15} Ibidem; p. 11.
\textsuperscript{17} E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; \textit{The Puppet Masters}..., op. cit.; p. 162.
\textsuperscript{18} It shall be noted that civil law jurisdictions typically divide companies into public and privet. For public companies, additional rules apply such as securities laws and stock exchange rules. In contrast, common law countries do not typically distinguish between public or private at the company level, but rather they do so based on whether share offerings are made to the general public.; [In:] E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; \textit{The Puppet Masters}..., op. cit.; p. 163.
\end{flushright}
personality from their shareholders who have limited powers to manage the corporation. The control of the company is usually conducted by the board of directors. Corporation theoretically enjoys unlimited continuance and free transferability of shares. In general, the company’s shareholders have limited liability that indicate that shareholders can only be liable up to the amount of the investments which were made in a company and their personal assets will not be accessible by the corporation's creditors and other claimants. The limited liability characteristic is crucial as it promotes entrepreneurship and facilitates capital formation from a broad base of investors. The abovementioned obvious positive features may be also misused to facilitate economy crimes and other violations of law.

1.1.1.1. Private limited companies and public limited companies whose shares are not traded on a stock exchange

Generally, it can be said that corporations can be divided into public limited companies (joint stock or share companies) and private limited companies (companies limited by shares or guarantee). The main differences between abovementioned are that the shares of the first type are freely exchangeable and there are no limits on the number of shareholders. These two characteristics normally permit a public limited company to issue registered or bearer shares, offer shares to the public and trade them on a stock exchange. In order to possess such flexibility, public limited companies are in most jurisdictions under very strict provisions and supervision. The latter consists of regular and comprehensive financial and non-financial disclosure and enhanced responsibility at the board level.

On the other hand, private limited companies are allowed to issue mainly registered shares at the same time restricting transfer of its shares and limiting the number of shareholders. In addition, they may not be allowed to issue shares to the public at large, which means that stock trading is not available for private limited companies. The abovementioned features create less

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19 Vast majority of jurisdictions possess corporations model that consist of only the board of directors (one-tier board). In other countries provisions require beside the board of directors another organ called the supervisory board. This two-tier board then consists of management and supervisory boards. [In:] Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 38.

20 Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 22.

21 Ibidem.

22 Ibidem; p. 22-23.

23 Ibidem.

24 In Ireland and the United Kingdom company regulations enable private limited companies to issue bearer shares. [In:] Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 38.

strict environment for private limited companies. That said, in most countries the number of private limited companies is greater than the public ones.  

In Europe it can be observed that private limited companies are misused when there are very low share capital requirements for private limited companies, in contrast to public companies. What is more, the abuses occur, if the shareholders’ identities are of "secondary relevance", For example, in the United Kingdom the research carried out by the Performance and Innovation Unit of the UK Cabinet Office concluded that U.K. shell companies have been involved in almost all money laundering schemes. In 2000, the US Financial Crimes Enforcement Network (FinCEN) recognized an emerging trend of non-publicly traded, US-incorporated shell companies involved in suspicious wire transfer activities. The Limited liability companies (LLCs) in the United States have, furthermore, been exposed to misuse as the law in some states does not require disclosing the members’ identities and a company can be controlled anonymously. Also in Hong Kong, private limited companies have become attractive for money launderers as these entities are enable to use nominee shareholders and corporations as directors and officers, and are available off-the-shelf. 

Public limited companies may also be vulnerable to illicit activities as in many jurisdictions they are enabling to issue bearer shares that are equity securities which are owned by whoever holds the physical stock certificate. In this case the company does not register the owner of the stock and it does not follow transfers of ownership. 

As nearly all articles or reports relating to the misuse of corporate vehicles are addressing their concerns to the shell and shelf companies, both these terms shall be explained.

I.1.1.2. Shell companies

The shell company term refers to the entity that has no independent operations, significant assets, current business activities or employees. In short, it can be stated that the shell company is

27 Ibidem.
31 http://www.investopedia.com/terms/b/bearer_share.asp#ixzz1uGkzJoVZ; (24.06.2012).
32 In the Puppet Masters Report authors refer to significant assets in the following meaning – “operationally necessary assets meant primarily to benefit the company rather than its owners (for example, office space, furniture, computer or industry-specific equipment)”; [In:] E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; *The Puppet Masters ...*, op. cit.; p.34.
a non-operational company that may possess financial assets such as stock, cash, properties, etc. of other companies.  

The OECD in its report *Behind the Corporate Veil* from 2001 defines shell companies as: “companies, which are entities established not to pursue any legitimate business activity but solely to obscure the identity of their beneficial owners and controllers, constitute a substantial proportion of the corporate vehicles established in some OFCs [off shore financial centres].” As it can be observed this definition implies that the word “shell” has a pejorative implication and furthermore suggest illegal purposes.  

Shell companies, in contrast to typical companies, do not conduct ordinary business activities that affect the information obtained on their existence. The ordinary business operation include activities such as registration within the chamber of commerce, creation of website, purchase of supplies and equipment, purchase or rent of an office. Additionally, a normal company has employees that can be investigated by authorities, produces financial reports and statements that can be compared to other similar companies. A non-operational company, such as shell company, may carry out some of these activities (hold an annual meeting of shareholders).

Moreover, shell companies are in general also used for legitimate purposes such as merges or joint ventures. In a merger case two companies will arrange a transaction, so as to fuse under a third, neutral shell company. A joint venture (JV), for instance, may use shell company in some third jurisdiction in order to obtain equal legal position for both parties. Shell companies may also be used to separate liabilities, create distinctive equity or debt tranches in a single asset, and serve as a personal holding company (including personal or family assets) for ease of inheritance or as protection against attachment by creditors.

The misuse of shell companies that can be observed, after addressing various reports, generally occurs in combination with additional mechanisms to conceal beneficial ownership. Typical mechanisms include exercising control through contracts (in lieu of “typical” ownership and control positions), adding layers of corporate vehicles, hiding behind bearer shares, and

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33 E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; *The Puppet Masters...*, op. cit.; p. 34.
37 Ibidem.
38 Ibidem.
39 Ibidem.
ensuring that the beneficial owners are located (or the identifying information is stored) in another jurisdiction.  

As an example of the misuse of shell companies, the case of Anthony Seminerio shall be presented. Anthony Seminerio was an assemblyman in the New York State legislature who between 1998 and 2008 was offering his services to the citizens of New York. During these years Seminerio by using a alleged consulting company, named “Marc Consultants” defrauded various individuals and entities. The latter once paid him hundreds of thousands of dollars quid pro quo official actions that were taken to benefit those entities. In consequence, those who paid Seminerio were treated propitiously by the Assembly and New Your state officials. In addition, Seminerio used his company to hide the illegal payments, as the New York’s Public Officers Law allows a member of the Assembly to account profits in the name of the company, in lieu of in the names of individual clients of that business. The investigation revealed that Seminerio used Marc Consultants (a shell company) to collect corrupt payments regarding favourable treatment and to finance his private expenses. Furthermore, it was discovered that Marc Consultants address was the Seminerio’s house and the sole individuals with signature authority were Anthony Seminerio and his wife. 

I.1.1.3. Shelf companies

A shelf company is an entity that presents the following typically (but not uniformly) features:

- is incorporated with a standard memorandum or articles of association;
- has inactive shareholders, directors, and secretary; and
- is left dormant - that means, sitting “on a shelf”—for the purpose of later being sold.

After the sale transaction, the inactive shareholders usually transfer their shares to the purchaser, and the directors and secretary submit their resignations. Following the sale, the purchaser may obtain the company’s credit and tax history. Moreover, there is a possibility that the company director(s) will maintain in function as nominees. If that happens, the outsiders will see only the ownership change, assuming, that such a change is required to be registered somewhere.

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40 E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; The Puppet Masters..., op. cit.; p. 35.
42 E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; The Puppet Masters..., op. cit.; p.34.
44 Ibidem.
It is worth mentioning that as shelf companies are typically established for the sale and purchase purposes the prices for their acquisition vary in relation to factors such as age of the company, pre-existing lines of credit, maintained financial records, and bank accounts. 45

The biggest advantage of shelf company is that an individual does not need the time to set up a new corporation. As in some jurisdictions, incorporation procedures can be burdensome, it is easier, faster, and less expensive to shift ownership of an already existing shelf company than to incorporate a new one. 46 Although, the main reason for purchasing a shelf company is that the individual wishes for having it immediately, not in a few weeks, nowadays many countries have simplified their procedures and reduced their requirements, thus creating a possibility to use an online form. That said, the abovementioned justification may no longer be valid. 47

The misuse of shelf entities may occur, if the perpetrators can easily and efficiently hide behind the corporate veil, misleading investigators to a formation agent who sold the company with no records of the purchaser and no obligation to note the ownership change. 48

The World Bank Puppet Masters Report provides an example of Raul Salinas case where the brother of a former Mexican President (Carlos Salinas) transferred to United Stated US$100 million via private banking connection with Citibank. The scheme operated from 1992 till 1994, during which the bank contributed Salinas in transferring assets at the same time concealing the origins and destination of them. The shelf companies were used to facilitate these actions. 49 First of all, Citibank established three Panamian shelf companies [Madeline Investment S.A., Donat Investments S.A., Hitchcock Investments S.A] that functioned as the board of directors of Trocca Ltd. Another company (Tyler Ltd.) was identified as a primary shareholder. It shall be noted that all shelf companies had been established in 1979, nearly 15 years prior to Trocca Ltd. Tyler Ltd. was incorporated in 1984. In consequence, Salinas with the Citibank support evaded any connections between him and the companies, being at the same the beneficial owner of the accounts. 50

The case can be presented in a diagram for as follow:

46 Ibidem.
48 Ibidem.
I.1.1.4. International business corporations (IBCs)

The offshore financial centres (OFCs) offer international business corporations (IBCs) for non-residents. It is worth to mention, that international business corporations (IBCs) may be a specific type of shell companies as they are frequently used by non-residents who want to incorporate in an offshore jurisdiction. In addition, IBCs can be seen as model shell companies as they are restricted in business activities in the incorporated jurisdiction and they are often excluded from local income taxes. The possibility of the IBC incorporation can be found in jurisdictions such as Seychelles, Belize, Bahamas and in Nevis.

In the Report of Financial Stability Forum concerning OFCs experts conclude that “Offshore Corporations or International Business Corporations (IBCs) are limited liability vehicles registered in an OFC. They may be used to own and operate businesses, issue shares or bonds, or raise capital in other ways. IBCs may be set up with one director only. In some cases, residents of the OFC host country may act as nominee directors to conceal the identity of the true company directors. In some OFCs, bearer share certificates may be used. In other OFCs, registered share certificates are used, but no public registry of shareholders is maintained. In many OFCs, the costs

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51 E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; The Puppet Masters..., op. cit.; p. 35.
52 Ibidem.
of setting up IBCs are minimal and they are generally exempt from all taxes. IBCs are a popular vehicle for managing investment funds”, 54 What is more, IBCs in some jurisdictions may be established with minimal capital requirements, except from the entire domestic taxes on profits, capital gains, and other incomes. The only restrictions that are imposed on the IBCs is the fact that these companies are not permitted to conduct businesses in the jurisdictions in which they were incorporated and with that jurisdiction's residents. Moreover, they may be not allowed to offer their shares to the public. 55

It is worth to mention that IBCs are generally used for legitimate commercial purposes, such as holding intellectual property, engaging in international trading activities, legally obtaining the benefits of tax treaties, and serving as holding companies. They are furthermore, under laws of many jurisdictions, excluded from operating in banking, insurance, and other financial sectors. 56

Although international business companies are being mostly used for legitimate activities, there are evidences of their misuse. The vulnerability relies on a substantial degree of their "anonymity" attributes and the type of regulatory regime to which they are subject. In many offshore countries, these companies are permitted to issue bearer shares and may use nominee shareholders and nominee directors to hide ownership and control. 57 In addition, IBCs are frequently subjected to minimal or no formal supervision, and in most cases are not required to file annual returns or annual accounts. Some offshore jurisdictions exclude the use of bearer shares, or, if bearer shares are permitted, there is an obligation to disclose the beneficial ownership and control information to the authorities. On the other hand, as the IBCs are not permitted to carry any commercial activities within the jurisdiction of incorporation or with the residents of such a jurisdiction, the monitoring or supervisory authorities may not have any incentive to examine their business activities. 58

The reason why offshore companies are vulnerable for illicit activities can be found in their bylaws, as it is often that such countries possess dual regimes for resident and non-resident entities. There are some jurisdictions that do not allow employing bearer shares. However, if bear shares are permitted, they are monitored with greater scrutiny, together with the requirement to file an annual return attaching a list of shareholders and information on directors and officers. 59 On the other hand, International Business Companies/or sometimes called the exempt companies may issue bearer shares and furthermore may not be required to file an annual returns or disclose beneficial

56 Ibidem.
57 Ibidem.
58 Ibidem.
59 Ibidem.
ownership. In short, as IBCs possess features of successful anonymity and little or no supervision, they are attractive business forms for misuse.⁶⁰

### I.1.2. Trusts

The trust is mainly used for the transfer and management of assets. It offers a successful mechanism for managing assets given to minors, individuals who are incapacitated, and others who are otherwise inexperienced in financial management. Trusts can be used for charitable purposes, estate planning and for corporate purposes.⁶¹ The latter means that trusts are being used to structure transactions, such as securitization programs, and employee benefits programs, including pension schemes, international employee stock option plans, and compensation structures.⁶²

Historically, the trust was an institution originated from Norman law that was further developed by English law (mainly the English Court of Equity) and was primarily known in common law countries.⁶³ However, recently there can be observed examples of civil law jurisdictions which are adjusting trust’s regulations into their regimes.⁶⁴ The institution was based upon a concept to improve protection of owner’s assets from the risk.⁶⁵

The trust is a business form that assures the separation of legal ownership from beneficial ownership. The concept of trust is simple and it can be described as follow. In order to establish a trust, the trust creator (the settlor) needs to transfer the legal ownership of a property to a person or corporate entity (the trustee).⁶⁶ By the transfer the trustee holds and manages the property, in accordance with the provisions of the trust deed, for the benefit of the beneficiary, who is identified in, or ascertainable from, the trust deed. It is worth mentioning that the settlor may also be himself/herself a beneficiary.⁶⁷

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⁶¹ Ibidem; p. 25.
⁶² Ibidem.
⁶⁶ Trustee owes beneficiary a duty of loyalty, which means that the beneficiary interest shall be placed over the trustee’s.; [In:] E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; The Puppet Masters..., op. cit.; p. 167.
As it was mentioned previously, trusts and legal arrangements (as a general rule) are distinguishable from other corporate entities, because they typically do not possess a separate legal personality. That said, a trust is not permitted to hold property, engage in business, or be a party to contracts. Hence, the majority of trusts are used for legitimate purposes, such as family estate planning, managing charitable donations, and various corporate functions.\(^{68}\) In the latter case a trust may be used to isolate the funding of an employee pension plans from the attachable assets of a business. Trusts may also be used to hold company stock with the specific intention of upholding control over a company either after the grantor has died or, if still alive, simultaneously to act as an asset protection trust.\(^{69}\)

It is worth pointing out that settlor, trustee, beneficiary, and assets may be companies or other corporate vehicles. In addition, in jurisdictions that recognize trusts, they are granted confidentiality that is not observed regarding, for example, legal persons like corporations. In addition, some jurisdictions (e.g. Panama\(^{70}\)) strict confidentiality regulations prohibit the disclosure of any information regarding trusts.\(^{71}\)

Conventionally, under the structure of a legally binding trust, the settlor is obliged to cede control of the assets he has transferred to the trustee.\(^{72}\) The latter, after the transfer, has an virtual control over the entrusted assets.\(^{73}\) Additionally, the trustee is required to monitor the terms of the trust deed and has a fiduciary duty to act truthfully and in good faith in the best interest of the beneficiaries or (in case where there are no named beneficiaries) in the best interest of the trust. The tradition features of trust consist of limitations on duration, fixed terms, the idea that trustees can be removed only after a legal challenge and that trust could only benefit individuals or charities, not being used to delay, hinder, or defraud creditors (that was presented in the Statute of Elizabeth).\(^{74}\)

\(^{68}\) E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; *The Puppet Masters*..., op. cit.; p. 168.
\(^{69}\) Ibidem.
\(^{70}\) Panama trust law states that if a trustee, government agent, or any person transacting with the trust discloses information about the trust, except as required by law, then that person will be sanctioned with a penalty of up to six months in jail and a fine of up to US$50,000.108. (Panama Law No. 1, Art. 37); [In:] E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; *The Puppet Masters*..., op. cit.; p. 168.
\(^{71}\) E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; *The Puppet Masters*..., op. cit.; p. 168.
\(^{72}\) Some countries enable the settlor to serve as co-trustee, e.g. USA and Canada; [In:] Organisation for Economic Co-operation and Development, *Behind the Corporate Veil*..., op. cit.; p. 39.
\(^{73}\) Organisation for Economic Co-operation and Development, *Behind the Corporate Veil*..., op. cit.; p. 25.
\(^{74}\) Ibidem.
The abovementioned structure of valid trust may be modified, as some jurisdictions have change the principal requirement that the settlor has to give up the control of assets entrusted. In consequence, the settlor may be recognised as a beneficiary, co-trustee or protector, which grants the power of veto to trustee stipulations and even possibility to change them. Moreover, in some cases there is a possibility to establish trust with a settlor that is funded by other party (the economic settlor). The latter identity will then not be revealed in any trust documents.

Moreover, in some cases there is a possibility to establish trust with a settlor that is funded by other party (the economic settlor). The latter identity will then not be revealed in any trust documents.

Trusts present moreover features that expose them for misuses. They are said to possess a greater degree of privacy and autonomy than corporate entities. In addition, trusts are basically contractual agreements between two private parties that enjoy compliant regulations. Nearly all jurisdictions that are familiar with trusts have deliberately chosen not to regulate trusts in the same manner as they regulate other corporate forms, such as corporations. As a consequence, some cases may present difficulties when authorities from one country seek for information or execution of judgements in other jurisdictions, where the trust is not recognised under that jurisdiction’s law. That said, there may not be authorities which are in charge of trusts supervision. It is worth to mention that as the trust role may be challenging to prove under the investigation, it is common for authorities to focus on other aspects of the case. As a result, in many cases the use of trusts to facilitate the criminal actions may not be revealed and documented.

