

## CORPORATIONS AND MONEY LAUNDERING IN THE WAKE OF PANAMA PAPERS

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### Abstract

*Business and trade never required law. Business pre-dates law. Business consists of mutual undertaking of performance of certain obligations between at least two parties. The driving force behind the performance of these obligations, since the time of barter system, has not been law and punishment it can inflict. But rather it has been the desire to obtain the mutual benefits and negatively the conformity to social norm of making good on one's undertaking in trade so as to keep of engaging in trade or business with others. Even in absence of law a person who does not fulfill his obligations in a business is punished through his ouster among the traders due to his reputation.*

*The purpose of law is equity among greatest number of people in all aspects. Law facilitated business to grow larger than ever more complex, transcend boundaries and involve more and more people giving birth to the modern markets, economic systems and corporate world. However, how two of the most important creations of law and business the Corporation and Financial Service are used to defeat the fundamental purpose of law-Equity. The essay tries to explain.*

“...But most of all, the legal profession has failed. Democratic governance depends upon responsible individuals throughout the entire system who understand and uphold the law, not who understand and exploit it. On average, lawyers have become so deeply corrupt that it is imperative for major changes in the profession to take place, far beyond the meek proposals already on the table. To start, the term “legal ethics,” upon which codes of conduct and licensure are nominally based, has become an oxymoron. Mossack Fonseca did not work in a vacuum--- despite repeated fines and documented regulatory violations, it found allies and clients at major law firms in virtually every nation. If the industry's shattered economics were not already evidence enough, there is now no denying that lawyers can no longer be permitted to regulate one another. It simply doesn't work. Those able to pay the most can always find a lawyer to serve their ends, whether that lawyer is at Mossack Fonseca or another firm of which we remain unaware. What about the rest of society...”

“John Doe”

Mossack Fonseca Whistleblower

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Corporate personality is one of the most important creations of the modern legal systems. Originating from the celebrated case of *Salomon v Salomon & Co.* the concept of corporate personality as a legally distinct entity and a subject of law on its own, arguably, laid down the foundations for the development of business to its present form.

The idea of a corporate personality is based on the ideas of collective identity of a formal association of individuals separate from its distinct members. This acknowledgement of a corporation and vesting it with certain rights and duties allowed for the constituent individuals to enjoy some immunity by shielding some their acts under the garb of the corporations. This covering of the individuals' acts reduced the friction in business relations among persons and between business persons and law for acts which may inconsistent with each other or with the law. In simpler words, a father and son running a business may have a dispute with a client if the client pays the son but the father refuses to accept it as payment for the service or goods provided, similarly if the business (association) of father and son is not recognized as a unit, the law may require both of them to obtain license or perform other formalities if their trade required also one may be at cross with law if he engages in the trade together with other, another possibility would be that one may claim no-liability towards a customer for the acts of other if carried out by the other, even if it is in the course of business.

The instrument of corporate personality in a legal system has great contribution to the development of world business and social utility. Corporations have taken over areas from luxury to governance and necessities so far as to be influential factors of international politics.

One of the prime reasons behind this success of corporate bodies is that it allows people to take on gargantuan endeavors at the same time mitigating the catastrophic risk they would pose should an individual decides to pursue such endeavors. In other words a corporate body, in undertaking a risk, breaks down the risk which befall the individual members that are relatively small scaled, depending on the type of corporation. This feature also allows for sharing of cost burden, profit sharing, resource assimilation among other things.

A large number of these corporate bodies are engaged with the affording money to other bodies and individuals, popularly known as financial services. The financial service sector has grown at rapid pace in the post war<sup>2</sup> era. The financial sector has transcended all boundaries and financial companies are now engaged in tasks from financing the public welfare initiatives to issuing sovereign debts. The financial bodies, in the present world, form the capillaries of the world economy, linking the different sectors to each other thereby creating a complex web which connects all the constituents and factors active in the world economy. The influence of any factor is transferred to other members of the economy through this financial web, which can be seen in the relative interplay between the stock exchanges of the world or the 2008 crisis. The enormity of the financial system can be appreciated by considering that in 2014, the World Bank estimated

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<sup>2</sup> World War II (1939-45)

that financial sector provided a credit 176% of the GDP, only in the domestic markets<sup>3</sup>. This percentage share was noticeably higher in developed countries than relatively underdeveloped and developing countries, with an average of 211.1% among the OECD countries and -2.3% in Afghanistan<sup>4</sup>. The financial system also houses a large share of savings in any economy.

This complex web of fiancé allows for efficient transfer of wealth across the world, however this very feature which has been an important aspect of globalization of trade and commerce provides the lacunae and means for unscrupulous individuals to use these instruments of economic and legal systems to amass illegal mammon in different corners of the world so as to escape taxes, legitimate regulations and disclosure. This causes a variety of effects to all the constituents of these systems similar to the ripples created in a closely knit web.

