Narrative Report on USA

USA is ranked at sixth position on the 2013 Financial Secrecy Index. This ranking is based on a combination of its secrecy score and a scale weighting based on its share of the global market for offshore financial services.

USA has been assessed with 58 secrecy points out of a potential 100, which places them it in the lower mid-range of the secrecy scale (see chart 1).

USA accounts for over 22 per cent of the global market for offshore financial services, making it a huge player compared with other secrecy jurisdictions (see chart 2).

Chart 1 - How Secretive?

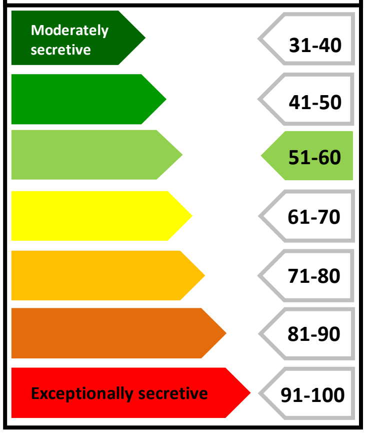
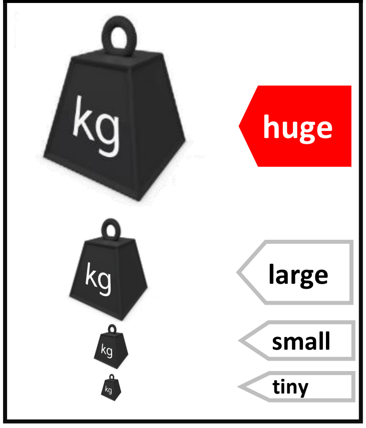


Chart 2 - How Big?



Part 1: Telling the story

26 September 2013

The United States offshore financial centre

Overview

The United States is the world's largest economy and its main financial centre in Wall Street is, on some measures, the world's biggest. It provides secrecy for non-residents, both at a Federal level and at the level of individual U.S. states. Taken as a whole, the United States provides a very wide range of offshore secrecy services. For decades, successive U.S. governments have encouraged many of these developments to attract capital for balance of payments reasons[1].

In terms of size, the U.S.' main rival as a financial centre is the City of London. However, unlike the City, which built its strength on overseas empire and has historically been an outward-focused (hence offshore) financial centre, the financial markets of the United States were more domestically focused, and diluted in a relatively much larger economy. As a consequence, offshore finance – both in terms of U.S. persons using foreign secrecy jurisdictions, as well as foreigners using the U.S. itself as a secrecy jurisdiction - has been more politically contested in the United States than it has been in the UK and in smaller tax havens.

In general, the United States has played a pioneering role in devising ways to defend itself against foreign tax havens, but has failed to address its own role in attracting illicit financial flows and supporting tax evasion.

The U.S. is a major tax haven because it provides tax free treatment and various forms of secrecy for non-resident individuals, corporations and other entities. On the tax side, it charges a zero rate on some categories of income, including interest paid by banks and savings institutions to non-resident individuals or foreign corporations; interest on government debt and interest on some types of corporate debt. On the secrecy side, the U.S. also has weak and relatively few treaty commitments to exchange relevant information with other jurisdictions, which need that information so they can tax their own citizens properly. Historically, the U.S. government also has not required income earned locally by non-residents to be reported to the U.S. government – which means that even where it may be required to exchange the information under international agreements, it doesn't have the information available to exchange. *However, beginning in 2013, information reporting has been extended at least to bank deposit interest earned by residents of other foreign countries.*[2]

Furthermore, gaps in U.S. money laundering laws allow U.S. financial institutions to handle the proceeds of a long list of crimes, as long as those crimes are committed outside the U.S. (p186-9) A significant share of U.S. residential and commercial property is owned by offshore shell companies, under secrecy arrangements that help non-resident foreigners earn income that can be kept secret from the tax and criminal authorities of their home country. State-level secrecy facilities, notably those provided by anonymous shell companies, complement the Federal-level secrecy facilities. These factors, which help the United States attract foreign dirty money, arise from deliberate law-making rather than mere omission: they represent the classic behaviour of a secrecy jurisdiction. Financial secrecy provided by the U.S. has caused untold damage to the ordinary citizens of foreign countries, whose elites have used the United States as a bolt-hole for looted wealth.