Trust may be misused for many purposes which include the concealment of the existence of assets from tax authorities, creditors, ex-spouses, and other claimants or to conceal the identity of the beneficial owner of assets. Establishing a trust is frequently connected with the creation of the final layer of anonymity for those seeking to hide their identity. The case of the UK media

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76 Ibidem.
78 In the view of the World Bank Puppet Masters Report – trusts are problematic when it comes to investigation, prosecution, executing civil judgments and recovering assets, because they are rarely in the main scope under the corruption investigations; E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; *The Puppet Masters*..., op. cit.; p. 46.
79 “Trusts that engage in financial services activities, such as unit trusts that pool funds from the general public, are often regulated. In Japan, a civil law jurisdiction, the court supervises all private trusts except trusts engaged in commercial business”. [In:] Organisation for Economic Co-operation and Development, *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*, 2001; p. 73.
magnate Robert Maxwell presents a good example. He created a complex web of companies to conceal ownership of assets that was held together at the top by two trusts. Other examples show connections with money laundering schemes, more specifically in the layering and integration stages.\textsuperscript{82} With regard to corruption, trusts can be abused to conceal the money granted to the government officials. According to the World Bank \textit{Puppet Masters Report}, in most cases investigators were unable to discover the ultimate jurisdiction where the trusts were established. However, the jurisdictions that were identified pointed mainly to the U.S. states, the Bahamas, the Cayman Islands and Jersey.\textsuperscript{83}

One of such cases was documented in Nigeria and concerned Diepreye Alamieyeseigha (Former Governor of Delta State). This official had established in 2001 a Bahamian trust (“Salo Trust”) for beneficial purposes for himself and his family. The account of a trust was established in the UBS bank in his name, and the Alamieyeseigha supposedly did not know that this would give him the status of a trust beneficiary. In consequence, he did not reveal this account in his Declaration of Assets which all governors are required to file. Instead, Alamieyeseigha stated that he is the settlor, the trustee and the beneficiary of the “Salo Trust”, which meant that it was a name trust with no separation between him and assets.\textsuperscript{84} The allegations towards Diepreye Alamieyeseigha were in relation to the London account, opened in 1999 with UBS bank with initial sum of US$ 35,000. The balance in 2005 showed the amount of US$ 535,812 that came from different sources (mainly economic settlors) often recorded as “Foreign Money Deposit”. During the investigation the governor maintained that the found were just donations made by his friends and political associated with regard to education of governors children.\textsuperscript{85} However, his testimonies were inconsistent and other proofs showed suspect transactions that transferred at least US$ 1.5 million in two deposits by Aliyu Abubakar. The abovementioned funds were, in January 2002, directly converted into bonds and shifted to the portfolio holdings of Falcon Flights, Inc. the Bahamian company. The latter was purchased or incorporated by the trustees of the Salo Trust accordingly to the trust deed, resulting with a “nested corporate vehicle structure”.\textsuperscript{86}

What is more, misuses of trust may lead to frauds. In such cases, a settlor attempts to avoid taxes by transferring assets into the trust and then misleadingly maintain that he has relinquished control over the assets. The scheme can be described as follows. First of all, the settlor will fulfil all

\textsuperscript{82} Organisation for Economic Co-operation and Development, \textit{Behind the Corporate Veil...}, op. cit.; p. 25.
\textsuperscript{83} E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; \textit{The Puppet Masters...}, op. cit.; p. 44.
\textsuperscript{84} Ibidem; p. 46.
\textsuperscript{85} Ibidem.
\textsuperscript{86} Ibidem.
formalities that are necessary to establish a valid trust, that means he will set up an irrevocable trust and appoint a third party trustee, not naming himself as a beneficiary in the trust deed.  

As it was mentioned above trusts are attractive for perpetrators because they possess provisions that:

- allow the names of the settlor and the beneficiaries to be excluded from the trust deed,  
- permit the settlor to retain control over the trust,  
- permit trusts which are established for non-charitable purposes to have unlimited duration and to be revocable,  
- allow the trust deed to include a "flee clause" – a provision that demands the assets of the trust and information about the trust to be moved to another jurisdiction and new trustees to be appointed upon the occurrence of certain events, such as a service of process or change in legislation,  
- allow the trust management decisions not being recorded or disclosed in writing to anyone,  
- permit a creation of cascade arrangements that can successfully conceal the beneficial owners identity,

### I.1.3. Foundations

Under the civil law regulations a foundation can be seen as corresponding to the common law trust. A foundation (based on the Roman law *universitas rerum*) is a separate legal entity that does not have shareholders or owners and possesses property that has been transferred from a donor to serve a particular purpose for an unlimited time.

In general foundations are managed by a board of directors. In some jurisdictions, e.g. in Belgium and Poland, foundations are restricted only for public purposes (public foundations), in others, such as Austria, Denmark, Germany, Greece, Italy, Liechtenstein, the Netherlands, the Netherlands Antilles, Panama, and Switzerland, provisions enable to establish foundations to

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88 Ibidem; p. 25.
89 Ibidem.
90 Ibidem.  
91 Ibidem.  
92 Financial Action Task Force; *The Misuse of Corporate Vehicles, including Trust and Company Service Providers*; 13 October 2006; p. 28.  
93 Ibidem.  
94 Ibidem; p. 27
conduct private purposes (private foundations). Furthermore, some civil law jurisdictions enable foundations to involve in commercial activities.95

The Nevis Multiform Foundation can serve as a suitable example, as this is a foundation that can change its form whenever it will suit its objectives. For instance, if at the beginning the foundation is established to protect assets, but at the same time there is a need to engage in commercial activities, then such a company foundation is appropriate. In consequence, there is a possibility to modify it to a trust.96 Moreover, Nevis Multiform Foundation can have several forms - trust, company, partnership and ordinary private foundation, and it can freely be converted from one to another at any time. There is no need to provide any cause, no penalties would also be imposed.97

Typically, foundations are to a great extent controlled and transparent entities that in order to legally operate need to be registered with the authorities file annual financial statements and submit themselves to supervision by particular governmental authorities. Foundations are also required to be adequately autonomous from its founder.98 It is worth mentioning that the income derived from the main assets (as opposed to the assets themselves) is used for the statutory purposes.99

With regard to illegal activities, the foundations may be misused when a jurisdiction’s provisions are insufficient and regulatory and supervisory bodies are inadequate. Additionally, the foundations are vulnerable if founders are enabled to exert significant power over them.100 The degree of anonymity is also an important matter. The higher degree of anonymity is offered, the greater possibility of misuse can be observed. Panama’s law does not require government approval for the establishment of a foundation or the modification of its memorandum, there is also no government agency that supervises foundations. In addition, foundation documents enclosing the identity of beneficiaries (which may contain the founder himself) are not required to be publicly filed; the foundation is also not obliged to submit annual reports or accounts. In Panama, there is also a possibility for using a nominee to form the foundation, thus ensuring that his identity is not revealed to the outside world.101

The example of a case where the foundation was used for hiding the proceeds of corruption may be the Case of Joseph Estrada, Former President of Philippines. The Former President used the

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95 Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 27.
97 Ibidem.
98 Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 27.
100 Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 27.
established in 2000 the Erap Muslim Youth Foundation, Inc. to deposited funds obtained from illicit “juteng” gambling operators (according to the Sandiganbayan -the Philippines’ antigraft court- US$4.3 million out of the US$11.6 million were from that illegal actions).  

In consequence, the establishment of foundation to “foster educational opportunities for the poor and underprivileged but deserving Muslim youth and students of the Philippines and support research and advance studies of youth Muslim educators, teachers and scientists” occurred only the cover for shifting money. What is more, during the investigation the Sandiganbayan discovered that initially funds were secretly placed in other bank accounts, set up by his auditor, Yolanda Ricafort. When Philippine Congress started to investigate Estrada for corruption, he transferred some of the funds to the Erap Muslim Youth Foundation account.

I.1.4. Limited partnerships and limited liability partnerships

A partnership is the relationship existing between two or more individuals or entities that join together to carry on a trade or business. Each partner shall contribute money, property, labour or skills, in return expecting to share in the profits and losses of the business. Traditionally, partnerships are business forms in which at least one (in case of limited partnership) or all (in general partnerships) partners have unlimited liability for the business obligations. This means that in a case of solvency problems, creditors may recover their claims from personal assets of the general partner(s). A partnership like any other business form is oblige to filed an annual return reports, and furthermore information on deductions, gains, losses, etc., from its operations. The only difference, in contrast to corporations, is that partnership does not pay corporate income tax, because it “passes through” any profits or losses to its partners. Each partner includes his or her share of the partnership's income or loss on his or her tax return.

It shall be noted that there are basically three types of partnerships:

I.1.4.1. General Partnerships

This is the most traditional business form that rests on two or more individuals that agree on carrying out a business for a commercial purpose. Generally, in common law countries there are no requirement to register general partnerships with a government entity or court or to commit the

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103 Ibidem.
104 Ibidem; p. 159.
106 Organisation for Economic Co-operation and Development, Behind the Corporate Veil ..., op. cit.; p. 28.
107 Ibidem.
governing contract to a written document. On the contrary, civil law countries usually require both elements. The determination of ownership and control under common law regulations may be done through the revision of both partnership agreements and any contracts with third parties. The only obstacle that can occur is that such documents are normally not publicly available, if they exist at all.

General partners share equal rights and responsibilities in connection with management of the business, and any individual partner can bind the entire group to a legal obligation. As it was mentioned above, each individual partner bears full responsibility for all of the business's debts and obligations. That said, unlimited liability may be seen here as demotivating factor, but it shall be reminded that general partnership enjoy one major tax advantage. As a result, a partnership profits are not taxed to the business, but instead passed through to the partners, who include the gains on their individual tax returns at a lower rate.

I.1.4.2. Limited Partnerships (LPs)

The construction of a limited partnership enables each limited partner to restrict his or her personal liability to the amount of his or her business investment. Hence, not every partner can profit from this limitation, as at least one participant is required to have a general partner status, being exposed to full personal liability for the business's debts and obligations. Being a general partner enables to maintain the right to control the business, whereas the limited partner(s) do(es) not participate in management decisions. Both general and limited partners benefit from business profits.

Limited partnerships can, in general, be only established through a formal process that includes the creation of a written partnership agreement. The limited liability is furthermore conditional, as limited partners who take a too active role in the partnership’s business can be found to have breached their limited status and be held jointly and severally liable, along with the general partners, to settle creditor obligations occasioned by criminal, tort, or other civil actions.

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110 Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 28.
112 Ibidem.
113 Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 28.
115 Ibidem.
I.1.4.3. Limited Liability Partnerships (LLPs)

Recently, in certain jurisdictions there are a business forms that are called the limited liability partnerships (LLPs). The LLPs also retain the tax advantages of the general partnership form, but it offers personal liability protection to its participants. Individual partners in the limited liability partnership are not personally responsible for the wrongful acts of other partners, or for the debts or obligations of the business.\(^{116}\)

In case of limited partnerships, they need to be reiterated if the limited partners want to benefit from limited liability. The registration requirements vary throughout jurisdictions.\(^{117}\) In some, both limited and general partners are obliged to be registered, while others require only the registration of the general partners. Furthermore, other jurisdictions’ laws, enable individuals or corporations to serve as general partners.\(^{118}\)

In relation to LLPs’ possibility of misuse, it shall be stated that such entities must be registered with the authorities. Nevertheless, LLPs may be used for asset protection schemes to defeat, or obscure, the ability of a judgment creditor\(^{119}\) to lay claim on a debtor's assets. That is possible due to the fact that LLPs enjoy availability of “charging order” protection.\(^{120}\)

That said, a creditor who gains a judgement against a partner may not prevent that partner's interest in the partnership or any specific assets being transferred into the partnership. Instead, the creditor is only enabled to place a “charging order” on the partner's interest, which means that any future allotments from the partnership will be granted to the creditor rather than the partner. One issue shall be mentioned here.\(^{121}\) Although the judgement creditor may have possessed a charging order, he or she is may not be able to force the partnership to make a distribution. If the partnership does not make any distributions (a likely scenario since the debtor often controls the partnership) the creditor will not be able to satisfy his judgement.\(^{122}\) Additionally, a creditor that possesses a

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\(^{117}\) Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 28.

\(^{118}\) Ibidem.

\(^{119}\) “A judgment creditor is a party that is granted a money judgment. The latter entitles such a creditor to enforce the judgment through liens, execution and levy.”; http://bankruptcy-law.freeadvice.com/bankruptcy-law/collections/judgment_creditor.htm.

\(^{120}\) “A charging order is a court-authorized right granted to a judgment creditor to attach distributions made from a business entity to a debtor who is a partner of the business entity. The charging order is usually limited to the amount stated in the judgment and is corresponding to a garnishment of wages or income. It does not give the creditor management rights in the entity, nor can the creditor interfere in the management of the entity to which the debtor is a partner/member.”; http://www.investopedia.com/terms/c/charging-order.asp.

\(^{121}\) Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 29.

\(^{122}\) Ibidem.
"charging order" may be considered, for tax purposes, a substitute partner in the partnership and be forced to pay taxes on the debtor's share of the partnership's profits, even if no distributions are made.123

1.2. The concept of the beneficial ownership

1.2.1. Origins

The concept of beneficial ownership can be simply described by the N. Rockefeller sentence “The secret to success is to own nothing, but control everything.”124 In this view, it can be stated that beneficial owner is an individual that profits from the assets that are not in his legal possession.

The idea of beneficial ownership is believed to derive from the United Kingdom during the development of the trust law, where distinction between legal and beneficial ownerships was made. Under the trust law the legal ownership lays in the hands of trustee, who holds it for beneficial owner (cestui que trustent).125

Nowadays the term beneficial ownership is used not only with regard to trusts. Still, though, the concept refers to the individual who ultimately controls the asset at the same time gaining profits from it. An example of a person who is absent temporally leaving a land in possession of another, with a stipulation of regaining it at any time can be a good illustration of beneficial ownership.126 It shows that the individual not only benefits but also execute control in the end. The latter is done not directly and secretly, concealing the identity to the outside world. Presented features can be attractive for perpetrators who want to misuse corporate vehicles, as the beneficial ownership creates the facade that other individual or legal person is controlling the business.127

1.2.2. Definition

Definition of beneficial ownership that is accepted internationally is the one formed by the FATF. It states that: “Beneficial owner refers to the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It

123 Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 29.
126 Ibidem.
127 Ibidem.
also includes those persons who exercise ultimate effective control over a legal person or arrangement.”\textsuperscript{128}

It shall be further noted that terms \textit{ultimately owns or controls} and \textit{ultimate effective control} pertain to “situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control.”\textsuperscript{129} Additionally, the term \textit{customer} according to the FATF shall also refer to beneficial owner of a beneficiary under a life or other investment linked insurance policy.\textsuperscript{130}

The significant feature of beneficial ownership that shall be mentioned is the fact that definition explicitly refers to natural persons as those who has ultimate control. In contrast, legal persons first of all, cannot be under the definition a beneficial owner and secondly, they also cannot have the ultimate control, as they are controlled by natural persons.\textsuperscript{131}

With regard to the misuse of corporate vehicles, it shall be stated that here the beneficial ownership is used in the meaning of control. The latter, furthermore can be regard to an individual(s) who have controlling interest rather than those who own the entity.\textsuperscript{132}

In the context of European Law, the Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 in the Art. 3 (6) provides a definition of the beneficial ownership and the threshold of 25% to hereafter stated prerequisites.

“Beneficial owner means the natural person(s) who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted. The beneficial owner shall at least include:

(a) in the case of corporate entities:

(i) the natural person(s) who ultimately owns or controls a legal entity through direct or indirect ownership or control over a sufficient percentage of the shares or voting rights in that legal entity, including through bearer share holdings, other than a company listed on a regulated market that is subject to disclosure requirements consistent with Community legislation or subject to equivalent international standards; a percentage of 25% plus one share shall be deemed sufficient to meet this criterion;

(ii) the natural person(s) who otherwise exercises control over the management of a legal entity;

\textsuperscript{128} Financial Task Force; \textit{International Standards on Combating Money Laundering and Financing of Terrorism & Proliferation; The FATF Recommendations}; February 2012; p. 109.

\textsuperscript{129} Financial Task Force; \textit{International Standards on Combating Money Laundering...}, op.cit.; p. 109

\textsuperscript{130} Ibidem; footnote No.51; p. 109.

\textsuperscript{131} E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; \textit{The Puppet Masters...}, op. cit.; p. 19.

\textsuperscript{132} Ibidem; p. 21.
(b) in the case of legal entities, such as foundations, and legal arrangements, such as trusts, which administer and distribute funds:

(i) where the future beneficiaries have already been determined, the natural person(s) who is the beneficiary of 25% or more of the property of a legal arrangement or entity;
(ii) where the individuals that benefit from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates;
(iii) the natural person(s) who exercises control over 25% or more of the property of a legal arrangement or entity.  

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I.3. Mechanisms for Achieving Anonymity

The most essential feature that perpetrators look for is the ability to hide the identity. This can be obtained by various methods. Despite the fact that mechanisms, such as bearer shares, nominee shareholders, and nominee directors, were developed to serve legitimate purposes, they can also be misused to conceal the identity of the beneficial owners from the authorities. Furthermore, they may be used jointly to maximise secrecy. The potential risks presented by these mechanisms have led some jurisdictions to develop counter measures that prevent attempts to conceal identity.  

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The main devices used to achieve anonymity are as follows:

I.3.1. Bearer shares

Bearer shares are negotiable instruments that grant ownership of a corporation to the individual who possesses the bearer share certificate. The person who has physical possession of the bearer share certificate is presumed a legal shareholder of the corporation that issued such bearer share. That individual is also empowered to execute all of the rights of a shareholder.  

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Bearer shares are furthermore documents that do not contain the name of the shareholder and are not registered, except the possibility of their serial numbers. In contrast to the registered shares, which are transferred by written instrument, bearer shares are transferred by delivery of the share certificate.  