### **Money Laundering-Panama Papers**

As noted above the corporate personality is one of the most complex creations of legal systems. The separation of individual personality from the personality of the association allows the individual to garb his/her illegitimate acts and attribute them to the association and thereby reap benefits pertaining thereto. There are a number of modes through which this is done. One of the most common forms is Money Laundering. Money Laundering may itself refer to a number of methods to convert illegally obtained into “clean” money or legitimized money by integrating it in the financial system. This means that money laundering also involves income or wealth generated (black money) on which tax is not paid.

Money Laundering originated with the concept of taxation where the individual tried to hide and use their incomes without paying the taxes to the sovereign. However, modern day money laundering grew fundamentally with the growth of organized crimes, bootlegging and international narcotics trade. These activities created a great demand for legitimizing illegal income and integrating it into the financial system. Although there are many ways in which money is laundered, they can be categorized principally into bank methods, smurfing, currency exchanges, and double-invoicing and they largely involve placement, layering and integration as the common steps<sup>5</sup>.

Out of the many methods and means the focus of this essay remains on the creation of shell companies, trusts etc. in connivance with banks and other financial institutions. A shell company or corporation is defined as “a corporation without active business operations or significant assets<sup>6</sup>.” Also shell companies may be defined as corporations “which exist on paper only, with no real employees or office have legitimate uses<sup>7</sup>”. The term, itself, does not refer to the purpose of the entity but rather refers to the entity in relation to others. A shell corporation or creation of

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<sup>3</sup> “Domestic credit provided by financial sector (% of GDP)” online <http://data.worldbank.org/topic/financial-sector>

<sup>4</sup> Ibid at “Domestic credit provided by financial sector (% of GDP)” hyperlink

<sup>5</sup> Lawrence M. Salinger, Encyclopedia of White Collar & Corporate Crime, Volume 1, page 78

<sup>6</sup> “Shell Corporation” online, <http://www.investopedia.com/terms/s/shellcorporation.asp>

<sup>7</sup> “Launderers Anonymous” online, <http://www.economist.com/node/21563286>

one is not per se illegal but the same become a cause of grave concern as they are widely used for moving money from one jurisdiction to another with lenient disclosure norms so as to retransfer it to the origin country as legitimate money. This is achieved through concealing the true identity of the owners and beneficial owners. The prime objective behind this illegal use of the shell corporations is to create “hard-to-trace” layers to facilitate tax-avoidance, illegal transfer and acquisition of assets to, both, utilize illegal income and evade tax etc.

The issue of offshore holdings, by people from all spheres, fleetingly rattled the world with leak of documents from the Panama based law firm Mossack Fonseca. The documents were leaked by an employee of the firm using the pseudonym “John Doe” to the International Consortium of Investigative Journalists. The data in form of documents, spreadsheets, email chains and obscure records consist of 11.6 million files amounting to 2.6 terabytes<sup>8</sup> and dating back as far 1977<sup>9</sup>. The data reveals the collusion of the corporate, legal and political systems, including super rich individuals, corporations, law firms, politicians, banks as well as alleged NGOs and welfare foundations<sup>10</sup>.

The data presents an appalling image of the global financial system, active for over three decades. The offshore entities have been linked to 12 current and former country leaders<sup>11</sup> along with more than 128 public officials and politicians<sup>12</sup>, around 61 relatives of politicians and officials, number of FIFA officials linked with bribery allegations and soccer players, other sportsmen, number of entertainment personalities known fraudsters, drug lords and kingpins of organized crime families<sup>13</sup>. Apart from these, many notable banks were also the driving force behind creation of shell companies for their clients to conceal their wealth and its sources<sup>14</sup>. The documents reveal how complex networks of banks, corporations and jurisdictions were used to route and reroute money, assets and rights thereto over several layers and countries to render the true owners untraceable. These networks were also used by corporations to escape liabilities for many acts<sup>15</sup>.

Despite the immense amounts of data, the stir created by the Panama leaks was short-lived in the global mainstream perspective, with a limited number of consequences and responses curtailed to domestic investigations that only where there are proactive independent agencies.