A history of federal-level secrecy: from before globalisation to the present day

The United States has long been a secrecy jurisdiction or tax haven. Around the time of the 1921 Revenue Act, the U.S. House Ways & Means Committee, in a clear statement of tax-haven intent, stated that "the exemption of … interest from taxation would be in keeping with the action of other countries and would encourage non-resident alien individuals and foreign corporations to transact financial business through institutions located in the United States." Later, in 1966, the tax-exemption stance was officially reconsidered but nothing was done, on the grounds that it might, as one Senate report put it: "have a substantial adverse effect on our balance of payments."

Information-sharing arrangements with other countries were rudimentary in the early decades of the last Century. After the Second World War John Maynard Keynes and Harry Dexter White, the main architects of the Bretton Woods agreements, sought to boost transparency by requiring the United States to inform European governments about the assets and income of their respective citizens, to help those war-ravaged countries raise sufficient tax revenues. These proposals, driven primarily by concerns that economic crisis could deliver European countries into Soviet hands, were eviscerated by the American Bankers' Association (p74-76): in the IMF's Articles of Association, co-operation on flight capital would no longer be 'required' as Keynes and White wanted, but merely 'permitted.'

But the United States' offshore status really took off during the period of rapid financial globalisation from the Reagan era onwards.

Several factors spurred the changes. Rapid financial globalisation began to undermine New Deal regulations which had kept financial interests in check following the Great Depression; and financial deregulation and advances in communications technology further accelerated cross-border financial flows, spurring offshore banking generally. Meanwhile, foreign tax havens increasingly began to serve as unregulated and secretive conduits for financial inflows into and out of Wall Street, making them a big reason for the growth in the power and reach of Wall Street. The lure of Tax Haven USA as a magnet for secrecy-seeking illicit financial inflows further spurred the growth of the U.S. financial sector.

In 1970s the U.S., hitherto a country with external surpluses, faced growing deficits, exacerbated by the Vietnam War. It increasingly needed foreign loans to finance these deficits and it did so, in significant part, by attracting tax-evading and other illicit foreign money. Foreigners invested in the U.S. for many reasons, not least the fact of the U.S. dollar being the global reserve currency - but secrecy and tax-free treatment was always a key reason too. Had the U.S. implemented full transparency and taxed interest and other income earned by foreign investors, the financial inflows (and U.S. external deficits) would have been substantially smaller.

In 1981, the U.S. introduced a new mechanism in the field of financial regulation: the International Banking Facility. This allowed banks in the U.S., which had previously needed to go offshore to get around domestic financial regulations, to keep a separate set of books that effectively allowed them to obtain these exemptions while remaining at home. This attracted significant funds out of foreign tax havens and back to the US, and marked a further step offshore for the United States.

In ongoing efforts to fill the deficits, the U.S. authorities began to allow foreigners who lent to U.S. corporations (and to the U.S. government) an exemption on the 30 percent withholding taxes that would normally have been levied when they received their interest payments on those loans. Initially this was achieved by tolerating a convoluted loophole involving the Netherlands Antilles, but this messy mechanism was replaced in 1984 with a more direct tax haven offering: the so-called Portfolio Interest Exemption, under which non-residents could invest directly in U.S. markets and receive interest payments tax-free, and typically in secrecy. *Time Magazine* accurately summed up this move: “Suddenly America has become the largest and possibly the most alluring tax haven in the world.”

Occasional efforts have been made to curb the U.S.’ role as a tax haven – but usually these were defeated by Wall Street lobbyists. Federal-level regulations in January 2001, in the final days of the Clinton administration, would have required banks in the U.S. to inform the IRS about all bank interest paid to non-resident individuals: reporting that was already required for residents of the U.S. and Canada. Had this become law, the requirements would still have been quite narrow: the regulations did not require the U.S. to share the information with other foreign countries: just to have it available; and it also only involved bank interest paid to individuals: other forms of investment income were excluded.

The George W. Bush administration oversaw a dramatic change in attitude, encapsulated in the words of Treasury Secretary Paul O’Neill – who, when asked to respond to estimates that fewer than 6,000 of over 1.1 million offshore accounts and businesses were properly disclosed, responded: “I find it amusing.”

Treasury withdrew the narrow Clinton-era proposed regulations in July 2002 and replaced them with ones that only required this information to be reported for residents of 16 designated countries: Australia, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden and the UK. (These countries, it seems, were the ones willing to exchange information reciprocally with the U.S.) However, these watered-down proposed regulations were never implemented.