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It is worth mentioning that in general, bearer shares are used for legitimate purposes, for instance to facilitate the transfer of shares and to avoid costs that can be connoted with the transfer

134 Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 29.
of registered shares (stamp duties, expenses incurred through the use of a notary, cost of printing new registered share certificate, etc.).\textsuperscript{137} On the other hand, bearer shares present high level of anonymity constitute them attractive for unlawful purposes, such as money laundering, tax evasion, financial frauds and other illicit conducts. This happens, in particular, when they are issued by private limited companies. Bearer shares appear in numerous (but not all) jurisdictions, both onshore and offshore. In Europe it can be observed that public limited companies are enabled to issue bearer shares while private limited companies are not allowed to do so.\textsuperscript{138}

The misuse of bear shares may occur with regard to the fact that companies, by issuing them, are frequently exempt from having to keep a share register. This significantly diminishes the amount of information that the authorities may obtain for various purposes.\textsuperscript{139}

In some offshore jurisdictions bearer shares are not allowed as these countries are aware of the potential for concealing the identity of the beneficial owner. Jurisdictions that prohibit the issuance of bearer shares are Barbados, Bermuda, Costa Rica, Cyprus, Guernsey, and Jersey.\textsuperscript{140} Gibraltar’s exempt companies may issue bearer shares, but the law requires them to be deposited in a Gibraltar’s bank and the identity of the beneficiaries must be disclosed to the authorities. In addition, the custodian bank has to verify that “they hold the bearer shares to the order of the named beneficiaries and that no change in ownership will occur without the consent of the Financial and Development Secretary”\textsuperscript{141}. The abovementioned limitations have been observed to cause little attention of exempt companies in issuing bearer shares. In addition to aforesaid methods preventing misuse of bearer shares, anti-money laundering regulations have also influenced the private sector by requiring certain intermediaries to identify their customers.\textsuperscript{142}

Although, bearer-shares are still in use, many jurisdictions have recently reformed their laws eliminating these instruments by \textit{dematerialization} and \textit{immobilization}.\textsuperscript{143} The first of mentioned, requires bearer-shares to be computerized and registered in company’s books. In contrast, immobilization obliges companies to deposit the bearer shares with a custodial agent, who holds the share for the beneficial owner. That protects the holder from making unrecorded transfers.\textsuperscript{144}

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\textsuperscript{137} Organisation for Economic Co-operation and Development, \textit{Behind the Corporate Veil...}, op. cit.; p. 30.
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\textsuperscript{138} Ibidem.
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\textsuperscript{139} Ibidem.
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\textsuperscript{140} Ibidem; p. 30-31.
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\textsuperscript{141} Ibidem.
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\textsuperscript{142} Ibidem.
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\textsuperscript{143} E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; \textit{The Puppet Masters...}, op. cit.; p. 41.
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\textsuperscript{144} Ibidem; p. 41, 43.
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In this respect, establishing a company that uses a bearer shares is relatively simple. Suitable example can be seen in the United Kingdom. This jurisdiction enables establishing a company using on-line application form. That said, a Private Company Limited by Shares (with bearer-share warrants) can be established electronically by the service provider. Upon the payment and submission of the order to set up the company, the provider electronically files the application with the U.K. Companies House. In the governmental records, the provider will be the initial shareholder of the company and subscriber to the Memorandum and Articles of Association. Additionally, the service provider will issue bear-share warrants that do not encompass any names of true owners. He may also include to the company structure a nominee director and nominee secretary. In total, the process of setting up such a company will take less than a day, and total costs will result in an approximately amount of £515.95. Nevertheless, some jurisdictions have introduced regulations that oblige intermediaries to register the transfer process of the bearer shares, to guarantee the registration of the ownership change.

I.3.2. Nominee shareholders and omnibus accounts

Nominee shareholders are companies established with the purpose to hold shares and other securities for the investors. They also appear in the same registry as shareholders.

The main apprehension that can be observed regarding the use of nominee shareholders is that this instrument allows the beneficial owners to safeguard their identity from investors and other stakeholders. For example, Formal Nominees are advertised as basic component used to establish legal entities, when the ultimate owner does not want to disclose his interest or association and appear in any disclosed documents.

The concern is furthermore put towards an omnibus accounts – securities accounts created for numerous investors. The greatest benefit that can be observed is that omnibus accounts reduce transaction costs regarding clearing and settlement fees and procedures. On the other hand, when

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146 Ibidem; p. 41.
147 Ibidem.
148 Ibidem; p. 43-44.
150 E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; Technical Seminar: Beneficial ownership and control: a comparative study Disclosure, information and enforcement; March 2012; p. 10-11.
they are opened in the name of an account provider, they may be used as a shelter for illegal activities, for example to hide the real identity of beneficial owners.\textsuperscript{152}

\textbf{I.3.3. Nominee directors and "corporate" directors}

For the purposes of hiding the identity of the beneficial owner, nominee directors and corporations serving as directors (corporate directors) can be used as less information are provided to the company’s registry.\textsuperscript{153} Although the nominee director appears on all of the companies documents and in its official registers, all duties are carried out by the beneficial owner of the company. Moreover, in many jurisdictions, the nominee or corporate director is not required to own company’s shares.\textsuperscript{154}

It shall be noted that most OECD Member countries and many OFCs such as Cyprus, Isle of Man, Jersey, Malta, and the Netherlands Antilles, do not acknowledge nominee directors. As a result, an individual who admits the directorship need to fulfil all requirements, including fiduciary obligations.\textsuperscript{155}

Countries that do not recognise the concept of nominee directors have one major advantage. The directors are more prone to ensure that the beneficial owner is not acting illegally. In this manner, some jurisdictions that use nominee directorships have introduced restrictions on the number of positions one individual may hold. In Ireland, for instance, a person may hold a maximum of 25 directorships.\textsuperscript{156}

In short, the use of the nominees shareholders or directors may be seen as a controversial way of managing company, as it offers a blurry picture of the ownership and control inside the corporation.

\textbf{I.3.4. Chains of corporate vehicles}

The use of chains of corporate vehicles can have pure legitimate motives. For example, governmental-owned and –operated corporate vehicle structures are in many situations established to conduct public or commercial activities in the name of the State. Moreover, family owned businesses may also create the chains of corporate vehicles, where the ownership and control are divided to individual members of family, so as to maintain the control of the company in the family hands.\textsuperscript{157}

\textsuperscript{152} J. A. McCahery, E. P. M. Vermeulen; \textit{Mandatory Disclosure and Related Party Transactions...}, op. cit.; p. 14.
\textsuperscript{153} Organisation for Economic Co-operation and Development, \textit{Behind the Corporate Veil...}, op. cit.; p. 31.
\textsuperscript{154} Ibidem; p. 31.
\textsuperscript{155} Ibidem; p. 31-32.
\textsuperscript{156} Ibidem.
\textsuperscript{157} E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; \textit{The Puppet Masters...}, op. cit.;
However, it can also suggest that the controlling beneficial owners create chains of corporate vehicles, because they do not want to appear in any official documents and are applying abusive and opportunistic behaviour.\textsuperscript{158} Many layers of corporate vehicles may comprise considerable problems for authorities and investigators. Firstly, it shall be pointed out that rules of registration do not distinct between corporate vehicles that own or control another (in a larger structure) and corporate vehicles that are purely nominee providers. That said, it can be difficult for an authority or investigator to proceed, especially if the country of the shareholding entity does not possess the same or similar regulations.\textsuperscript{159}

In consequence, chains of corporate vehicles are frequently used by the perpetrators of illicit activities. This means that criminals are establishing many entities, each in a different jurisdiction to maximise anonymity and obstruct potential authorities that would seek to trace beneficial ownership.\textsuperscript{160} The jurisdictions that are attractive for such purposes are predominantly those where “beneficial ownership information is not maintained, readily obtainable, or able to be shared”\textsuperscript{161}. As the potential combinations are practically unlimited, a simplified scheme may be presented as follows. An IBC in jurisdiction X may be owned by another IBC in jurisdiction Y, which in turn is owned by a third IBC in jurisdiction Z. The third IBC may then be owned by a trust established in yet another jurisdiction.\textsuperscript{162}

Diagram 2. Simple chain of corporate vehicles.

\begin{itemize}
\item \textbf{TRUST} \hfill [jurisdiction A]
\item \textbf{IBC} \hfill [jurisdiction Z]
\item \textbf{IBC} \hfill [jurisdiction Y]
\item \textbf{IBC} \hfill [jurisdiction X]
\end{itemize}

\begin{flushright}
\textbf{Diagram 2. Simple chain of corporate vehicles.}
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p. 55.\textsuperscript{158}
\textsuperscript{158} E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; \textit{Technical Seminar...}, op. cit.; p. 13.
\item \textsuperscript{159} E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; \textit{The Puppet Masters...}, op. cit.; p. 57.
\item \textsuperscript{160} Organisation for Economic Co-operation and Development, \textit{Behind the Corporate Veil...}, op. cit.; p. 32.
\item \textsuperscript{161} Ibidem.
\item \textsuperscript{162} Ibidem.
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I.3.5. Intermediaries - company formation agents, trust companies, lawyers, trustees, and other professionals

Reports that so far have been published regarding the misuse of corporate vehicles concluded the essential role is played by the intermediaries. The term *intermediary* refers to corporate service providers such as company formation agents, trust companies, lawyers, trustees, accountants, brokers, and other professionals, that have an significant position in the formation and management process of corporate vehicles in most OFCs.¹⁶³ Although such intermediaries are present both in onshore and offshore jurisdictions, those from offshore countries are believed to generally play a key role in dissembling the identity of the beneficial owners of corporate vehicles.¹⁶⁴

Corporate service providers, in major cases, create the company structure in such manner, so as to guarantee the beneficial owner anonymity and frequently act as the intermediary between the client and the authorities in the jurisdiction of incorporation.¹⁶⁵ Additionally, they regularly contribute nominee shareholders and nominee directors so that the beneficial owners' names do not appear on any company or official records. Other intermediaries, such as private banks that provide services to high net worth individuals, have also been recognized in assisting their clients to establish shell entities that hide the owners' identities.¹⁶⁶ Furthermore, there are countries that possess regulations which dismiss financial institutions from conducting due diligence on clients referred by an intermediary (such as a lawyer, notary, or licensed corporate service provider) who has affirmed that it has ascertained the identity of the client.¹⁶⁷ The beneficial owner anonymity can be also accomplished when the intermediary is establishing bank accounts in his name or when an intermediary vouches for the client, in this manner permitting the client to remain undisclosed.¹⁶⁸

The most attractive intermediaries are those who enjoy the professional confidentiality privileges regarding their clients. For example lawyers and notaries may be attractive as some jurisdictions, granted them the right to refuse to provide evidences to the authorities, even when these professionals were acting in a non-legal capacity. Some offshore jurisdictions extend this privilege to companies management.¹⁶⁹

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¹⁶⁴ Ibidem.
¹⁶⁶ Ibidem.
¹⁶⁸ Ibidem.
¹⁶⁹ Ibidem.
I.3.6. Front Men

Front men are used by the perpetrators mostly in the corruption cases. They are purposely picked individuals that may have rather biographical than contractual connections with the principal. Moreover, front men bear all the risks and liabilities associated with “being the true end-user parties in relation to a corporate vehicle, even though they may be doing so for another person”.\textsuperscript{170} The World Bank \textit{Puppet Masters Report} declares that almost half of the investigated case of grand corruption involved the use of front men. Usually, the use of front men can be associated with those who hold some public offices.\textsuperscript{171}

For example, the former President of Chile Augusto Pinochet had used his position and shifted illegal funds by using foreign corporate vehicles. To do this, he used a Meritor Investments Ltd., Redwing Holdings, and a trust numbered MT-4964 that were owned by Marco Antonio Pinochet Hiriart and Ines Lucia Pinochet (Pinochet’s son and daughter).\textsuperscript{172} Furthermore, bank accounts were opened under the names of these two persons, and Maria Veronica Pinochet another Pinochet’s daughter. Pinochet’s lawyer (Oscar Custodio Aitken Lavancy) was also involved in the scheme as he was in control of six other corporate vehicles. All abovementioned individuals served successfully as front men for Pinochet, who held the control over the assets allowing him to separate his name from the scheme.\textsuperscript{173}

Although, front men can be attractive instrument for perpetrators, the World Bank \textit{Puppet Master Report} states that when the investigators find such an individual, he or she will typically surrender, confess and cooperate.\textsuperscript{174} This may happen because front men cannot hide him behind any provisions, such as bank secrecy regulations or professional privileges, as he/she is allegedly operating own business. Moreover, it is beneficial for investigators to recognise front men as he/she will present information on the identities of the main perpetrators and assist in building the case against them.\textsuperscript{175}

To sum up, this chapter presented the corporate vehicles that are abused for illegal activities. As can be observed the most vulnerable form is the trust as it is basically an contractual agreement that in majority of jurisdictions is not strictly regulated. This chapter also demonstrated instruments that enable perpetrators to conceal their identities. In addition, it can be concluded that the major issue lies in the concept of the beneficial ownership and control.

\textsuperscript{170} E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; \textit{The Puppet Masters...}, op. cit.; p. 62.
\textsuperscript{171} Ibidem.
\textsuperscript{172} Ibidem; p. 63.
\textsuperscript{173} Ibidem.
\textsuperscript{174} E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; \textit{The Puppet...}, op. cit.; p. 63.
\textsuperscript{175} Ibidem.
II. MONEY LAUNDERING

II.1. Basic information

Nowadays the bigger attention has been put by the authorities to the problem of money
laundering. It has been estimated that this criminal activity gains every year trillions of dollars.
Moreover, this problem grew due to the terrorist’s attacks that occurred on September 11, 2001 and
after that time. Since then a great efforts have been put to decrease these phenomenon by using
more complex methods to investigate the movement of illegitimate money.\footnote{A. Giriraj, P. K. Mishra, Money Laundering: An Insight into the Modus Operandi with Case studie; p. 3; http://www.skoch.in/images/stories/security_paper_knowledge/Arvind\%20Giriraj\%20and\%20Prashant\%20Kumar\%20Money\%20Laundering.pdf; (26.06.2012).}

Money Laundering is described as the procedure that aims to convert ill-gotten gains or so
called “dirty” money in order to create the impression that such money originates from a legitimate
source. Money Laundering is used worldwide to conceal criminal activities that are associated with
drug or arms trafficking, terrorism, extortion, bribery, insider trading, illicit tax practices, market
manipulation and other criminal offences.\footnote{Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 34.} It is furthermore linked to the organised crimes where
the procedure is well structured in order to hide illegal activities.\footnote{A. Giriraj, P. K. Mishra, Money Laundering..., op. cit.; p. 2.} In short, it can be alleged that
the money laundering process aims to transform illegal ("laundered") funds into legitimate ones.\footnote{Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 34.}

The studies that have been conducted regarding money laundering note that currently the
perpetrators have the tendency for international operations as they enable them to successfully hide
and/or profit from the unequal anti-money laundering regulations in various jurisdictions.\footnote{Ibidem.}
Furthermore, researches confirm that filtering ill-gotten money has to be obtained through a series
of transactions, so as to the funds look like they were legally gained, dissembling at the same times
their true origins.\footnote{Ibidem; p. 3.}

Historically, the term Money laundering firstly appeared in the newspaper report related to
the Watergate scandal in the United States in 1973.\footnote{Ibidem; p. 3.} In addition, the origins of the phrase can be
connected with Mafia ownership of Laundromats in the United States that were used to clean huge
amounts in cash from extortion, prostitution, gambling and bootleg liquor.\footnote{Ibidem} Moreover, in India
money laundering is popularly known as hawala transactions. Although traditionally the hawala
transactions were used to transfer money or information by the Arabic traders who wanted to avoid robberies, its attractiveness for the perpetrators occurred in early 1990’s as at that time many India’s politicians were caught on this illegal scheme.\textsuperscript{184}

The United Nations Report from 1993 states that: “The basic characteristics of the laundering of the proceeds of crime, which to a large extent also mark the operations of organised and transnational crime, are its global nature, the flexibility and adaptability of its operations, the use of the latest technological means and professional assistance, the ingenuity of its operators and the vast resources at their disposal”.\textsuperscript{185}

Money laundering scheme is usually divided into three stages:

1. \textit{Placement} is a step during which illegally obtained money is being placed. At this stage, the launderer inserts the dirty money into a legitimate financial institution.\textsuperscript{186} Many different techniques can be used to place the dirty money, for example bank deposits, transactions between offshore corporate entities, etc. It shall be noted that the Placement stage is the riskiest step as, in most cases, it involves large sums of money that need to be placed. Furthermore, nowadays banks and other financial institutions are required to report high-value transactions that include also the origins of funds.\textsuperscript{187}

2. \textit{Layering} phase involves relying on diverse financial transactions that aim to further change the funds’ forms, making it more difficult to pursue. Layering may consist of numerous bank-to-bank transfers, wire transfers between different accounts in different names and countries, making deposits and withdrawals to continually vary the amount of money in the accounts, changing the money’s currency, and purchasing high-value items (boats, houses, cars, diamonds etc.) to change the form of the money. This is the most complex step in any laundering scheme, and it’s all about making the original dirty money as hard to trace as possible.\textsuperscript{188}

3. \textit{Integration} phase is the last stage when money re-enters to the economy in legitimate-looking form. In this stage launderers are using bank transfers to locate money, for example at the accounts of local businesses in which funds are being invested in exchange for a cut of the profits. Integration phase is the hardest to be discovered if there are no evidences of activities in the previous stages.\textsuperscript{189}

\textsuperscript{184} A. Giriraj, P. K. Mishra, \textit{Money Laundering...}, op. cit.; p. 4.
\textsuperscript{185} Ibidem; p. 3.
\textsuperscript{186} Organisation for Economic Co-operation and Development, \textit{Behind the Corporate Veil...}, op. cit.; p. 34.
\textsuperscript{187} A. Giriraj, P. K. Mishra, \textit{Money Laundering...}, op. cit.; p. 4.
\textsuperscript{188} Ibidem.
\textsuperscript{189} Ibidem.
II.2.  **Money Laundering Typologies**

As the channels and organizations through which funds are laundered are persistently evolving, money laundering experts are using variety models and techniques which then are presented as typologies that show recent changes and shifts in money laundering schemes and structures. Such typologies are essential as they are used by international institutions to make governments and financial markets aware about potential hazards.\(^{190}\)

In recent years the money laundering specialists have observed a substantial change that has occurred in international money laundering schemes – perpetrators have shifted towards the non-banking sectors and non-financial businesses and professions. The last are progressively attractive channels for introducing ill-gotten money into the financial sectors.\(^{191}\) The use of internet banking, internet casinos, smart-cards and e-cash is also a current attraction for money launderers. Of rising attention within this context are, furthermore, the financial instruments and strategies used by alternative assets classes (e.g. Private Equity, Hedge Funds and Managed Futures) because of their innovative approach, less harsh provisions and vague environment.\(^{192}\)

According to the OECD “money laundering may, and does occur in basically all jurisdictions”.\(^{193}\) Nevertheless, perpetrators have a preference to use countries that facilitate concealment. As it was mentioned previously, such jurisdictions have strict secrecy laws, lax regulatory and supervisory regimes. The corporate vehicles have furthermore impenetrable anonymity features that obscure the ownership of assets. Jurisdictions with the political stability, large economy and complexity of the financial services sectors may also be targeted by money launderers.\(^{194}\) In this respect, both onshore and offshore corporate entities may and are vulnerable to money laundering schemes. To illustrate the abovementioned situation, profits from criminal activity in an onshore jurisdiction can be transferred first to an offshore bank account opened in the name of an offshore centre-established corporation. Then, money can be transferred throughout diverse jurisdictions (as well onshore as offshore), using once more corporate vehicles. In the last stage, in order the funds to appear again in the home jurisdiction, a domestic company may be established to ”borrow” money from the offshore entity.\(^{195}\)


\(^{191}\) Ibidem; p. 3.

