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TAX ADVISORY PAPER

November 15, 2006

IRS Considering “Mass Audits” Of Persons Behind US Shell Companies; Russia, the Ukraine and Other Former Soviet Union Countries Get Information

The IRS is on the verge of launching “mass audits” of persons thought to be hiding behind US shell companies organized in states such as Wyoming, Nevada and Delaware. The IRS and some Members of Congress believe that these companies are being used by US and non-US individuals and companies to avoid tax, launder money and finance terrorism.

The IRS wants to find US people cheating on their obligation to file and pay US taxes. But they may find as many or more non-US individuals—Germans, Russians, French, Dutch, Australian—that, in fact, are fraudulently evading their home country taxes.

At a November 14, 2006 hearing before the US Senate Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations, an IRS official said that the IRS thinks that investigations directed at shell companies will yield a “bonanza” of information leading to large tax collections.

The IRS and a number of Members of Congress believe that the laws of States like Nevada are too lax when it comes to requiring disclosure of the beneficial owners of the company. This situation makes the US a hiding place for anyone wishing to secret assets and avoid reporting income.

The IRS is pushing for increased transparency as to beneficial ownership of legal entities so individuals and companies cannot conceal interest for the purpose of evading tax obligations or facilitating other financial fraud

and money laundering. The specter of terrorist activities was raised as well.

Secrecy in the US, it was said, is as bad as it is in foreign “tax havens”. This subject had been explored last August in hearings before the same Committee, Chaired by Senator Coleman (Republican-Minnesota).

This topic and anything else having to do with “tax havens” is a favorite of Senator Levin (Democrat-Michigan) whose influence has grown with the recent mid-term elections. According to Senator Levin, “The Subcommittee on Investigations exposed how offshore and U.S. professionals are helping U.S. citizens move assets offshore and dodge U.S. taxes, adding to tax haven abuses that cost U.S. taxpayers an estimated \$40 to \$70 billion dollars each year.” The lack of transparency, he said, is “an open invitation to criminal abuse.”

According to the IRS, bearer shares and nominee officers in places like Nevada and Wyoming are especially popular means of establishing an anonymously-owned entity.

For the first time it was revealed what the IRS is doing to attack the problem. In Nevada alone it has found that there are approximately 250 resident agents in Nevada that each service 185 or more corporations. The largest of these agents serves nearly 30,000 entities. The IRS has begun investigations of promoters of Nevada corporations and resident agents. “These investigations have revealed widespread abuse, as well as problems in curtailing that abuse.”

While the promoters may be acting within the laws as they stand today, “many of their clients are engaged in fraudulent activity in violation of tax, money laundering, and other laws”, according to the IRS testimony. Anywhere from 50 to 90% of the companies examined are currently, or have been previously, non-compliant with Federal tax laws. One practice discovered is the placement of bearer shares and stock ledgers in an offshore entity, so as to hide the identity of the beneficial owners.

There are over 650,000 active and inactive entities in Nevada alone. Taking other states into account, the IRS suspects that non-compliance is mammoth.

Nevada and Wyoming appear to be lightning rods for IRS attention. Delaware is generally perceived to be a less abused jurisdiction.

The IRS plans to move forward with this enforcement initiative in a highly methodical way. “We are looking at a number of strategies to target the widespread tax non-compliance by many of the shell companies represented by resident agents and promoters”, according to the IRS spokesperson. “[W]e are contemplating mass audits of non-filers that would produce a list of non-filer and non-compliant participants.” The targets will then be sorted to move the wealthy people to the top of the list.

Promoters will be used as sources of information, and “John Doe” summons—sent to record-keepers without having to provide the names of actual targets—will be issued. These have been effective in other investigations such as those targeting offshore credit card schemes.

The IRS is coordinating its efforts with other government agencies including the FBI, the Treasury Department’s Financial Crimes Enforcement Network (FinCEN) and the Department of Homeland Security.

Also for the first time the IRS said that information on the beneficial ownership of US shell companies was being sought to satisfy requests for information from other countries. Surprisingly some of the countries most frequently requesting information from the IRS are Russia, Latvia, Lithuania, and the Ukraine. It had not been known previously that these former Soviet bloc countries were actively obtaining information from the US IRS.

Indeed, “[m]ost of the tax treaty requests for exchange of information involving U.S. shell companies (LLCs and corporations) are received from Eastern European countries and the Russian Federation. These U.S. shell companies, organized mainly in Delaware, Nevada, Arkansas, Oklahoma, and Oregon, are used extensively in Eastern Europe and the Russian Federation to commit Value Added Tax (VAT) fraud.” The IRS spokesperson went on to reveal the number of requests in recent years. “In 2005, 77 percent of the 561 requests were made by Russia, 9 percent by the Ukraine. Of the 369 requests made in 2006, 64 percent were from Russia and 7 percent were from the Ukraine.”

The IRS has been very active in pursuing this information for its “treaty partners”. “Since Russia, Latvia, Lithuania, and the Ukraine are the main countries affected by this type of tax fraud, they continue to express their concern that the U.S. Limited Liability Company (LLC) regime is an offshore haven used to falsify VAT transactions.”

“When other countries ask us for company owners and we have to stand red-faced and empty-handed, it undermines our credibility and our ability to go after offshore tax havens that help rob honest U.S. taxpayers,” Senator Levin said.

Congress and the IRS, together with cooperative state governments no doubt will move aggressively to solve the problem of secretive US shell companies and noncompliant taxpayers.

Persons that have used US shell companies need immediately to review their situation. If there are problems, they should consider voluntary steps—again, as quickly as possible—to avoid civil and criminal fraud and other penalties. Steps to avoid “home country” consequences will depend on the particular circumstances. If the individual or company is contacted by the IRS before coming forward voluntarily, the ability to resolve the matter on favorable terms disappears and one is likely confronting a very bad set of alternatives.

Advisers that have assisted clients with questionable structures also need to be mindful of the possible repercussions.

Moore & Bruce, LLP is a specialist international law firm with principal offices in Washington, D.C., London, and Wilmington, Delaware.

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