The U.S. protects itself from foreign tax havens, while remaining a tax haven for foreigners

While historically content to allow foreigners to use the United States as a tax haven, the U.S. has always been concerned that U.S. taxpayers might evade taxes by *pretending* to be foreigners – disguising their identities through offshore tax havens or otherwise – and to evade U.S. taxes. So in 2001 the United States enacted the so-called Qualified Intermediary (QI) programme. The basic idea was to help the U.S. government ferret out U.S. tax cheats, while preserving the U.S. as a secrecy jurisdiction for foreigners.

The QI programme was a devious piece of secrecy legislation, which worked as follows.

If the U.S. had simply asked foreign financial institutions to report on all income originating in the U.S., then it would have received a lot of information not only about potential U.S. tax cheats, but also about foreign tax cheats. Once it had this information, its treaties might oblige it to share this information with some foreign governments.

So instead it *outsourced* the collection of information to banks and other financial institutions: in theory, they would collect the information, keep it outside the United States, then pass only the information about U.S. residents to the U.S. authorities, while screening out all the information on foreigners. This way, the U.S. authorities would never receive information it might be required to share with others, and preserve its status as a tax haven. (Note that this is broader than the proposed 2001 and 2002 regulations, above: it involves not just bank interest but a wider range of income-generating assets.) This legislation was classic, deliberate, carefully crafted tax haven behaviour. David Rosenbloom, a top tax lawyer with inside knowledge of the drafting of this legislation, explained his view of (p136) the original intent:

> 'It's not clear to me that the QI program is well adapted to the objective of ferreting out Americans – that is not how it started at all. The program was not aimed at identifying Americans. The program was aimed at protecting the identity of foreigners while allowing them to invest in the US,' he said. 'Making sure that Americans weren't in the picture was part of it, but the real focus was on this competitive aspect abroad.'

The programme functioned poorly even on its own terms, for the simple reason that financial institutions could not be trusted: subsequent criminal probes into UBS and other Swiss banks revealed that some banks had simply lied, and hid their tax-evading U.S. customers.

The QI program was overtaken by the so-called Foreign Account Tax Compliance Act (FATCA, see here), enacted into law in March 2010, to come into force on January 1, 2014. This was essentially a tightened-up version of the QI program, preserving its essential tax haven structure as described above, but expanding its scope.

The original intent of FATCA was to subject foreign financial institutions (FFIs) and other foreign entities investing their funds or clients' funds in the U.S. to a 30 percent withholding tax on U.S. source income, unless those institutions or entities agree to disclose to the U.S. Government information about U.S. persons' foreign financial accounts. This is a version of automatic exchange of information - not between governments, but between FFIs and entities and the U.S. Government.

In a testament to FATCA's potential strength, Senator Carl Levin said in July 2011 that foreign banks were engaging in a "massive lobbying effort" to dilute it. The lobbyists managed to get its implementation delayed, but the U.S. has still made significant progress in putting the technical and political infrastructure in place to enforce the 30 percent withholding penalty for non-compliance.

In the face of massive resistance from foreign governments and financial interests, strong complaints about the purported compliance burden, existing foreign laws, and the need for the U.S. to transform this from a unilateral self-protection mechanism into a more cooperative bilateral one, the original version of FATCA has been modified in certain ways. In particular, the U.S. Treasury Department has published two model intergovernmental agreements (IGAs) to serve as a basis for bilateral agreements with jurisdictions to implement FATCA[3]. According to the Treasury Department, it is currently engaged with more than 75 jurisdictions and has already concluded bilateral agreements with Germany, Japan, Norway, the United Kingdom, Denmark, Mexico, Ireland, and Switzerland.[4]

New legislation introduced in September 2013 under Senator Levin's Stop Tax Haven Abuse Act, not yet enacted, would further tighten up FATCA by, among other things, establishing legal presumptions to overcome secrecy barriers, closing loopholes, allowing a range of sanctions against non-cooperative jurisdictions; introducing country-by-country reporting requirements for transnational corporations, and strengthening penalties against promoters of abusive schemes. It would also create a tougher environment for people and entities doing business with foreign banks that reject FATCA, and would, crucially, let the U.S. Treasury take action against financial institutions by extending anti money laundering tools into the tax area.

State-level facilities

Measures relating to company incorporation in the U.S. are governed by state, rather than federal law. Several states have grown to specialise in hosting corporations that provide secrecy.