\(^{192}\) Ibidem.

\(^{193}\) Organisation for Economic Co-operation and Development, *Behind the Corporate Veil...*, op. cit.; p. 34.

\(^{194}\) Ibidem.

\(^{195}\) Ibidem.
Diagram 3. Money laundering scheme.

As Money Laundering process is evolving, there can be observed different methods which are used by the criminals worldwide. The organization that since the mid 1990s has contributed typologies reports is the FATF. The aim of this force is primarily to contribute data that may be used to improve anti-money laundering regulations. Their reports have recognised hereunder structures or methods:

- **Structuring deposits (known also as Smurfing)** - This method is used to divide large amounts of ill-gotten gains, so as to make such small amounts to be less suspicious for financial institutions. Generally, it relies on depositing of cash or purchasing of bank drafts at various institutions by several individuals, or carrying out transactions below reporting thresholds.

- **Shell companies and Front Companies** - Money launderers use widely both shell and front companies for their illicit purposes. These companies may be established only for such reasons. Perpetrators frequently use financial transfers to conceal the true origins of the funds and to mingle the dirty and clean money together. These transfers are usually being named as "expenses" for supposed goods or services, but in fact they are constructions of legitimate transactions through fake invoices and balance sheets.

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198 Ibidem.
• **Investing in legitimate business** - It is common for money launderers to invest into legitimate businesses as to clean dirty money, to accomplish larger authenticity and shrink the detection risks. Investments may be done into brokerage firms or casinos that accept large sums of money, so it is easy for the dirty funds to be blended in. Moreover, launderers may invest into businesses that need cash in order to start to operate. Such small, cash-intensive businesses might be bars, car washes, strip clubs or check-cashing stores. These companies may also be used for banking relationships establishments with overseas financial institutions.

In 2009 the FATF published its report regarding the money laundering that currently occurs in the football sector, as the money there play an significant role. The attractiveness of perpetrators to the football sector can be explained with regard to its structure, financing and culture. Furthermore, the FATF experts noted that the problem is more complex and serious than it was alleged. With regard to money laundering the schemes that are used include the misuse of corporate vehicles, tax havens, cross-borders transfers, front companies and other instruments. Additionally, the report proved that the football sector is used also for corruption and tax offences.

• **Informal Money or Value Transfer Systems (hawala, hundi, fei-chien and the black market peso exchange)** - The abovementioned systems, regardless of the terminology, are in their essence alike, as they are informal remittance transactions. In consequence, for the transaction to take place there is a need of three parties - remitting party, remittance service providers and a recipient. That said, hereafter only hawala process will be presented as it is believed to be the most exploited one.

Hawala can be explained as a combination of money transfer networks that have been operating since ancient times. They were also important regarding exchange. Nowadays, hawala still operates and relies mostly on reputation of those who provide the hawala services. In addition, it shall be noted that the hawala is seen as an illegal procedure in majority of countries.

Basically, hawala system operates as a wide and liquid network of individuals who assist in the transfer of funds by exchanging credits and debts. The system can be described as follows:

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200 Organisation for Economic Co-operation and Development, *Behind the Corporate Veil*..., op. cit.; p. 34.
202 Ibidem.
“Individual (A), working in New York, wants to send remittances back to his family (B) in rural India. (A) contacts a local hawaladar (Ha). (Ha) arranges to take (A)’s dollars and a service fee.

In return, (Ha) gives (A) a code to pass on to (B) for identification upon delivery. (A) could phone his relatives and inform them of the upcoming transfer, or as in the past, pre-established dates, times, and amounts are often arranged by mail or word of mouth. (Ha) would then contact his business partner in India (Hb), providing him with the code and corresponding amount to be paid. (Hb) then pays (B), who identifies himself by the code, the stipulated amount in rupees. The identification code could indicate family lineage or is often a passage from the Qur’an.

For (A) and (B), the transaction is complete. However, (Ha) and (Hb) have an outstanding debt and claim, respectively”.  

The below Diagram illustrates the hawala system.

Diagram 4. The hawala system.

Hawala transactions can be beneficial, as in contrast to formal financial system, it is believed to be less expensive. Furthermore, the transactions are in general quicker, taking one or two days to reach the recipient.  

Additionally, exchange rates are also important and they are believed to be more favourable than those seen in the formal systems. Lastly, hawala system is attractive, because it enables parties to evade currency controls and bureaucracy. For instance, in

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206 Ibidem; p. 7-8.
case of undocumented workers the hawala system is more suitable as they cannot use the formal financial systems in order not to be determined. On the other hand, hawala is a threat to the financial markets as it depends on undocumented transactions between individuals. What is more, it allows perpetrators to shift swiftly their illegal funds with relatively low costs.

- **Credit Cards (front-end loaded)** – By using this method perpetrators firstly obtain cards that allow them to create debts that are repaid then by cash.

- **Electronic Funds Transfer** - Use of wire transfers services to transfer funds to associates.

In their report from 1996 the FATF experts observed that Money laundering trends could be described as being twofold. First trend was referred to specific traditional techniques that still being used by the perpetrators to launder money. The second that was acknowledged concerned the financial sector and its likelihood for considerable threats.

According to the FATF Report on Money Laundering Typologies criminals are currently using both traditional and new methods to clean illegally gained money. Banks still remain as a essential devices used for disposal of ill-gotten funds. In this manner various accounts are being created in false names or in the name or interests operating on behalf of other beneficiaries. The last group consists of agents such as solicitors, attorneys, brokers and accountants. Furthermore, traditional banking sector includes shell or front companies. In general the accounts are operated to assist the deposit or transfer of dirty money.

The FATF experts are furthermore focused on the emerging threats which can be found in the insurance and securities sectors. The latter one is believed to be vulnerable to infiltration especially by the money launderers at the layering stage. It is because of its international nature as the brokerage companies have offices all over the world and most transfers are transmitted through various jurisdictions. Moreover, securities markets are said to be very liquid as the purchases and sales can be conduct during relatively short time. Another reason why securities can be used for money laundering or other illicit purposes is that brokers are in most cases not interested in the origins of clients funds. This is because the securities markets environment is very competitive and

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208 A. Duaij; *Hawala: The Main Facilitator for Middle Eastern Organized Crime Groups*; p. 2.
210 Ibidem.
211 Ibidem.
212 Ibidem; p. 4.
213 Ibidem.
214 Ibidem; p. 6-7.
brokers’ compensation is usually based on sales commissions. The FATF experts noted that discovering money laundering schemes in the securities environment is incredibly hard. It is believed that all international financial systems may be potentially infiltrated by illegal funds. In countries that are non-FATF members it is difficult to monitor and obtain information concerning money laundering. Moreover, in many situations criminals aim economies that are cash intensive and where there are weak or none mechanisms to track huge amounts of money transactions. The best example to illustrate these situations is the abovementioned description of hawala system.

Studies performed on the Japanese Yakuza showed that this criminal organization is one of the world’s most noticeable and lucrative as it ploughs funds in a variety of assets located in Asia and Pacific countries. Moreover, evidences showed that “overseas Chinese organised crime groups are engaged in criminal enterprises in Asia and elsewhere in the world”.

In Asian region money laundering techniques which are dominating are:

- the use of shell corporations;
- the use of bearer instruments;
- the use of wire transfers;
- the use of remittance services;
- the purchase of luxury items and real estate;
- false invoicing;
- laundering through casinos;
- laundering through securities transactions.

In other parts of the world, the banking sector is continually of great significance especially in the placement process. Africa is the region where there is little information available to the FATF experts. The Eastern Europe, especially Russia, is believed to be frequently engaged in tax

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216 Ibidem.
217 Ibidem; p. 8.
218 Ibidem; p. 9.
219 Ibidem.
220 Ibidem.
221 Ibidem; p. 10.
frauds by using well organised corporations for illicit purposes (e.g. establishing networks of international contracts with other criminal organizations).\textsuperscript{222}

The FATF report shows that some countries may have characteristics that are preferable for money launderers. The features are:\textsuperscript{223}

- banking systems that are corrupt or corruptible;
- no money laundering legislation or an absence of meaningful legislation;
- the ability to buy or establish a bank with very little capital;
- law enforcement structures ill-equipped to investigate financial crime;
- a high propensity for official corruption;
- a desperate need for capital;
- disinclination on the part of law enforcement authorities to co-operate with one another.

\textbf{II.2.1. The use of Corporate Vehicles in money laundering}

The FATF specialists in one of the reports have concluded that “the most significant feature of the misuse of corporate vehicles [is] the hiding of the true beneficial ownership”.\textsuperscript{224} The misuse of corporate vehicles in money laundering proceeds may be furthermore divided into three sub-categories:

\textit{(1) Multi-jurisdictional structures of corporate entities and trusts} are frequently used to conceal identity of the true owners or to set up a fraudulent scheme (typically financial frauds and Ponzi schemes\textsuperscript{225}). Such multinational forms may be established and used to create a legitimate appearance of the business and what is more are perfect devices through which the money laundering procedure can be camouflaged. Moreover, these structures can be used to divert funds, disguise payment schemes and obscure the trail of the proceeds derived from criminal activity.\textsuperscript{226}

\textit{(2) Specialized intermediaries and professionals} are in most cases involved in establishment processes (setting up corporate vehicles and or complex corporate structures) that are then exploit

\begin{footnotes}

\textsuperscript{223} Ibidem; p. 12.

\textsuperscript{224} J. Hanley-Giersch, \textit{Money Laundering Typologies ...}, op. cit.; p. 6.

\textsuperscript{225} According to Securities Exchange Commission “a \textbf{Ponzi scheme} is an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors. Ponzi scheme organizers often solicit new investors by promising to invest funds in opportunities claimed to generate high returns with little or no risk. In many Ponzi schemes, the fraudsters focus on attracting new money to make promised payments to earlier-stage investors and to use for personal expenses, instead of engaging in any legitimate investment activity”. http://www.sec.gov/answers/ponzi.htm.

\textsuperscript{226} J. Hanley-Giersch, \textit{Money Laundering Typologies ...}, op. cit.; p. 6.
\end{footnotes}
for laundering funds. Such professionals, knowingly but often also unknowingly, are making excessive use of the legal loopholes that exist in some jurisdictions, mainly where there are not strict regulations and only minimal disclosure of financials and ownership is required. Specialized financial services, as they possess professional knowledge, are vulnerable to criminal activities such as set up structures used for ill-gotten purposes that aim to hide the ultimate beneficial ownership by using corporate shareholders located in off-shore jurisdictions, corporate directors and bearer shares.  

(3) Nominees and shell companies are in particular used to conceal the ultimate beneficial owner either by setting up a nominee bank account, using nominee shareholders or nominee directors.

As it was mentioned previously, shell companies are especially attractive for money launderers as they may purchase a company that not only will conceal the origin and identity of the beneficial owners, but as well the origins of funds.

The involvement of intermediaries in the money laundering procedures has risen as they are used particularly to assist or conduct the financial operations. That is because they have expertise and they also provide criminals with a veil of legitimacy, especially when there is a need to deal with financial institutions.

Typically, criminal organizations are establishing companies that have legitimate commercial purposes in order to combine dirty with clean money. Such companies are believed to use different false accounting practices in order to launder money. The establishment of various offshore entities, through which funds may be channelled, offers another way of obscuring the true intent of transactions. Furthermore, using publicly traded companies may be beneficial for perpetrators, because they can profit twice from the mechanism. Firstly, the establishment of publicly traded company facilitates a money laundering scheme. Secondly, perpetrators profits when shares of such a company are sold to unaware investors.

In short, the use of corporate vehicles in money laundering cases may presuppose many forms and combinations that aggravate possibilities to combat money laundering. However, recently there can be observed an increase interest of perpetrators in the securities sectors, as they are very liquid and cash-incentivises. The next section will provide more information in that manner.

228 Ibidem.
229 Ibidem.
230 Ibidem; p. 6.
II.2.2. Money Laundering Through the Securities Sector

Many recent researches proved that securities sectors may be exposed to criminals because of its global character and diversity. What is more, the securities sector is attractive, as nowadays trading uses electronic devices and transactions which do not stay within national borders.\(^{233}\)

Money that is laundered throughout the securities sector may be divided to those who are created from outside and inside the sector. For funds generated from outside, launderers usually use securities transactions or business forms for hiding the origins of funds.\(^{234}\) Inside sector illegal activities encompass embezzlement, insider trading, securities fraud, market manipulation and others. In such situations, transactions or manipulations are in the first place creating gains that then need to be laundered. Both outside and inside money laundering schemes are offering potential double advantages, as they permit to gain legal funds and further profits from the related securities frauds.\(^{235}\)

It shall be noted that securities markets can be limited to assured persons or firms, such as stockbrokers, banks or certain independent financial advisors who may be only permitted to perform transactions. These securities transactions administrators are in general restricted or prohibited from accepting cash when structuring them. Consequently, funds need to be converted in some way from cash before entering the securities sector. That said, the FATF’s experts believe that the use of the securities sector for laundering may be considered for the layering and integration stages of money laundering.\(^{236}\) Under the layering stage securities markets may be used in that way as through purchases of securities using ill-gotten money that firstly shall be introduced into the financial system (which happens at the layering stage).\(^{237}\)

II.2.3. Money Laundering and Market Manipulations

Other important issues that can be addressed to the abuses of securities markets and money laundering are market manipulations. These illegal activities can be further referred to the term "pump and dump", as it illustrates the artificial inflation of a stock based on misleading information.\(^{238}\) It shall be pointed out that these securities frauds may multiply the perpetrators' gains, and that is why most jurisdictions treat it as a predicate offence for money laundering. What

\(^{234}\) Ibidem.
\(^{235}\) Ibidem.
\(^{236}\) Ibidem; p. 17.
\(^{237}\) Ibidem; p. 18.
is more, there have been cases where this type of securities fraud has been set up with the proceeds of other crimes.\textsuperscript{239}

The proceeding relies on individuals who acquire large blocks of stocks in a company before it is publicly traded or while it is dormant or not yet operational. As usually the purchaser need to proceed very quickly, cash or account with possible quick liquidity are preferable. Here the money launderers can operate freely, as they may usually access large amounts of money in a short notice.\textsuperscript{240} What is more, the purchase of companies’ large blocks of stocks is frequently completed at an extremely low price. Later than the perpetrators have gathered bulky stock holdings in the company, they may utilise unscrupulous brokers to promote the securities to their clients and this is the point when the securities fraud begins.\textsuperscript{241}

Misleading information is released to the public to promote the company and its business operations. It is common for the company to advertise that is has new, innovative product that will bring income. While this artificial information is dispersed, the share prices for the company rise due to the public interest and increased demand.\textsuperscript{242} In the typical operation, the company has no legitimate operation and the information given to the public are simply provided to inflate the price of the shares. What is more, the perpetrators may split transactions between numerous brokers and/or channel transactions through multiple jurisdictions. Such procedure will generate the appearance of market demand.\textsuperscript{243} After the share price will obtain its peak, the perpetrators of this securities fraud will liquidate their share possessions and obtain a profit from the artificial inflation of the price. Ultimately, the company will fail making the shares worthless. At this point, two events can be observed. First of all, the money laundering has occurred, because a money launderer by selling his stock in the company has layered the illicit funds he originally invested. Secondly, he has generated additional illicit proceeds that require laundering using a securities fraud.\textsuperscript{244}

In accordance to the abovementioned possibilities for misuse the securities markets for money laundering, it is believed that these markets hold specific characteristics that attracts money launderers. Corresponding to the FATF Report on Money Laundering Typologies the features can be described as follows:

\textsuperscript{240} Ibidem.
\textsuperscript{241} Ibidem.
\textsuperscript{242} Ibidem.
\textsuperscript{243} Ibidem.
\textsuperscript{244} Ibidem.
Dirty money are rarely used for the placement stage in the securities sectors. However, some cases demonstrate that ill-gotten funds may be used for purchasing securities in cash transactions, although they are restricted or prohibited.245

Professional services such as brokers are vulnerable to criminals as the environment they work in is very competitive and incentivised for large gains. In many cases such operators may tend to disregard regulations in order the transaction to take place and the client would not to take his business to the competition.246

Due diligence weaknesses may also be attractive for money launderers, especially if the securities markets due diligence procedures on customers or the origins of their funds are not always executed in a compliant manner or do not go beyond the last step of the transaction.247

The securities markets as they are of international character are said to be attractive for money laundering because great number of transactions are multi jurisdictional.248

In some cases, under the securities transactions the ownership and control can be hidden. For that purpose perpetrators are using nominees, legal entities, trusts, etc.249

On the basics that were presented above, it can be concluded that business environment, especially corporate vehicles are nowadays very vulnerable for money laundering misuse. It shall be pointed out additionally, that there can be observed features of the jurisdiction provisions and tradition (e.g. hawala) that attract perpetrators.

Hereafter the examples of cases to illustrate how money launderers abuse corporate vehicles shall be presented.

The first case presents a small corporation was established in 1994 in eastern European country A with the aim on trading on a venture capital market. Other Company B was at that moment a manufacturer of magnets and has subsidiary which traded oil to and from the Soviet Union. Company B was reporting in its statement million of dollars and constant growth in sales.250

The main seat was located in another country (Country C) and as a result of its enormous growth need to, in 1996, met the requirements. At that moment also its shares stared to be traded on the stock exchange in the Country A. As the company was well-known it attracted many high profiled persons and was represented by a well-known law firm. What further occurred was that the

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246 Ibidem.
247 Ibidem.
248 Ibidem.
249 Ibidem.
founding shareholders were linked to an organised crime group and their transactions were placed in the European and Caribbean “tax heavens”.\textsuperscript{251}

In later years Company B wanted to raise an additional USD 74 million to make acquisitions and support the Company. The problem occurs with regard to the “soft” intelligence that was uneasy to be confirmed and therefore raised questions of the connection of the Company B with the organised crime group. After assurance and special reviews from other auditing and accounting firms, the 74 million was receipted.\textsuperscript{252}

After a short time of four months the auditors raised worries regarding the connection to the organized crime group and that the transactions might have been fake. Soon it was established that the company was a cover for a money laundering activities, for example sales and bank accounts were forged, transactions were performed on a cash or barter basis, assets values were overestimated, etc. in the meantime original shareholders were able to perform normal transactions (sell their shares) and transfer profits to Eastern European banks. The scheme interested authorities in both Country A and B and initiated legal proceedings.\textsuperscript{253}

The second case considers money laundering activity of a drug-trafficking organization hidden behind two companies. Perpetrators pumped to the stock market large sums of money from a mafia-related business. The money came mostly from frauds and was placed in a private banks also controlled by mafia members located in other country in the Caribbean region.\textsuperscript{254}

The plan was to establish two companies in Country V and listed them on the stock market. Then foreign investors under false names started to buy shares of these two companies. The requirement that need to be fulfilled under the Country V’s law was that none of the investors would buy more shares that he/she had percentage ownership.\textsuperscript{255} To be seen as legal entity the companies had established all of the required corporate bodies, where front men played minority role as all power was in the hands of the criminal organization. Moreover, when the shares increased to the amount of USD 42 million, they were subscribed through banks in the Country V. In reality the original funds were laundered on the national level by numbers of transfers going through the same number of companies’ accounts.\textsuperscript{256} The money ended their way in the same account and the same country and after a while stared its circle again. This stimulated the foreign investments of the two companies and raised their shares up to 640 percent of their face value. To achieve this high value

\begin{thebibliography}{99}
\bibitem{252} Ibidem.
\bibitem{253} Ibidem.
\bibitem{254} Ibidem, p. 15.
\bibitem{255} Ibidem; p. 40.
\bibitem{256} Ibidem.
\end{thebibliography}
the over-priced shares were provided to the mafia members who at the end become themselves the victims of the scheme.257

The third case presents the fall of the former Ukrainian Prime Minister (Pavel Lazarenko) who between May and September 1997 laundered approximately USD 70 million. Lazarenko and his accomplice in early 1997 found out that EuroFed (an offshore bank placed in Antigua) was for sale and they had decided to buy it. Firstly Lazarenko opened the personal account and soon with Kiritchenko purchased 67 percent interests of the bank. In the indictment there can be found that the main purpose to such big purchase was to “conceal and disguise the nature, origin, location, source, ownership and control of the money that was paid for the benefit of Lazarenko”258.

In the recent years money laundering is observed to become more complex, sophisticated and with greater speed procedure that occurs globally. The main reason can be associated to the globalization process that has encouraged businesses actors (and especially their business environments) to operate globally. Moreover, complexity of many transactions may be used for illegal purposes such as money laundering or financial frauds. For that reasons governments are joining their forces by establishing international organizations that are responsible for fighting against criminal activities. One of the methods is to provide guidelines and introducing improved legislations. Despite all the efforts that have been carried, money launderers are still using and searching for innovative and complex forms that are difficult to uncover.

258 US v. Lazarenko, Case No. 00-cr-0284-CRB (N.D. Cal.), Indictment filed May 18, 2000, Count 1 Conspiracy to Commit Money Laundering, at para. 21.
III. REGULATING OR OVERREGULATING?

The misuse of corporate vehicles can be seen as a threat for the legitimate businesses because it leads regulators to introduce stricter and burdensome provisions that in consequence raise operational costs. What is more, money laundering, for instance, is believed to be the most harmful hazard to the financial systems, as it jeopardizes countries trustworthiness. That is why, recently the most attention is paid towards solutions (domestic and international) that will decrease these damaging activities. In this manner, many organizations or forces have been established internationally with the main objectives to provide guidelines, recommendations and carry out researches that can be used to combat the money laundering, corruption and other misuse of corporate vehicles.

The negative economic effects that can be observed regarding the misuse of corporate vehicles concern the harm that is done to the financial-sector institutions that are crucial to economic growth. In addition, the decrease of productivity in the economy's sector by diverting resources may occur, that result in slow economic growth and distortion of the international trade and capital flows to the disadvantage of long-term economic development. For instance, perpetrators that use the corporate vehicles may additionally facilitate crime and corruption in developing jurisdictions, threatening the well-balanced economic growth.

It shall be stated that this thesis does not aim to present all organizations and provisions that can be addressed to the misuse of the corporate vehicles, as the number of them is significant and they are established domestically, regionally, and internationally. Nevertheless, it is beneficial to demonstrate the most recognized institutions and organizations that are involved in creating the framework against the possible abuses.

III.1. Financial Action Task Force on Money Laundering ('FATF')

This is an inter-governmental body founded in Paris in 1989 during the G-7 summit and is responsible for promoting the development of and correspondence with rules and standards that aim to efficiently protect the global financial system against money laundering and terrorist financing. It supervises its members' development in implementation of anti-money laundering measures, assesses money laundering techniques and countermeasures, promotes global compliance with anti-money laundering regulations and cooperates with other international bodies.

260 Ibidem.
262 Ibidem..
Moreover, the FATF is mostly recognized for its Forty Recommendations and Nine Special Recommendations on Terrorist Financing that together offer a comprehensive framework of rules applied to the money laundering.\textsuperscript{263} These intercontinental principles jointly called the “40+9 Recommendations” have as an objective to assist jurisdictions in formulating a “risk-based approach” in fighting money laundering and financing of terrorism. The FATF is also providing other reports that show, for instance, current trends in money laundering schemes or vulnerable sectors exposed for abuses. These publications aim to facilitate jurisdictions in implementing the Recommendations.\textsuperscript{264}

In 2008 the FATF issued the Lawyer Guidance that relate to legal professionals who are involved in one of the five selected activities, mainly those under which legal professionals, for instance, help clients in purchasing or selling real estate; assist to establish, manage or operate legal persons, or create or administer trusts or hold client’s money.\textsuperscript{265} The 2008 Lawyer Guidelines introduces a risk-based approach that recognizes no “one-size-fits-all” solution to the prevention of money laundering and financing of terrorism. Furthermore, this document presents the opinion that the greatest risks should receive the most attention.\textsuperscript{266} In relation to legal professionals, this indicates that they should focus on their clients’ location, the scope of their business and the character of the services demanded when evaluating whether they are engaged in the illegal activities. Yet, it is still too early to state whether the 2008 Lawyer Guidelines have produced the desirable results. However, it is obvious, that as the legal cultures and systems are considerably different, they might not be that quickly employed.\textsuperscript{267}

Moreover, the FATF is responsible for issuing the list of "Non-Cooperative Countries or Territories" (NCCTs) that is commonly known as the FATF blacklist. This list encompasses of countries which the FATF recognize as non-cooperative in the global fight against money laundering and terrorist financing.\textsuperscript{268} At the beginning the list was updated frequently, however since November 2009, there have been no official changes and it become unserviceable. Based on the authors observations, it can be argued that the list did not provide any consequences for the countries that were placed there. Furthermore, some of the countries that appeared on it did not possess the proper facilities or resources that would enable them to combat the possible abuses of their jurisdiction provisions.

\textsuperscript{263} E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; \textit{Technical Seminar...}, op. cit.; p. 38.
\textsuperscript{264} Ibidem.
\textsuperscript{265} Ibidem.
\textsuperscript{266} Ibidem.
\textsuperscript{267} Ibidem.
Therefore, the blacklisting approach may have twofold consequences. Firstly, from the international organisation point of view, it can force a obstinate states to comply with the standards. If not, the reputation and attractiveness of the jurisdiction and its beneficial regulations may be harmed, resulting in capital withdrawals of investments and other economic effects. Some experts are in a view that blacklists are methods to impose economic sanctions on non-cooperative jurisdictions. The blacklisting may be an incentive that influences significantly the reputation of the jurisdiction and their financial institutions. However, the question arises whether the deprivation of reputation is a sufficient incentive for the jurisdictions and their financial institutions to take more suitable actions.

On the other hand, the blacklisting process that was also created by the OECD restores some countries reputations and their attractiveness for investors. For example, jurisdictions such as the Cayman Islands, Bermuda, Jersey, Guernsey, and the Isle of Man and Singapore by complying with the OECD initiatives are now appearing in the investors eyes as jurisdictions with good governance. Besides, fulfilling the OECD recommendations and other standards these jurisdictions have maintained their fiscal sovereignty.

It shall be pointed out that in February 2012 the FATF published its revised Recommendations that comprise, *inter alia*, solutions that are estimated to considerably enhance transparency regarding beneficial ownership structures. The FATF 2012 Recommendations present the view of stricter provisions regarding obtaining and holding up-to-date information on the companies’ beneficial ownership. They also present the view concerning the “customer due diligence” (CDD) for legal persons and arrangements. The FATF 2012 Recommendations state that: “When performing CDD measures in relation to customers that are legal persons or legal arrangements, financial institutions should be required to identify and verify the customer, and understand the nature of its business, and its ownership and control structure. The purpose of the requirements […] regarding the identification and verification of the customer and the beneficial owner, is twofold: first, to prevent the unlawful use of legal persons and arrangements, by gaining a sufficient understanding of the customer to be able to properly assess the potential money laundering and terrorist financing risks associated with the

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270 Ibidem; p. 1.
271 Ibidem; p. 21.
272 E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; *Technical Seminar…*, op. cit.; p. 38.
273 Ibidem.
business relationship; and, second, to take appropriate steps to mitigate the risks. As two aspects of one process, these requirements are likely to interact and complement each other naturally.  

Additionally, in February 2012 the FATF published International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, where it presented 3 types of lists:

- High-risk and non-cooperative jurisdictions that have strategic AML/CFT deficiencies and to which counter-measures apply.  
- High-risk and non-cooperative jurisdictions with strategic AML/CFT deficiencies that have not made sufficient progress in addressing the deficiencies or have not committed to an action plan developed with the FATF to address the deficiencies.  
- Jurisdictions with strategic AML/CFT deficiencies that have provided a high-level political commitment to address the deficiencies through implementation of an action plan developed with the FATF.

III.2. Organisation for Economic Co-operation and Development (OECD)

The OECD aims to "promote policies that will improve the economic and social well-being of people around the world". It created the governmental forum under which there is a possibility to create solutions to widespread issues. Furthermore, the OECD provides studies and suggestions that foresee the future trends and changes. This organisation is mostly known for its report published in 2001 that summarised the misuse of the corporate vehicles and opened the bigger discussion regarding what is behind the corporate veil.

III.3. Basel Committee on Banking Supervision

The Committee was established in 1974 by the Central Bank Governors of the G-10 countries and its role is to promote reliable supervisory standards worldwide. Although, the Committee has no formal supranational authority, it prepares and publishes extensive supervisory guidelines. Additionally, it proposes recommendations on the best practice standards. It is worth to

276 Ibidem.
277 Ibidem
278 OECD website - http://www.oecd.org/pages/0,3417,en_36734052_36734103_1_1_1_1_1_00.html; (20.06.2012).
note that the documents (recommendations, guidelines) published by the Basel Committee on Banking Supervisory are not legally binding.\textsuperscript{279}

\textbf{III.4. Wolfsberg Group}

This is an association of international financial institutions that develops anti-money laundering guidelines for international private banking sector. It cooperates with other institutions (such as the Transparency International, other experts) and publishes guidelines regarding banking and terrorist financing.\textsuperscript{280}

\textbf{III.5. Egmont Group of Financial Intelligence Units}

This is an informal working group, which was founded in 1995 by a number of national intelligence units. Its main objectives are to offer a forum for Financial Intelligence Units (FIU’s), support anti-money laundering programmes and develop modus operandi for information sharing.\textsuperscript{281}

\textbf{III.6. World Bank and International Monetary Fund (IMF)}

Both organizations are assisting in strengthening financial supervision and regulation globally. Recently, the World Bank published \textit{the Puppet Master Report} that presents the misuse of corporate vehicles in the 150 grand corruption cases. Moreover, these institutions also closely cooperate with the OECD and the Basel Committee on Banking Supervision, and together with the FATF, the World Bank and the IMF have established a joint structure under which they are trying to accomplish widespread measurements.\textsuperscript{282}

The law itself can be a great tool that may be used in combating the misuse of the corporate vehicles. First of all, it can be observed that there is no uniformity or universal international law regulations that can be addressed to the issue of the misuse of corporate entities. Instead, as it can be concluded there are various regulations and laws that apply only to the specific vehicles (e.g. trust, foundations) or more general provisions that can be employed to larger group of entities (e.g. company law). What is more, the legal culture differs among countries, and that is why for some jurisdictions it is especially difficult to diminish the abuse of the corporate vehicles, as they do not have suitable instruments to do so. In consequence, it is believed that perpetrators are attracted to jurisdictions that do not possess appropriate enforcement and investigation instruments.

\textsuperscript{279} J. Hanley-Giersch, \textit{Money Laundering Typologies...}, op. cit.; p. 9.
\textsuperscript{280} Ibidem.
\textsuperscript{281} Ibidem.
\textsuperscript{282} Ibidem.
It shall be reminded that some concepts or regulations that now are recognized to facilitate criminal actions were established in the aim of contractual freedom or protection of assets (e.g. trust). Moreover, as the law is under constant development some of innovative instruments such as derivatives or hedge funds may potentially be misused in the future.

As can be observed, the main issue concerning the abuse of business entities and other arrangements relates to the successfulness of the concealing of the beneficial ownership and control. That said, the law of a country that enables high anonymity for the true owners can attract perpetrators. In addition, such regulations may apprehend both domestic and international authorities and their abilities to obtain and share information in that matter. As it was examined by the OECD’s experts, company and especially trust regulations that introduce low transparency standards fatally hamper the ability of identification the beneficial owners of corporate vehicles, increasing at the same time the probability for its misuse.283

According to the OECD there are particular issues managed under the company law that may increase the possibility for the misuse. Such matters are as follow: 284

- Availability of bearer shares.
- Recognition of nominee shareholders and nominee directors.
- Availability of "corporate" directors.
- Residency requirements of directors.
- The local presence requirement.
- Requirement to maintain shareholder register.
- Maintenance of shareholder registers in jurisdiction of incorporation.
- Annual reporting requirements; and
- Location where books and records are to be maintained.

Another very important regulation that may be used for illicit purposes is the trust law. As it was mentioned before, the use of trusts occurs primarily in common law countries and in civil law jurisdictions that adopted and amended their legal frameworks in order to benefit from the concept of trust. The trust law regulates the contractual agreement between the parties and in most jurisdictions there are no strict requirements regarding the disclosure of the identity of the beneficial owner. In addition, it can be argued that as the objective the trust shall remain in the use of those who seek to separate beneficial and legal ownership. On the other hand, jurisdictions that recognize trusts shall be aware that there are instruments to limit the possibilities of its abuse. For instance, introducing the requirements for the trustees (like for other intermediaries and service providers) to identify the beneficial owners and permit authorities to acquire such information in case of investigation. There is also possibility to impose sanctions on the trustees and oblige them

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284 Ibidem.
to report suspicious in their view actions. Another positive example can be seen in jurisdictions such as Bermuda, Cyprus and Jersey, which oblige trusts which hold companies shares, to disclose the beneficial owner(s).\textsuperscript{285}

The most important law that may apply to the misuse of the corporate entities are the anti-money laundering (AML) regulations. They are created both on domestic and international levels. The main objective of such regulations is to enhance the ability of the authorities to obtain information on beneficial ownership and control preventing or revealing the criminal activities.\textsuperscript{286} Provided that the anti-money laundering regulations are enforced successfully, they may act as an effective mechanism for the authorities to obtain information on the beneficial ownership and control of corporate vehicles.\textsuperscript{287}

Anti-money laundering requirements apply to variety of organizations and institutions. For instance, financial institutions are obliged under these laws to identify their clients and to uphold and update identification records.\textsuperscript{288}

Furthermore, the anti-money laundering policy has introduced the Know Your Customer (KYC) procedures that shall be performed by all financial institutions.\textsuperscript{289} This approach applies to the proceedings used by financial institutions that exchange information between each other regarding their clients before entering any contracts with them.\textsuperscript{290} This is done through due diligence and the application of bank regulations. The KYC is crucial, as it permits to verify the identity of the potential client, its activities and sources of revenue, and its background and financial structure.\textsuperscript{291} The policy of the KYC aims to recognize any suspicious transactions that may be carried by the client, as the complexity of criminal activities require those institutions to look at the “bigger picture”.\textsuperscript{292}

Moreover, authors believe that it can be said that due diligence and reporting obligations are challenging for legal professionals in two ways. Firstly, the KYC provisions are potentially costly and burdensome activities. Secondly, the transparency regulations may further be an issue, as they oblige to report any suspected or detected misuse of corporate vehicles.\textsuperscript{293} In addition,\textsuperscript{285} Organisation for Economic Co-operation and Development, *Behind the Corporate Veil...*, op. cit.; p. 45.
\textsuperscript{286} Ibidem; p.46.
\textsuperscript{287} Ibidem.
\textsuperscript{288} Ibidem; p. 46-47.
\textsuperscript{290} E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; *The Puppet Masters...*, op.cit.; p. 266.
\textsuperscript{293} E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; *Technical Seminar...*, op. cit.;
secrecy regulations such as the client confidentiality or lawyer-client privilege may be problematic especially for the professionals. The abovementioned issues induce the FATF to introduce the abovementioned 2008 Lawyer Guidelines that help fighting money laundering without undermining the lawyer-client privilege, the duty of client confidentiality or in other way hampering the delivery of legal services in general.294

Although, the anti-money laundering regulations can be seen in a vast majority of jurisdictions, its usage may bring some problem, as some jurisdictions may still do not have any customer identification requirements.295 As a result, while some countries apply these requirements only to financial institution, other broaden them to company and trust service providers. And other once exempt these parties from having to undertake independent due diligence if a client is introduced by certain specified intermediaries.296

The bank secrecy regulations are as well essential, as they are responsible for maintaining financial operations. Additionally, they can be an obstacle for authorities that want to gain and share information on the beneficial ownership and control of corporate vehicles, if they do not allow for disclosure of such information.297 On the one hand, there should be no surprise that individuals and corporate vehicles have a valid right not to have their affairs undisclosed. In that manner companies, for instance, do not want to disclose their confidential information to opportunistic creditors, competitors, customers, and suppliers.298 In case of individuals, mainly those who have significant net worth or occupy high profile positions, the bank secrecy laws may prevent them from threats of extortion and kidnapping. On the other hand, though the need to shield legitimate privacy interests cannot validate refusal to access a relevant information when unlawful activity is alleged.299

As it was stated before some jurisdictions possess laws that refuse authorities to access information on a person or legal entity except when the person in question gives its permission. For instance, in the Cook Islands, commercial records can be inspected only in the Companies Office Registry after the company provides its approval.300

The problem with strict secrecy laws in some jurisdictions hamper the international possibility of sharing and exchanging information, even when unlawful activity is suspected.