There is no exact time or date when this business started: by and large it has simply been the result of omission: a permanent, prolonged failure to enact active legislation that would require transparency, and the exploitation of these gaps by private operators. State officials began seriously marketing state-based secrecy arrangements internationally from the period of globalisation in the 1970s and 1980s (see here, for an example of Delaware's proselytising for secrecy in Asia in 1986, with slogans such as "we protect you from politics".) A few states such as Delaware, Wyoming and Nevada took an early lead in offshore secret incorporations, and remain leaders today. They did so by displaying clear characteristics of 'captured states,' where decisions about relevant legislation are taken between lawmakers and financial services interests behind closed doors, and complex democratic processes are deliberately excluded. This is much easier in small states than in large ones, as the *New York Times* reported on the rise of such secrecy facilities in some states:

> ' 'Surprisingly,'' notes one legal study, ''much of the difficulty of these large states appears to be . . . because of their legislatures.'' The large states persist in viewing corporation laws as complex moral and political problems rather than - as in happy Delaware - a way of making everybody rich.'

The phenomenon of 'state capture' is generic to secrecy jurisdictions, and explored in depth in the "Ratchet" chapter of Treasure Islands.

Almost two million corporations and limited liability companies (LLCs) are formed in U.S. states each year, without the states asking for the identity of the owners. Some serve legitimate purposes but many, in the words of Senator Carl Levin, "function as conduits for organised crime, money laundering, securities fraud, tax evasion, and other misconduct." A Department of Justice report revealed, for example, that anonymously-held shell companies in Pennsylvania and Delaware were used to unlawfully divert millions in international aid intended to upgrade the safety of former Soviet nuclear plants.

Company formation businesses provide nominee officers and directors to serve as fronts for the real owners. Nominees may provide their own name and social security number to the authorities to obtain a company bank account or obtain an Employer Identification Number from the IRS - but having this information available gets you no closer to the real owners, who will frequently be protected behind attorney-client privilege and other secrecy layers and structures created elsewhere, often in foreign secrecy jurisdictions.

Company formation businesses boast of being able to set up anonymous companies in hours, sometimes for as little as $100, with no meaningful review. States offer artificially aged "shelf companies" – which you can buy off the shelf with a supposedly long-established history and impeccable credit record, providing a veneer of respectability. Companies offer not only nominee services but also local telephone listings and live receptionists, to give a veneer or probity and solidity. U.S. Republican Senator Norm Coleman notes:

> "These formation and support services rival those offered in some of the most notorious offshore tax and financial secrecy havens."

Only limited progress has been made in tackling these arrangements. Bearer shares were outlawed in the last two U.S. states (Nevada and Wyoming) in February 2007, following concerns about terrorist financing. In August 2013 Senators Chuck Grassley and Carl Levin introduced the Incorporation Transparency and Law Enforcement Assistance Act which would, if enacted, require states to obtain appropriate and updated beneficial ownership information about companies formed under state laws, and provide it under a subpoena or summons. This is welcome legislation but still limited: even if enacted, foreign jurisdictions chasing illicit money would still need to go through potentially complicated court procedures to obtain the information they need. It has, predictably, been countered by a powerful lobbying counter-drive from the corporate community who instil fear about "additional burdens" as well as state-level officials who fear a loss of revenue in their individual states if the law is enacted. However, with commitments made by the Obama Administration in the context of the G-8, the active engagement of law enforcement officials, investor groups and small businesses, the pressure is mounting to act.

Nevada and Wyoming, two of the biggest offenders in this area, indicated in late 2011 that they intended to crack down on secrecy business run out of their states. No concrete actions have yet been seen, however.

In addition to secrecy facilities, individual states offer various other facilities with an 'offshore' flavour. Vermont, for instance, has been setting itself up as an offshore captive insurance jurisdiction in an attempt to compete directly with the likes of Bermuda or the Cayman Islands. A New York Times story about it notes:

> "Companies looking to do business in secret once had to travel to places like the Cayman Islands or Bermuda. Today, all it takes is a trip to Vermont. . . . the states are offering a refuge from other states' insurance rules.
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> . . .
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> This has given rise to concern that a shadow insurance industry is emerging, with less regulation and more potential debt than policyholders know, raising the possibility that some companies will find themselves without enough money to pay future claims. Critics say this is much like the shadow banking system that contributed to the financial crisis."

This article commenting on the New York Times story explains why this ticks so many different 'offshore' boxes.

Read More

Reuters has provided some useful case studies of state-level secrecy arrangements in its Shell Games series: see their stories on Chinese Reverse Mergers, on Medicare fraud (Georgia and Florida,) on Wyoming, on Arizona, and on Nevada.

Any number of stories exist about the U.S. being used as a secrecy jurisdiction by foreigners. One of the most egregious ones is the case of U.S. bank Wachovia in helping Mexican drugs gangs launder the proceeds of hundreds of billions of dollars. Read about it here and here. See also Ken Silverstein's October **2013 article in The Nation**, outlining Miami's role in attracting dirty money.

Read **Treasure Islands**, particularly pp124-146 of the UK edition, and pp107-128 of the U.S. edition, for more detailed information about how the United States became a secrecy jurisdiction. The chapter "Ratchet" looking at Delaware (and Jersey) also explores the wide range of different 'offshore' aspects that some U.S. states have deliberately created.

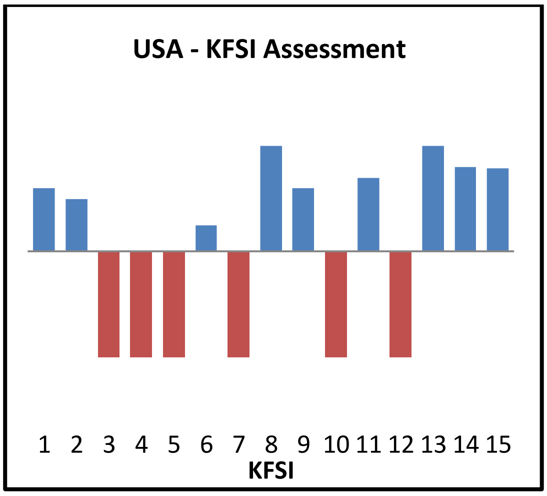
With thanks to Nicole Tichon (Tax Justice Network USA) for her help with this article.

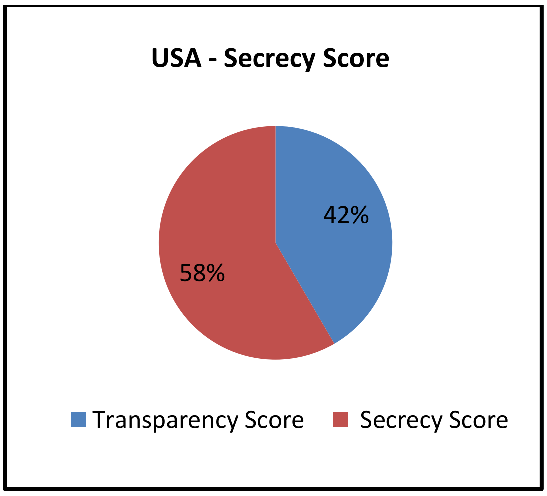
Next steps for USA

The USA's 58 per cent secrecy score shows that it must still make major progress in offering satisfactory financial transparency. If it wishes to play a full part in the modern financial community and to impede and deter illicit financial flows, including flows originating from tax evasion, aggressive tax avoidance practices, corrupt practices and criminal activities, it should take action on the points noted where it falls short of acceptable international standards. See part 2 below for details of the USA's shortcomings on transparency. See this link http://www.financialsecrecyindex.com/kfsi for an overview of how each of these shortcomings can be fixed.

Part 2: Secrecy Scores

The secrecy score of 58 per cent for the USA has been computed by assessing the jurisdiction's performance on the 15 Key Financial Secrecy Indicators, listed below.





The numbers on the horizontal axis of the bar chart on the left refer to the Key Financial Secrecy Indicators (KFSI). The presence of a blue bar indicates a positive answer, as does blue text in the KFSI list below. The presence of a red bar indicates a negative answer, as does red text in the KFSI list. Where the jurisdiction's performance partly, but not fully complies with a Key Financial Secrecy Indicator, the text is coloured violet in the list below (combination of red and blue).

This paper draws on key data collected on the USA. Our data sources include regulatory reports, legislation, regulation and news available at 31.12.2012[5]. The full data set is available here[6]. Our assessment is based on the 15 Key Financial Secrecy Indicators (KFSIs, below), reflecting the legal and financial arrangements of the USA. Details of these indicators are noted in the following table and all background data can be found on the Financial Secrecy Index website[7].