294 E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; Technical Seminar..., op. cit.; p. 37.
295 Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 47.
296 Ibidem.
297 Ibidem; p. 48.
299 Ibidem; p. 48.
300 Ibidem.
Moreover, in cases when the secrecy can be lifted under certain conditions, the investigation may still be impeded, enabling the perpetrators to move their resources to a different jurisdiction. Nonetheless, the increasing number of jurisdictions possess laws that enable the authorities to:

a) share non-public information with other domestic and foreign authorities,

b) cooperate in criminal matters where the alleged offence does not constitute a crime in the jurisdiction where assistance is sought, or

c) undertake investigations on behalf of foreign authorities.

Furthermore, the tax authorities (similarly to financial institutions) are in some jurisdictions, obliged to inform the taxpayer in question when a foreign authority has requested information concerning that taxpayer, with the exception where there is a suspicion of a tax fraud. The abovementioned requirement may have twofold consequences. Firstly, from the taxpayer perspective such a notification can be beneficial, as it gives an opportunity for the taxpayer to bring an appeal in court against any decision to permit the exchange of information. Secondly, it may also lead to significant delays in obtaining information by the foreign authority.

**III.7. Combating illicit use of corporate vehicles in Europe**

In the European Union rules concerning the misuse of the corporate vehicles were unified. The latter regulations come from 2005 and it is the Third Directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing. This Directive amended the previous regulations, introduced additional requirements and protections for situations of higher risks, meaning cases when there is a trade with banks located outside the European Union.

The Directive applies to many aspects of formation and operation of corporate vehicles, including service providers (for instance auditors, tax advisors, lawyers and accountants). Furthermore, it declares that legal professionals are required to employ continuous due diligence behaviour throughout their relationship with clients. In order to do that they are obliged to:

- identify their clients and, more importantly, verify their identity on the basis of information obtained from a reliable source,
- identify the beneficial owner of a client who is a legal person, trust or similar legal structure,

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302 Ibidem; p. 46.
303 Ibidem.
304 Ibidem.
305 E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; *Technical Seminar…*, op. cit.; p. 37.
• understand the ownership and control structure of the corporate client,
• report suspicious transactions to the national financial intelligence unit (the FIU).

The European Union policy vis-à-vis transparency and disclosure in a corporate governance framework can only be successful when legal rules and other institutions assure the enforcement of and compliance with the particular legal requirements.\textsuperscript{307} Directives that are addressing the issue of the beneficial ownership, do not particularly stipulate the enforcement or intervention measures. Alternatively, the European laws require implementation of measures and penalties in order to detect and enforce compliance with the disclosure regime that is provided in the Directive.\textsuperscript{308} Furthermore, each Member States is obliged to appoint a single competent authority responsible both for enforcement and international cooperation with other foreign authorities. The latter, can inform publicly about imposed penalties, but it can be done only if the disclosure is proportionate and does not endanger the working of financial markets.\textsuperscript{309}

From above approaches it can be concluded that current framework regarding the misuse of corporate entities is significant and diverse. That is why there is a need for a substantial critique that positively influences future efforts.

The critique of the framework vis-à-vis the misuse of the corporate vehicles shall present the study carried by Professor J.C. Sharman. He aimed to test “the global rules prohibiting anonymous participation in the international banking system by seeking to break these same rules”.\textsuperscript{310} In Professors Sharman’s view such a practical approach may help to complete the deficiencies that still exist giving at the same time direct and crucial empirical evidences regarding the effectiveness of so far established standards. Furthermore, the empirical studies such as the one done by Professor Sharman can show the reality of the correspondence between the international organisations, their standards, and jurisdictions’ institutions.\textsuperscript{311}

The research:

• 45 – different service providers
• 22 countries
• Purchase of a sub-set of corporate vehicles – determination whether anonymity both in corporate vehicles and in the international banking system is possible;

\textsuperscript{307} E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; \textit{Technical Seminar...}, op. cit.; p. 44-45.
\textsuperscript{308} Ibidem.
\textsuperscript{309} Ibidem.
\textsuperscript{310} J.C. Sharman; \textit{Behind the Corporate Veil: A Participant Study of Financial Anonymity and Crime}; p. 3; http://www.etudes-fiscales-internationales.com/media/02/00/1507439115.pdf (25.06.2012).
\textsuperscript{311} Ibidem; p. 3-4.
Test of a claim that the rules and regulations are less effective in offshore financial centres than in the OECD member countries.312

During the study 45 requests were sent to 45 different corporate service providers in 22 different jurisdictions in order to establish anonymous corporate vehicles. In addition, he opened bank accounts that were linked to these shell companies. As a result, seventeen out of the 45 attempts to establish anonymous corporate vehicles ended with success. The remarkable finding was that only four of the successful requests were not done in the members of the OECD.313

Professor Sharman has furthermore challenged in his study the allegation that offshore centres or tax havens create the greatest hazard to the reliability of the financial system and because of their strict financial laws they facilitate criminal activities.314

The results of the study showed that in contrary to the allegations, the small offshore centres possess higher standards regarding transparency than the main OECD economies like the US and the UK. The study divides the jurisdictions into 3 groups:315

1. Jurisdictions with the highest standards, as they require widespread identity documentation before incorporation - Bermuda, the British Virgin Islands, the Bahamas, the Cayman Islands and Panama.

2. Jurisdictions that were less observant and allowed for establishment of anonymous shell company, but still required identification before opening a bank account - Belize, Hong Kong, Canada and Britain.

3. Jurisdictions where it was possible to incorporate an anonymous corporations bank accounts without appropriate documents – Somalia, the United States and the United Kingdom.

Professors Sharman study have also confirmed that opening bank accounts is more difficult, because banks require documentation that is followed by the ‘know your customer’ (KYC) policy. Better records of compliance were found in the offshore financial centres in contrast to jurisdictions such as the US and the UK.316 To support this argument, it can be pointed out that Professor Sharman was able to establish a company in Nevada and open an account in one of the most well-known American’s banks using only a scanned copy of a driver’s licence. He could not repeat this procedure with a Cypriot bank, when he bought a Seychellois International Business Company, as the bank requested a notarised passport copies, utility bills, bank references and filled questionnaire.317

312 P. M. Picard, P. Pieretti; Bank Secrecy, Illicit Money and Offshore Financial Centers; May 27, 2009, p. 21.
313 Ibidem.
314 J.C. Sharman; Behind the Corporate Veil..., op. cit.; p. 5.
315 Ibidem; p. 6.
316 P. M. Picard, P. Pieretti; Bank Secrecy, Illicit Money and Offshore Financial Centers; op. cit., p. 21.
317 Ibidem.
The results ruined the confident image of rule-effectiveness that can be observed in relation to the US and the UK and furthermore the common belief that the issue of the misuse of corporate vehicles and especially the problem of money laundering is mainly connected to the offshore financial centres and their beneficial regulations.\textsuperscript{318}

As can be concluded from the presented study the rules and regulations provided by the international organisations are not that successful as alleged. That said, Professor Sharman is in the view that there is a need to change and improve the framework that exist, otherwise combating the perpetrators involved in money laundering, tax evasion, major corruption and related financial crimes may be slow or negligible.\textsuperscript{319}

Although the presented critique indicate that the picture created by the major international organisations can be easily undermined, these organisations still for example pressure offshore financial centres and declare them as the biggest threats to the international financial markets. That is why, some explanation in this regard is needed.

\textbf{III.8. Offshore centres and the pressure for compliance}

The offshore financial centres have a negative opinion and are seen as parasites that prosper because they possess beneficial tax regulations, and therefore are exposed and vulnerable for money launderers and other perpetrators. Regarding this allegation, in recent years there have been introduced some initiatives that aim to discipline the offshore financial centres by forcing them to amend their favourable regulations. Notwithstanding, the international organisations are limited in their efforts, as they do not have the power to intervene into the sovereignty and autonomy of those jurisdictions.\textsuperscript{320}

Furthermore, as it was stated by Raymond Baker, director of Global Financial Integrity - “The focus of today’s summit is the stability of the global financial system. World leaders cannot possibly stabilize the global economy without first tackling the system of tax haven secrecy, anonymous corporations, and trade mispricing that got us into this mess.”\textsuperscript{321}

In consequence, international organizations still support the view that offshore financial centres need to amend their provisions, as they are primarily responsible for tax evasion and other financial crimes. Additionally, the demands are now placed towards the transparency and collaboration between jurisdictions and their financial institutions. Organisations such as the OECD, the United Nations and the European Union are constantly acting and initiate new methods

\begin{itemize}
  \item J.C. Sharman; \textit{Behind the Corporate Veil...}, op. cit.; p. 6.
  \item Ibidem; p. 1.
  \item P. M. Picard, P. Pieretti; \textit{Bank Secrecy, Illicit Money and Offshore Financial Centers}; op. cit.; p. 4.
\end{itemize}
and remedies that combat the issue of tax evasion as well as increase the international level of cooperation.\textsuperscript{322}

The European Union in the matter of tax evasion has focused on the implementation of good governance, meaning the transparency, exchange of information and fair competition. In contrast, the OECD has followed their own path applying a “peer-review” of the application of their standards for transparency and exchange of information. Besides, the UN adopting some of the OECD policies has introduced his individual Code of Conduct on Cooperation in Combating International Tax Evasion that can be relevant for developing countries.\textsuperscript{323}

To sum up, this chapter provided an simplified overview of the legal framework applicable when the misuse of corporate vehicles is considered. As it can be observed, the most attention is paid to the money laundering and, as a consequence, the anti-money laundering regime consists of extensive number of international organisations that also present interest in combating, corruption, tax evasion and other financial crimes. As it was presented before there is a list of seven main global organisations that are engaged in providing rules or have recognised monitoring duties. Some of them are operating only in specific sectors such as insurance or security; others undertake only some processes – for instance the FIUs, which collect reports from regulated institutions.

The variety of, for instance, the AML institutions may though be seen as an overabundance and misleading, as each of these organisations provide various standards, rules and reports. In this respect, from the jurisdiction point of view, it is hard to follow and comply with all the regulations that to some extent are creating an idealistic structure. Furthermore, it can be observed that the most attention is now paid to the money laundering issue. In this respect, all international institutions that have in their scope finance and/or crimes are applying AML regulations. They cannot do otherwise if they want to “benefit” (gain the prestige and funds for researches) from becoming the member of such an organisation.\textsuperscript{324}

From the author’s viewpoint, the current intergovernmental framework regarding the misuse of corporate vehicles presents a tendency to quote each other’s work. The reason behind may be because majority of these organisations enjoy the same membership, leading to self-corroboration. Some of the introduced resolutions concerning for instance money laundering coincide with other that were presented previously.\textsuperscript{325} Although the rules and regulations that can be addressed to the misuse of corporate vehicles can be identified, the main concern lies in the


\textsuperscript{323} Ibidem.

\textsuperscript{324} P. M. Picard, P. Pieretti; \textit{Bank Secrecy, Illicit Money and Offshore Financial Centers}; op. cit., p. 5.

\textsuperscript{325} Ibidem; p. 15.
issue of beneficial ownership. The next chapter will present and discuss current resolutions that aim to successfully combat the misuse of the business entities and other legal arrangements.
IV. THE WAY FORWARD

This chapter presents the possible solutions regarding the misuse of the corporate vehicles. In that manner, six main areas can be determined. Firstly, the main concern lies in obtaining the beneficial ownership and control. In this respect, the organisations and scholars relate to disclosure provisions. Furthermore, there can be observed an increase attention regarding intermediaries and service providers that play a crucial role in establishing and managing the corporate vehicles. Good corporate governance may also influence the combat towards the misuse of the corporate vehicles. The most significant emphasis (by organisations and scholars) is put on the enforcement, compliance and cooperation both on national and international levels. The hereafter chapter will discuss the benefits that can be observed when implementing these solutions.

IV.1. Beneficial ownership – piercing the veil

The concept of beneficial ownership with regard to corporate vehicles may seem simple in theory, but may be difficult to apply in practice, as identifying the individual who ultimately benefits or controls the vehicle through a complex corporate structure may be costly and time consuming. Additionally, the variety of international corporate and investment vehicles increase this difficulty. There is also no unified definition that can be addressed to the beneficial ownership, which means that the identification is based on a context-dependent process.\(^{326}\)

According to the World Bank Puppet Masters Report the term shall be understood as “a material, substantive concept”\(^{327}\), which means that beneficial ownership refers to the individual that has the real control over the vehicle. Furthermore, the Report argues that the term should not be narrowed just to the legal definition, but instead the attention need to be placed on two factors: “the control exercised and the benefit derived”\(^{328}\). As a result, the control will at all times rely on the circumstances, because it may be employed variously.\(^{329}\) The beneficial ownership and control may furthermore be presented as the percentage threshold. That approach can be found in France where “under Article 223-11 of the Autorité des marchés financiers (AMF) General Regulation the holders of financial instruments related to shares to be issued or with similar economic effect to holding shares (i.e., cash-settled equity swaps) must also be disclosed when one of the thresholds is reached (5%, 10%, 15%, 20%, 25%, 30%, 33.33%, 50%, 66%, 90% and 95%)”\(^{330}\).

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\(^{326}\) E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; The Puppet Masters..., op. cit.; p. 29.

\(^{327}\) Ibidem; p. 3.

\(^{328}\) Ibidem; p. 3.

\(^{329}\) Ibidem.

\(^{330}\) E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; Technical Seminar..., op. cit.;
such a formal approach is that the authorities will be given, at the beginning of the existence of corporate vehicle, information on the shareholders or the individuals of interest that may have additional information on beneficial owners. Moreover, the abovementioned approach may show the structure of the vehicle and be taken into account by the authorities whether there is a need for further investigation. On the other hand, in the view of Professor Vermeulen, presented at the OECD Technical Seminar in Moscow, March 2012, the abovementioned threshold may be inadequate regarding identification of the institutional beneficial owners.

The OCED presents the view that it is crucial for each jurisdiction authorities to have the possibility to obtain and share information on beneficial ownership and control of corporate vehicles domestically and internationally. Additionally, in its opinion the most effective method to identify the beneficial owner is to, when necessary, “pierce through the legal form of corporate vehicles in order to obtain information about the legal owner of the shares or the party that exercises effective control over the vehicle”. The term piercing the veil can be related to the situations when the authority attempts is to reach the bottom in the complex structure of the vehicle. Finding the true or ultimate beneficial owner applies to these entities or legal arrangements that use instruments so as to conceal the identity of an individual that has the most interest. In consequences, the current standard for financial institutions is to obtain and maintain information with regard to the identity of their clients, together with any individual that may beneficially own or control the bank account or money in question.

However, the laws and policies in obtaining information on the subject of the beneficial ownership and control differ among countries. Some may require a broad disclosure, up front at the formation stage that additionally needs to be updated especially when changes occur. Nevertheless, the majority of jurisdictions depend on their driven power, court-ordered subpoenas and other legal instruments that enable to pierce behind the corporate veil when it is indispensable.

The OECD Report from 2001 introduced many recommendations that could be addressed in all jurisdictions regarding the misuse of corporate vehicles for illicit purposes. Three main

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Note 331: E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; Technical Seminar..., op. cit.; p. 18.

Note 332: OECD Report; Identification of ultimate beneficial ownership and control of a cross-border investor; March 2007; p. 9.


Note 334: A Template prepared by the Steering Group on Corporate Governance; Options for obtaining beneficial ownership and control information; 1 September 2002; p. 4;
Mechanisms were recommended to obtain information on beneficial ownership and control. These mechanisms include:\(^{335}\)

1. an up-front disclosure system
2. mandating corporate service providers to maintain beneficial ownership information
3. primary reliance on an investigative system

The hereafter table presents the main characteristics of abovementioned mechanisms.