The Key Financial Secrecy Indicators and the performance of the USA are:

TRANSPARENCY OF BENEFICIAL OWNERSHIP – USA	
1.	Banking Secrecy: Does the jurisdiction have banking secrecy? **USA does not adequately curtail banking secrecy**
2.	Trust and Foundations Register: Is there a public register of trusts/foundations, or are trusts/foundations prevented? **USA partly discloses or prevents trusts and private foundations**
3.	Recorded Company Ownership: Does the relevant authority obtain and keep updated details of the beneficial ownership of companies? **USA does not maintain company ownership details in official records**
KEY ASPECTS OF CORPORATE TRANSPARENCY REGULATION – USA	
4.	Public Company Ownership: Does the relevant authority make details of ownership of companies available on public record online for less than US$10/€10? **USA does not require that company ownership details are publicly available online**
5.	Public Company Accounts: Does the relevant authority require that company accounts are made available for inspection by anyone for a fee of less than US$10/€10? **USA does not require that company accounts be available on public record**
6.	Country-by-Country Reporting: Are all companies required to comply with country-by-country financial reporting? **USA partly requires country-by-country financial reporting by some companies**
EFFICIENCY OF TAX AND FINANCIAL REGULATION – USA	
7.	Fit for Information Exchange: Are resident paying agents required to report to the domestic tax administration information on payments to non-residents? **USA does not require resident paying agents to tell the domestic tax authorities about payments to non-residents**

8.	Efficiency of Tax Administration: Does the tax administration use taxpayer identifiers for analysing information efficiently, and is there a large taxpayer unit? **USA uses appropriate tools for efficiently analysing tax related information**
9.	Avoids Promoting Tax Evasion: Does the jurisdiction grant unilateral tax credits for foreign tax payments? **USA partly avoids promoting tax evasion via a tax credit system**
10.	Harmful Legal Vehicles: Does the jurisdiction allow cell companies and trusts with flee clauses? **USA allows harmful legal vehicles**
INTERNATIONAL STANDARDS AND COOPERATION – USA	
11.	Anti-Money Laundering: Does the jurisdiction comply with the FATF recommendations? **USA partly complies with international anti-money laundering standards**
12.	Automatic Information Exchange: Does the jurisdiction participate fully in Automatic Information Exchange such as the European Savings Tax Directive? **USA does not participate fully in Automatic Information Exchange**
13.	Bilateral Treaties: Does the jurisdiction have at least 46 bilateral treaties providing for information exchange upon request, or is it part of the European Council/OECD convention? **As of 31 May, 2012, USA had at least 46 bilateral tax information sharing agreements complying with basic OECD requirements**
14.	International Transparency Commitments: Has the jurisdiction ratified the five most relevant international treaties relating to financial transparency? **USA has partly ratified relevant international treaties relating to financial transparency**
15.	International Judicial Cooperation: Does the jurisdiction cooperate with other states on money laundering and other criminal issues? **USA partly cooperates with other states on money laundering and other criminal issues**

[1] For a description of how these facilities emerged, see chapter entitled "The Fall of America" in Nicholas Shaxson's book, Treasure Islands.

[2] Deposit interest of $10 or more paid to any nonresident alien individual who is a resident of a foreign country with which the United States has agreed to exchange tax information pursuant to an income tax treaty or other convention or bilateral agreement, must be reported on Form 1042-S." See http://www.irs.gov/publications/p515/ar01.html for more details.

[3] With **IGA Model 1**, financial institutions don't report directly to the relevant jurisdiction but instead report to their 'home' country which then transmits the information to the relevant jurisdiction. This is the most common model. **IGA Model 2** is less common and more cumbersome; Switzerland is the pioneer. This does not envisage automatic information exchange immediately and directly. Instead, Switzerland hands over information for consenting account holders, and only aggregated information on the non-consenting account holders. Once that happens, however, Switzerland will consent to provide information 'on request' for the recalcitrant holders, in a way that is ultimately tantamount to automatic information exchange.

[4] In addition, to help reduce the reporting burden for foreign financial institutions, the U.S. made an online registry available to FFIs beginning in the summer of 2013, giving them until December of 2013 to enter their information into the system. The registry is set to be finalised by April of 2014.

[5] With the exception of KFSI 13 for which the cut-off date is 31.05.2013. For more details, look at the endnote number 2 in the corresponding KFSI-paper here: http://www.financialsecrecyindex.com/.PDF/13-Bilateral -Treaties.pdf

[6] That data is available here: http://www.financialsecrecyindex.com/database/menu.xml.

[7] http://www.financialsecrecyindex.com.