<table>
<thead>
<tr>
<th>Mechanisms that can be used to obtain information on beneficial ownership and control</th>
<th>Mandating corporate service providers to maintain beneficial ownership information</th>
<th>Primary reliance on an investigative system</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>An up-front disclosure system</strong></td>
<td>requires that intermediaries involved in the establishment and management of corporate vehicles, are obliged to obtain, verify, and retain records on the (beneficial) ownership and control of the corporate entities that they establish, administer, or for which they provide fiduciary services; implementation of this mechanism is cheap; when a foreign party is involved, costs and time extend; requires the identification practices such as the client identification, verification and recordkeeping, (costly and burdensome); potential for delays in the provision of information</td>
<td>the authorities may require information when illegal activities are suspected, when they perform their statutory or when the information are requested by other authorities domestically/internationally; unnecessary costs and burdens for corporate vehicles may be avoided; maintain a reasonable balance between ensuring proper monitoring/regulation of business vehicles and protecting legitimate privacy interests; limitation in costs – potential for delays in the provision of information.</td>
</tr>
<tr>
<td>- requires the disclosure of the beneficial ownership and control of corporate vehicles to the authorities, chambers of commerce or any other institutions responsible for the establishment or incorporation;</td>
<td>- obligation to update information when changes are made;</td>
<td>- information regarding the beneficial ownership and control are available at any times and obtainable from: * the corporate vehicles, * the ultimate beneficial owner, * the corporate service provider;</td>
</tr>
<tr>
<td>- high operational costs imposed on business entities and other legal arrangements.</td>
<td>- information is available at any times and obtainable from: *, the ultimate beneficial owner, * the corporate service provider;</td>
<td></td>
</tr>
</tbody>
</table>

**Tabel 1. Mechanisms used to obtain information on beneficial ownership and control.**

The methods and instruments that can be used in obtaining the beneficial ownership and control information may rely on particular factors, such as: \(^{336}\)

\(^{335}\) E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; *Technical Seminar...*, op. cit.; p. 35. Also can be found in Organisation for Economic Co-operation and Development , *Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes*, 2001.
the nature of business activity in a jurisdiction,
- the extent and scope of non-resident ownership,
- the corporate regulatory regime,
- the powers and capacity of the authorities to obtain beneficial ownership and control information,
- the functioning of the judicial system.

Moreover, in certain instances (such as listed companies), the beneficial ownership and control shall be disclosed as it is crucial for minority shareholders and other stakeholders to know who the ultimate owner of the entity is. In that manner, the disclosure and reporting regulations need to be transparent providing clear regulations that apply to corporate vehicles.\(^{337}\) Furthermore, enforcement and intervention, in situations when ultimate beneficial owners fail to comply with these rules and regulations, are fundamental for the corporate governance framework quality. However, the limitations on private enforcement actions by the individual investors shall be also considered. Likewise, these investors are more prone to search for the remedies through the public authorities, such as financial market regulators, or private institutions with quasi-governmental powers, such as stock exchanges.\(^{338}\)

Furthermore, many countries have amended their regulations in order to create the framework under which the intermediaries involved in the formation and management of corporate vehicles are obliged to gather, verify and retain information on beneficial ownership and control. They are also required to give under certain circumstances the authorities access to such records.\(^{339}\) For instance, even if service providers or intermediaries are obliged to determine the last beneficial owner, they may only be able to reveal the controller. What is more, in general service providers do not have sufficient resources or access to information. They may only and surely ask questions, search databases for information and evaluate whether a corporate vehicle’s financial operations are consistent with its profile. Besides that, their powers are limited.\(^{340}\)

Moreover, the ability to use a various instruments and methods that enable authorities to obtain the information on the beneficial ownership and control need to be applied individually to jurisdictions legal framework as not all standards are appropriate for all jurisdictions. In consequence, the current regulations may not be sustainable for instance for developing countries, as they do not have resources or legal structures to comply with these provisions. In short, it can be

\(^{336}\) OECD Report; Identification of Ultimate Beneficiary Ownership..., op. cit.; p. 10.

\(^{337}\) E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; Technical Seminar..., op. cit.; p. 50.

\(^{338}\) Ibidem.

\(^{339}\) Organisation for Economic Co-operation and Development, Behind the Corporate Veil..., op. cit.; p. 81.

\(^{340}\) E. Willebois, E. M. Halter, R. A. Harrison, J. Won Park, J. C. Sharman; The Puppet Masters..., op. cit.; p. 29.
argued that ‘one-size-fits-all’ approach intensify disproportions between countries. Furthermore, the perpetrators are like investors who take into account many features of the jurisdiction where they want to operate. The political environment, possible changes in the currency can be the decisive features for them.

Briefly, as it can be observed, the issue of obtaining the beneficial ownership and control information can be seen as controversial and challenging. The views and solutions that are presented both by scholars and international organisations emphasize that there is a need to introduce measures that will allow obtaining such information not only by the domestic, but also by the international authorities. However, to do this many jurisdictions have to amend their legislations so as to obtain a reasonable consensus achievable for every country. The latter may, though, be a tough to attain in the next few years as the world struggles with the global crises.

**IV.2. Disclosure**

On the one hand, prime duty of governments is to protect and prevent citizens from the potential perpetrators. On the other hand, jurisdictions need to stay open and flexible, if they want to benefit from the foreign investments. As consequence, it is suitable to create the laws so as to avoid unnecessary restrictions. However, there shall be an effective capacity to identify the ultimate owner or controller of an international investment vehicle or transaction.\(^{341}\) The necessity of obtaining such information lies in the determination of the true intentions and motivations. The disclosure system can be seen as a good solution.

The disclosure regime is argued to be the most suitable remedy regarding the misuse of corporate vehicles. Following this argument, many institutions are claiming that there is a need for stricter regulations. Such provisions can be seen as beneficial for minority investors, therefore they may contribute the fight against illicit activities of corporate entities. Moreover, to fulfil both these goals, regulators shall introduce disclosure regulations that are transparent and clear if they want to have a true picture of the beneficial ownership (especially the ultimate beneficial owner) and control mechanisms in their jurisdiction.\(^ {342}\)

In the view of Professors Vermeulen and McCahery\(^ {343}\) the reasons that can be assigned to the disclosure requirements lies in alerting the minority investors. The latter is needed when there are some essential modifications in the structure of corporate control and ownership, so minority investors can react to these changes. Furthermore, authors are stating that there is a need for

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\(^{341}\) OECD Report; *Identification of Ultimate Beneficiary Ownership...*; op. cit.; p. 10.

\(^{342}\) E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; *Technical Seminar...*, op. cit.; p. 13-14.

\(^{343}\) J. A. McCahery, E. P. M. Vermeulen; *Mandatory Disclosure and Related Party Transactions...*, op. cit.; p. 9.
additional resolutions in that manner. Even though jurisdictions will eliminate or limit, for instance, the bearer shares there are other ways to obstruct the identity of the ultimate beneficial owner. In consequence, the image of the corporate vehicle ownership and control will still be vague. However, if countries regulations require disclosure or reporting not on the ultimate level, but for instance at the level of director shareholders, then the use of other mechanisms (such as nominee shareholders, chains of corporate vehicles) may successfully conceal the true identity of beneficial ownership and control.  

As an example, the possible solution that may be helpful in disclosing the beneficial ownership was suggested to the United States Securities Exchange Commission (SEC) on March 7, 2011 to change provisions concerning the threshold for disclosure of the beneficial ownership to the level of “more than 5%” of a class of equity securities of publicly listed companies. In addition, the petition calls for the shorter time of the ownership reports to be filled and to expand the definition of the beneficial ownership. The latter should contain ownership interests held by person who use also derivative instruments. The objective of such a solution is to ensure that sustainable information will be provided to investors about individuals who virtually may influence a control of an issuer.

The good example was presented in the study carried by L. A. Bebchuk and R. J. Jackson Jr. They analyzed whether the rules in the United States should be tightened. First of all, authors supported the general view that introducing more strict disclosure can lead to information overload. In consequence, the market is provided with too many information that cannot be verified both by the authorities and the minority investors. In consequence, the latter ones investment choices may be negatively affected.

In addition, the disclosure regime aims on various types of beneficial owners. That said, when the disclosure and reporting regime is harsh and targets all types of beneficial owners, instead of those who are in the truly interest of the market, it may demotivate legitimate blockholders

344 E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; Technical Seminar..., op. cit.; p. 10.
345 Ibidem; p. 13-14.
346 Ibidem; p. 13-14.
348 Ibidem.
349 The types that are mentioned are:
“(1) passive beneficial owners who are only interested in a company’s share price,
(2) beneficial owners who monitor the performance of listed companies and initiate dialogues with management,
(3) beneficial owners that seek to acquire control over a listed company”. [In:] E. P.M. Vermeulen; OECD Russia Corporate Governance Roundtable; Technical Seminar..., op. cit.; p. 14.
activities. That may be the case, when the “owner” of the derivatives arrangements, that do not seek the control, is targeted by too strict disclosure and report provisions.\textsuperscript{350} Additionally, excessively severe rules may discourage commitment of outside blockholders and the dialogue between them and management of an underperforming company. This may lead to an increase in “vertical agency costs”.\textsuperscript{351}

The cost side of the disclosure regime shall also be considered. Currently, as there is a global crisis and the reduction of any unnecessary costs is searched, the stricter disclosure may rise costs for companies that could be shifted to other areas.

From abovementioned proposal and the points stated by L.A. Bebchuck and R.J. Jackson Jr., it can be concluded that in today’s financial market it is a challenging task for regulators to establish corporate governance framework that will be beneficial for every party. In this respect, the author supports opinion presented by Professor Vermeulen and McCahery that disclosure and reporting regimes shall be balanced and flexible, aiming to compromise the protection from the misuse of the corporate vehicles and the freedom of contracting which is the most basic rule in business world.\textsuperscript{352}

Nevertheless, the disclosure regime shall be developed in the way that enables governments to obtain all necessary information regarding who controls ultimately the entity. This will protect jurisdictions from those who want to abuse their beneficial regulations. Furthermore, experts are emphasizing that as financial markets became worldwide orientated there is increased need for legal provisions and rules that may allow more information sharing especially on international levels.\textsuperscript{353} Nonetheless, an extensive disclosure and reporting systems can aggravate the information overload that is already available on the market.\textsuperscript{354} In consequence, it shall be argued that regulators and policy makers need cautiously evaluate possible outcomes of stricter disclosure rules.

The World Bank \textit{Puppet Masters Report} also searches for a balance between strict and flexible regulations. The supporters of the stricter regulations put forward that “the identity of all beneficial owners of companies and key personnel in trusts (which do not have owners as such) should be publicly available”.\textsuperscript{355} It is believed that absolute corporate transparency would prevent money launderers and other perpetrators from successfully using the corporate vehicles.

\textsuperscript{350} E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; \textit{Technical Seminar...}, op. cit.; p. 13-14.  
\textsuperscript{351} Ibidem; p. 26.  
\textsuperscript{352} Ibidem; p. 14.  
\textsuperscript{353} Ibidem; p. 2.  
\textsuperscript{354} Ibidem; p. 26.  
\textsuperscript{355} Transparency International; Anti-Corruption Research News; \textit{Shell companies and Puppet Masters}; Knowledge for Transparency - Linking Anti –Corruption Research and Practice; Issue 9, April 2012; p. 3;
On the other hand, the practical viewpoint raises the issue that company registries are nowadays unequipped and they do not possess any resources necessary to meet an ambitious target that was presented above.\textsuperscript{356} In consequence, if the developed jurisdictions present the problems with enforcing tougher regulations, what then can the developing countries do. They are in the position where they cannot influence the formation of rules and regulations and they are required to make all their efforts to comply and implement current complex international standards\textsuperscript{357}

Disclosure can be a powerful tool to obtain information concerning the beneficial ownership and control and other significant information. It may though jeopardize business activities. It is inevitably connected with the increase of operational costs that may negatively affect the corporate vehicles dealings. In addition, from the administration point of view broad disclosure may overload financial institutions and other authorities with information making them miserable. In consequence, they may not effectively fulfil their obligations and duties. It may furthermore undermine jurisdictions that do not have sufficient resources to deal with loads of information at the same time. The costs will therefore also raise the expenses of the jurisdictions, as for instance more experts or investigators will have to be hired. To sum up, the stringent disclosure systems cannot be justified only upon the scandals that occur and minority shareholders protection, because that may considerably influence blockholders encouragement in monitoring.

\textbf{IV.3. Intermediaries and other service providers}

It can be argued that still, in many jurisdictions, the company law enable parties to set up corporate vehicles with no involvement of any professionals. That, in consequence, may facilitate the money laundering scheme. Nevertheless, in many instances there are other requirements that corporate entities need to fulfil before being established – open a bank account, or/ and apply for corporate ID number. Following this argument, intermediaries/service providers can also prevent the misuse of financial systems (including corporate vehicles) as they are the additional tier in the use of the financial system.\textsuperscript{358}

As it was mentioned previously, currently there can be observed an intensified attention towards intermediaries and other service providers, and their compliance with rules. It has been proven they play a significant role in money laundering, corruption and other financial offences.

\textsuperscript{356} Transparency International; Anti-Corruption Research News; \textit{Shell companies and Puppet Masters}; op. cit.; p. 3.

\textsuperscript{357} Ibidem.

\textsuperscript{358} E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; \textit{Technical Seminar...}, op. cit.; p. 41.
That said, many jurisdictions have changed their laws obliging intermediaries and service providers to check the identity of beneficial owners.

Moreover, based on various recommendations and reports it can be observed a general necessity of better execution of international standards with reference to intermediaries, especially those that establish, operate or manage the corporate vehicles. In that manner, banks for instance should ensure that they know who is behind the corporate veil’s account. In addition, the legal privilege shall be clarified by the regulators, stating which interactions between the lawyer and its client is privileged. Furthermore, the service providers that serve to establish shell companies, trusts and other corporate vehicles should be oblige to gather documentation on the identity of the beneficial owner for all the vehicles they create, making them accessible to law enforcement on request.359

Additionally, jurisdictions shall introduce incentives that induce intermediaries and service providers to imply the KYC policy, so as to recognize ad notify dubious transactions.360 For example, the Puppet Masters Report states that service providers have to in some cases (suspicious ones) exceeds their prime responsibilities, so as to uncover those who are in control or receive benefits.361

Nevertheless, there can be recognised an issue with regard to that intermediaries have not yet any status in international law.362 That is why, in the author’s opinion, the issue of the intermediaries needs further exploration and discussion. The current policy towards intermediaries and other financial service providers is not sufficient, as it leads to imposing only duties and obligations on these actors, at the same time not facilitating them with any new tools to comply with. As a consequence, there is a urgent need for further debate that enable to find a suitable solution.

IV.4. Corporate governance

The misuse of corporate vehicles shall also be discussed in relation to the good corporate governance. This issue challenges both authorities and stakeholders, such as employees and creditors, as difficulties may occur with, for example, executing stakeholder’s rights and acquiring corporate vehicles information. Additionally, the absence of information regarding the ultimate

359 Transparency International; Anti-Corruption Research News; Shell companies and Puppet Masters; op. cit.; p. 3.
360 P. M. Picard, P. Pieretti; Bank Secrecy, Illicit Money and Offshore Financial Centers; May 27, 2009; p. 5.
362 P. M. Picard, P. Pieretti; Bank Secrecy, Illicit Money and Offshore Financial Centers; May 27, 2009; p. 5.
beneficial ownership may likewise jeopardize the general public and stakeholders, who are uninformed as the decision-making process is blurred.\textsuperscript{363}

According to Professor Vermeulen the knowledge of beneficial ownership is an essential feature of a good corporate governance framework. Without information on ultimate owners, minority shareholders, stakeholders and public cannot obtain precise and trustworthy information that influence their choices on investments.\textsuperscript{364} Moreover, in order to effectively protect minority shareholders, it is required to introduce disclosure on regular basis and control-enhancing mechanisms. The latter ones provide controlling shareholders with voting/control rights in excess of their cash-flow rights.\textsuperscript{365} Furthermore, he states that any disclosure regime shall be facilitated with “a mix of public and private investigation and enforcement mechanisms, which encourage beneficial owners to effectively make disclosures and inform the company, other investors and the market about the control structure and their intentions”.\textsuperscript{366} To do so, he supports the non-judicial solutions such as “information requests” and private and public reprimands that will not cause additional costs for companies.\textsuperscript{367}

In addition, the problem of the corporate vehicles’ abuses appears both in countries that have concentrated and dispersed ownership. In the concentrated ownership systems, the concentration of control lies in the hands of one or more shareholders and it can be beneficial for minority investors, as the management is more responsible. This leads to the lower managerial self-dealing problems. On the other hand, though, controlling shareholders may have incentives to take advantage of business prospects and employ it in abusive related party transactions.\textsuperscript{368} In contrast, under the dispersed ownership system the control of the vehicle lies basically in the hands of the management as the corporate vehicle has various numbers of shareholders. In consequence, obtaining information with regard to the beneficial ownership and control may be difficult, creating as well an attractive environment for perpetrators. The latter, for instant, can invest certain amounts of money in different corporations, so as not to be caught by the required disclosure thresholds.

In order to build strong corporate governance framework, there is a need for incentives that motivate corporate vehicles and the beneficial owners to comply with the rules provided by the jurisdictions and international organisations. In this respect, the agency theory may be helpful to recognise the motives of abovementioned actors that can be furthermore applied to the misuse of corporate vehicles.

\textsuperscript{363} E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; \textit{Technical Seminar...}, op. cit.; p. 2.
\textsuperscript{364} Ibidem.
\textsuperscript{365} Ibidem.
\textsuperscript{366} Ibidem.
\textsuperscript{367} Ibidem.
\textsuperscript{368} Ibidem; p. 5.
In its essence, the principal–agent theory relies upon the dependent relationship between the principal and the agent. The principal, although it may have a superior power over the agent, depends on the information that the agent provides. The latter one, though, in some situations may not have sufficient incentives in order to provide information to the principal.\(^{369}\) Furthermore, the principal desires that agent acts in his interest, rather than in his own. That may generate conflicts, as the agent may not be motivated enough by the principal to act in the way he wishes.\(^{370}\)

The principal–agent theory can be applied to different relationships between various actors. In general, economists and lawyers relate it to the relationships that occur in companies between the shareholders and the management. Nonetheless, the agency theory may be applicable to the misuse of corporate vehicles for illicit purposes.

One of them applies the principal-agent-client model to the governance of money laundering. It recognises as the principal “the International Financial regime who governs money transaction directly through different channels by making laws to regulate this process”\(^{371}\). In addition, as the financial regime constitutes of two types of the international organisations, they may be treated in the way as principal itself. These two types are:

1. Organisations established to fulfil various purposes among which also anti-money laundering functions occur. (including the United Nations, World Bank, International Monetary Fund);\(^{372}\)

2. Organisations and institutions established to accomplish “specific objectives of anti-money laundering”\(^{373}\) (including Financial Action Task Force (FATF), the FATF Style Regional Bodies (FSRBs), Egmont Group and Wolfsberg Group of banks).\(^{374}\)

Following this approach the agent can be also divided into two groups (formal and informal agents). The first consists of the states, banking and financial institutions and organisations that are engage in operating money transactions through different channels. In contrast, the informal agents include for example money changer and, in general, relate to non regulated or partially regulated sectors that may not be monitored and tracked by the regulators.\(^{375}\)

\(^{369}\) H. Hansmann, R. Kraakman; *Agency Problems and Legal Strategies*; Yale Law School; Center for Law, Economics and Public Policy; Research Paper No. 301; p. 21; http://ssrn.com/abstract=616003; (20.06.2012).

\(^{370}\) Ibidem.


\(^{372}\) Ibidem.

\(^{373}\) Ibidem.

\(^{374}\) Ibidem.

\(^{375}\) Ibidem.
Under this relation the principal uses “the services of agents to perform its function of anti-money laundering at state level and international level”\textsuperscript{376}. The model assumes that when a money laundering takes place the agents may be used in order to decrease and limit these proceed. The principal main objective is to have a money transaction system based on two principals – transparency and availability to monitor the transactions.\textsuperscript{377}

Additionally, there is a third actor to this relation – the client who use the services of the agents for both legitimate and illegitimate purposes. As the clients “the individuals, group or organisation who get services of any type of agent for transactions of their money through different means at international and local levels”\textsuperscript{378} can be recognised.

The presented model also assumes that in order to decrease the use of illicit channels for money transactions the principal requires the agents to monitor and report suspicious activities of their clients. That is also written down in the various regulations that oblige the agents to comply and monitor changes in transactions. “So the states, financial institutions and organisations act as agent of the principal to implement their framed rules in order to achieve already set objectives”\textsuperscript{379}

The above presented application of the agency theory can be also modified and adjusted to the presented issue. In this respect, as the principal may be recognised the jurisdiction where the corporate vehicle is incorporated or international organisation and as the agent the corporate vehicle. In that relationship the jurisdiction should introduce such rules and regulations or standards of contracting that will incentive corporate vehicles to comply with the abovementioned rules. Moreover, the jurisdiction by introducing such regulations may motivate the beneficial owners to identify themselves to the authorities that in a greater perspective prevent the misuse of business vehicles. The rules and regulations, though, shall not aim to stricter disclosure that, as mentioned above, may not properly motivate the agents having adverse and conflicting effects. The other way that may be suitable lays in the informal enforcement provisions that presented below.

The principal – agent relationship may also be recognised on the international level. Here the principal may serve as an international organisation that creates the global framework against the misuse of the corporate vehicles. The agent, in this respect, jurisdiction (country) may be identified. The relationship is based on motivating the agent to comply with the standards and guidelines that the principal introduces. This relationship between the principal and agent has one major limitation – the sovereignty of the country. In this respect, incentives for the jurisdictions (the agents) cannot violate the sovereignty and shall be established on voluntary compliance. One

\textsuperscript{376} S. Azhar Hussain Shah, S. Akhter Hussain Shah, and S. Khan; Governance of Money Laundering..., op. cit.; p.1118.
\textsuperscript{377} Ibidem; p. 1129.
\textsuperscript{378} Ibidem; p. 1118.
\textsuperscript{379} Ibidem; p. 1125.
way to achieve this may be through creation and promotion of countries that posses the best standards for corporate vehicles preventing them from the possible misuses (branding the best jurisdictions). Moreover, the establishment of relevant international forum for discussion may help in exchanging ideas and solutions internationally.

From all abovementioned information, it can be concluded that the corporate governance, including the agency theory, plays a significant role with regard to the misuse of the corporate vehicles. In this respect, motivating the beneficial owners to identify their intentions and motives can be a benefit not only for the minority shareholders and other stakeholders, but also for the jurisdiction and its authorities. The latter one may then successfully fulfil their obligations and react when the suspicious activities take place. What is more, the good corporate governance framework may influence the overall appearance of the jurisdiction and, in this respect, attract potential investors.

Although, achieving the middle ground that would be beneficial for everyone is very hard, the investigation and enforcement mechanism might be helpful and needed, as without them the information may be inaccurate or misleading. Enforcement of the stated regulations is essential in this matter, as it gives the incentive for the business entities to update the information and ensure, for instance, that the beneficial owners are known in required documents. Furthermore, it is believed that poor enforcement demotivates those who are oblige to provide required information, as only one side is making efforts to fulfil stated obligations.

**IV.5. Enforcement, compliance and cooperation**

From the literature that can be obtained in the scope of the misuse of corporate vehicles it can be observed that the main solicitude lies in the matters of enforcement, compliance and cooperation.

In the view of Professor Vermeulen that shall be supported, the globalization and innovative improvements of nowadays financial markets necessitate greater cooperation between jurisdictions national securities regulators and other enforcement bodies. Since it is observed that the foreign investment is increasing, there is an imperative need for better investors’ protection through accrued information exchange and cooperation in enforcement versus the misbehaviour.

Such regulations can be seen for instance in the United States. Section 24(c) of the Exchange Act allows the SEC to provide non-public information and records to persons that the SEC deems appropriate. Among them one can find a federal, state, local or foreign governments and foreign financial authorities. The SEC can furthermore assist a foreign supervisory authority if

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380 E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; *Technical Seminar...*, op. cit.; p. 14.
381 Ibidem; p. 48.
382 Ibidem.
it affirms that it is carrying out an investigation concerning the violation of its laws (Section 21(a)(2) of the Exchange Act).\textsuperscript{383}

Following the abovementioned example, it may be argued that national legislation may design better provisions that work more efficiently than the international level of collaboration. However, as the regulations differ quite significantly, the international cooperation in exchanging information may be an enhanced solution.\textsuperscript{384} One of the prospects lays in developing and promoting adherence to generally accepted standards and best-practices as well as in exchanging information. The International Organization of Securities Commissions (IOSCO) can be seen as an example of such cross-border organization that provides standards for more than 95% of the securities markets in the world.\textsuperscript{385} The Commission introduced its Objectives and Principles of Securities Regulation (IOSCO Principles) that successfully support national regulators in their attempts to develop an efficient and transparent securities market. Additionally, regarding the ownership and control, the IOSCO provides accurate, instant and transnational information to investors.\textsuperscript{386}

Furthermore, the establishment of efficient mechanisms that can be used by authorities are believed to enable to fight and prevent the misuse of business entities and other arrangements. However, the use of such mechanisms needs to be reasonable. In that view, the Steering Group on the Corporate Governance has provided three, in their view, “fundamental objectives that offer a means for measuring the operational effectiveness of the option(s) to be used in a jurisdiction”.\textsuperscript{387} These objectives are:

1. Beneficial ownership and control information must be maintained or be obtainable by the authorities;\textsuperscript{388}

2. There must be proper oversight and high integrity of any system for maintaining or obtaining beneficial ownership and control information;\textsuperscript{389} and

3. Non-public information on beneficial information ownership and control must be able to be shared with other regulators/supervisors and law enforcement authorities, both domestically and

\textsuperscript{383} E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; \textit{Technical Seminar...}, op. cit.; p. 48.

\textsuperscript{384} Ibidem; p. 45.

\textsuperscript{385} Ibidem.

\textsuperscript{386} Ibidem.

\textsuperscript{387} A Template prepared by the Steering Group on Corporate Governance; \textit{Options for obtaining beneficial ownership and control information}; op. cit.; p. 4.

\textsuperscript{388} Ibidem.

\textsuperscript{389} Ibidem.
internationally, for the purpose of investigating illicit activities and fulfilling their regulatory/supervisory functions respecting each jurisdiction’s own fundamental legal principles.\footnote{A Template prepared by the Steering Group on Corporate Governance; Options for obtaining beneficial ownership and control information; op. cit.; p. 4.}

In addition, the Steering Group claimed that the jurisdictions should introduce reliable sanctions that are adequately enforced discouraging potential misuses and punishing non-compliance.\footnote{Ibidem; p. 5.} That is why the role of the jurisdictions and their authorities responsible for gathering, disclosing and protecting information concerning beneficial ownership and control structures is significant in the aspect of the international cooperation.

Moreover, the OECD also supports the widespread cooperation that will gradually improve the fight against the corporate vehicles misuse for illicit purposes.\footnote{Transnational Institute; Countering Illicit and Unregulated Money Flows. Money Laundering, Tax Evasion and Financial Regulation; Debate papers; December 2009; p. 20; http://www.tni.org/sites/www.tni.org/files/download/crime3_0.pdf; (27.06.2012).} Although the OECD has introduced standards that shall be followed by its members, not all of members comply with them. For instance the U.S. states such as Delaware, Nevada do not oblige companies to disclose any beneficial ownership information. In addition, the bearer shares that diminish transparency can be after all found in jurisdictions such as the U.S., the UK, Canada, France, Germany, Italy, Switzerland, Austria, Luxembourg and Costa Rica.\footnote{Ibidem.}

The studies that were carried by various experts or organisations have also proved, that poor countries are in general more scrupulous when applying corporate transparency rules than wealthier jurisdictions (mostly the OECD members). Another investigation discovered that the United States can be described as the worst jurisdiction as 24 out of 27 American providers agreed to sell a company without performing any customer due diligence.\footnote{Transparency International; Anti-Corruption Research News; Shell companies and Puppet Masters; op. cit.; p. 3.}

The global desire is to establish in each jurisdiction such framework that allows to obtain and share the beneficial ownership and control information by authorities anytime such information are needed.\footnote{A Template prepared by the Steering Group on Corporate Governance; Options for obtaining beneficial ownership and control information; op. cit.; p. 5.} In spite of all beneficial achievements that were introduced during the last decade, perpetrators are still one step ahead, creating new solutions that enable them to conceal or shift funds and remain at the same time anonymous. Furthermore, it need to be understand that the issue
of the misuse of corporate vehicles is not just the problem for governments, as such schemes negatively influence also financial markets in general and the public.  

In the author’s viewpoint, the success of any rules and regulations with regard to the misuse of corporate vehicles shall be based on the existence of incentives that would motivate entities to comply with all provided regulations. However, that might be difficult to achieve if the incentives are not motivating enough or the enforcement is not sufficient.

**IV.6. Informal enforcement**

In this thesis author follow the view that the most effective mechanisms to obtain the beneficial ownership and control lay more in the informal public enforcement and intervention approaches than in strict disclosure and reporting regimes. The major benefit that shall be stressed is that the regulators by applying such a policy are able to respond immediately and definitely, that positively influence the corporate governance framework. Furthermore, according to Professor Vermeulen there is “at least a suspicion that a proportionate and flexible disclosure regime supplemented by informal public enforcement measures is, in the long run, more effective”. The informal enforcement mechanism may also lead to better communication between governments and corporate vehicles, and especially there may be an improved understanding of the controlling owners apparatuses and intentions. Additionally, it can present a better access into innovative and complex ownership and control structures (e.g. cash-based equity derivatives) in the constantly changing financial markets. Nevertheless, designing such framework can be very difficult as there is a need to find the right mix of informal and formal enforcement mechanisms that give confidence beneficial owners to effectively make disclosures and inform the company, other investors and the market about the control structure and their intentions.

There are several advantages that shall be presented regarding the informal enforcement mechanisms. Firstly, the conflicts resolving may be obtained through joint commitment of public agents and private companies. These parties may offer more suitable and less costly forms of solving specific problems. Such solution may result in the increase of reliability in disclosure across listed companies, profiting minority investors and other stakeholders across the board. Moreover, the informal enforcement measures, in some way, will be more successful than the

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397 E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; *Technical Seminar...*, op. cit.; p. 50.
398 Ibidem.
399 Ibidem.
400 Ibidem; p. 48-49.
direct intervention, as they consider the complexity of investment structures followed by beneficial owners.\textsuperscript{401}

The consideration of a successful enforcement system shall be set at the measures that support the exchange of ideas and information between supervisory authorities and private actors in order to establish greater compliance with the disclosure and reporting provisions in the transnational financial marketplace.\textsuperscript{402} Once more, the informal, non-judicial, enforcement measures can be essential in this regard as they are much faster and effective. It also diminishes the burden on regulators and supervisory authorities, tighten the regulators, supervisory authorities with the business community, and promote cross-border cooperation.\textsuperscript{403}

It is a challenge for policy makers and regulators to design appropriate combination of informal and formal public enforcement measures that support controlling beneficial owners to successfully make disclosures and inform other investors and the market about their identity and objectives.\textsuperscript{404} The segmented enforcement framework and the informal enforcement mechanisms shall be considered as a possibility for a accurate mix of regulations. In this view, the flexibility of the disclosure and enforcement provisions may give the suitable opportunities of fast responding to regulators and financial institutions.\textsuperscript{405} What is more, the informal approach may, in current global situation be cheaper to introduce and follow by most jurisdictions. In addition, the strict disclosure regime observed in the US, is proved not to be that effective as it is suggested. That is why, the discussion regarding stricter disclosure shall include the studies that test its provisions. The more attention shall be paid towards enforcement, as this is the most important aspect of any legal framework. Without suitable exercising of rules and regulations, any introduced, changed or amended laws will remain only on paper.

\textsuperscript{401} E. P. M. Vermeulen; OECD Russia Corporate Governance Roundtable; Technical Seminar..., op. cit.; p. 48-49.
\textsuperscript{402} Ibidem.
\textsuperscript{403} Ibidem.
\textsuperscript{404} Ibidem.
\textsuperscript{405} Ibidem.
CONCLUSIONS

From all abovementioned information it can be concluded that the problem of the misuse of corporate vehicles cannot be undermined, as the profits that it provides for perpetrators are estimated in trillions of dollars. Furthermore, many research works have recognised that criminals shifted towards corporate vehicles and other legal arrangements (such as trusts or foundations) that enable them to siphon or hide stolen or illegally obtained funds.

This dissertation presented and discussed the main issues with regard to the misuse of the corporate vehicles for illicit purposes. It furthermore presented various organizations and their attempts in combating the misuse of the abovementioned. Although the standards and guidelines create appearance of a successfully working machine, many empirical studies prove that the reality is different. That especially may be true regarding the ongoing fight to force the offshore financial centres to change their (too) flexible provisions.

Furthermore, the provided information and examples seek to answer the question whether there are remedies that can successfully decrease the presented problem. In this respect, it can be argued that there are many legal solutions available for jurisdictions. However, they need to be cautiously assessed and applied individually to each country’s legal framework. For instance, the company law provisions in developing countries cannot impose very strict and burdensome requirements on business entities, because that will not stop the perpetrators, but rather individuals who seek to establish a legal form that will limit their liabilities for perfectly licit purposes. In addition, very strict banking provisions may be burdensome and costly both for all its users and the country itself, possibly augmenting the costs of obtaining several banking and financial services. On the other hand, though stricter provisions in some cases may be the only remedy preventing the jurisdiction from abuses.

Corporate Governance can also be a useful instrument that may help to decrease the misuse of corporate vehicles. The appropriate motivations, though, need to be introduced for corporations in order to publish information regarding the beneficial ownership and control. This may be accomplished only when, for example, corporations are assured that some information remains confidential. In addition, it shall be observed that the remedies for obtaining information on beneficial ownership should be considered with regard to the system of corporate governance (concentrated or dispersed), as the incentives for disclosure differ in these systems.

Another solution that can be addressed refers to the higher transparency among regulations that permit to conceal the beneficial ownership and control. One simple, but radical solution that was proposed in one of the papers stated that in order to obtain ideal transparency, jurisdictions should clearly “dispose of” all provisions that in any way enable individuals to conceal their true identity. Nevertheless, this approach cannot be treated considerably, because that would
significantly hamper the majority of business activities and lead to the withdrawals of foreign investments.

The matter of transparency is strongly connected with the most discussed one – disclosure. This issue was also considered under this thesis along with the question whether the introduction of stricter disclosure regulations can be a barrier for perpetrators. The presented information concerning this approach proved that the stricter disclosure regulations do not guarantee that authorities will successfully combat perpetrators. The latter ones will find other ways to defeat the system.

Moreover, the disclosure regime that encompasses severe and extensive requirements may lead to higher operational costs and the overload of available information. That may cause chaos among financial markets, as investors have too many information that hamper and slow down their decision-making processes on investment propositions. It can be also argued that introduction of stricter disclosure regime increases the competition and the phenomenon of the jurisdiction shopping that does not posses such laws. As a result, the disproportion between countries is supposed not only to remain but also to intensify. That may negatively affect the global markets that currently are struggling with many difficulties. That is why the author presents the position that regulators and policymakers should not focus on introducing additional regulations but on revising current regulations. Introduction of additional regulations may eventually lead to overregulation that aggravate business environment.

That is why enforcement, compliance and cooperation is essential. From the author’s point of view, the enforcement of existing rules and regulations shall not be extended infinitely, as it again results in overregulation. The more attention shall, though, be put towards informal enforcement that is believed to be a faster and more effective remedy. The informal enforcement focuses on motivating business actors in that way, so they voluntarily provide information to the authorities and to the public. That can be achieved through instruments such as information requests and creation of the business environment “beneficial ownership and control friendly”. The latter one may be accomplished, in the author’s point of view, by “branding” the beneficial owners, meaning that it may be profitable for the company and especially for beneficial owner to identify himself to the public. Following such solution, jurisdictions may introduce e.g. lists of corporations that voluntary comply with the transparency regulations. In addition, “branding” the beneficial owners can be obtained by presenting on the companies’ websites the identities of the beneficial owners so as to show to the public that they are trustworthy and reliable.

On the other hand, though, such solution is hard to achieve as in many cases beneficial owners create complex structures in order to hide behind the corporate veil.

To sum up, there is an inevitable relation between the misuse of corporate vehicles for ill-gotten purposes and the capacity to hide behind the corporate veil. The evidences that have been gathered in the last decade support the statement that this issue cannot be disregarded and certainly
needs a comprehensive solution. However, there is not yet any effective method that can be presented and employed all over the world. Even top legislatures have problems in finding the middle road that would be sufficient to, at the same time, incentivize those who operate business and to curtail those who attempt to abuse it.

Briefly, the discussion regarding the problem of the misuse of corporate vehicles shall remain open for any suggestions, as it can gradually influence the overall development of regulations that will lead to establishment and improvement of universal international standards.
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