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<sup>8</sup> Mar Cabra and Erin Kissane “Wrangling 2.6TB of data: The people and the technology behind the Panama Papers” online, <https://panamapapers.icij.org/blog/20160425-data-tech-team-ICIJ.html> para 2

<sup>9</sup> Marina Walker Guevara “ICIJ releases database revealing thousands of secret offshore companies” <https://panamapapers.icij.org/blog/20160509-offshore-database-release.html> para 17

<sup>10</sup> Ibid at para 18

<sup>11</sup> “Panama Papers The Power Players” online [https://panamapapers.icij.org/the\\_power\\_players/](https://panamapapers.icij.org/the_power_players/)

<sup>12</sup> “Giant Leak of Offshore Financial Records Exposes Global Array of Crime and Corruption” online <https://panamapapers.icij.org/20160403-panama-papers-global-overview.html>

<sup>13</sup> Ibid at 3 and 21

<sup>14</sup> Ibid at 12

<sup>15</sup> Ibid at 80 “Secrets and Victims”

The Panama Paper leaks is not the first international financial crime of money laundering which involved powerful individuals, financial institutions and corporations. In the last two decades of 20<sup>th</sup> century and early 2000s there have been a number of such known and unknown incidences of such nature.

The Bank of Credit and Commerce International (BCCI), founded in 1972 and registered in Luxembourg with head offices in Karachi and London and more 400 branches in around 80 countries, and assets of over 20 billion dollars, was one of the largest private bank in the world<sup>16</sup>. Soon after its creation it was found that the bank was merely a façade for massive money laundering operations and other financial crimes. The modus operandi of the bank was overly complex and multiple routing and rerouting of money over jurisdictions and countries which is the same as is used in the Panama Papers and other cases till now. The bank was moving so much money that it was able to stealthily control a significant share in some large American banks<sup>17</sup>. The clients of bank involved drug cartels, Saddam Hussein, the former dictator of Panama Manuel Noriega among others<sup>18</sup>. Some reports also linked many accounts to the Central Intelligence Agency. The BCCI was brought down when a number of regulatory agencies investigated its affairs and compelled a Luxembourg to shut down the bank's operations followed by forced closure of the bank in other countries. The BCCI was headed by the Sheikh of Abu Dhabi at time of its closure.

In 1996 reports emerged that Bank of New York was engaged in laundering over 15 billion dollars through various European banks, such as UBS, Credit Suisse etc., and companies. One of the indicted was the Russian vice-president of the bank along with officials across Europe. Apart from the mob money, dubious reports also emerged alleging siphoning and misappropriation of IMF grant to Russia and other domestic aids<sup>19</sup>. The case carried on to 2005 where the case against the bank was settled for 38 million dollars. In 2007 Russia filed a case against the bank for 22.5 billion dollars, which was later settled for a lesser amount of 14 million dollars<sup>20</sup>. During the course of proceedings the bank admitted to laundering around 7.5 billion dollars.

Another major site for money laundering operations was the Nauru Island, a small country in Micronesia which was used as tax haven for a number of years.

Apart from these there were several money laundering and other financial crimes reported through the last two decades of 20<sup>th</sup> century involving several individuals and corporations.

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<sup>16</sup> Kanas, Angelos, "Pure Contagion Effects In International Banking: The Case Of BCCIs Failure", Journal of Applied Economics

<sup>17</sup> Jonathan Beaty and S.C. Gwynne, "BCCI: The Dirtiest Bank of All" online, Time Magazine, July 1991 available at [http://www.bibliotecapleyades.net/sociopolitica/sociopol\\_globalbanking118.htm](http://www.bibliotecapleyades.net/sociopolitica/sociopol_globalbanking118.htm)

<sup>18</sup> Kanas supra note 15

<sup>19</sup> David Randall, "Banking scandal engulfs Europe" online <http://www.independent.co.uk/news/banking-scandal-engulfs-europe-1118106.html>

<sup>20</sup> Andrew Kramer, "Bank of New York Settles a Protracted Russian Lawsuit" online [http://www.nytimes.com/2009/09/17/business/global/17bony.html?\\_r=0](http://www.nytimes.com/2009/09/17/business/global/17bony.html?_r=0)

Despite these exposes, the majority of money laundering and evasion operations remain hidden and undetected as the prime objective behind them are anonymity and secrecy. However the absence of a powerful international monitoring agency and supplementary enforcement agencies cannot be overlooked as a reason behind continuing and growing money laundering and evasive maneuvers. The growing international trade and increased liquidity of assets has allowed the development more complex, layered and hard to trace maneuvers. It can be said there have not been any global steps to curb and prevent money laundering. The Financial Action Task Force on Money Laundering (FATF) was formed by G7 countries in 1989 with an objective combat tax crime and money laundering. The FATF issued 49 guidelines (initially 40), which form the principles for the countries to set a course of action to curb money laundering. The member countries observe each other's progress with respect to the implementation of the guidelines by mutual evaluation. There are at present 34 member jurisdictions along with other associate and observer members. Despite the passing of 27 years from its creations, the role of FATF has remained that of recommending and rating body with no power to impose sanction. The FATF structure only puts pressure on the non-cooperating states which is similar to the name-and-shame method. The efficiency of the FATF can be understood from the fact that member jurisdictions have been used as the site of financial crimes both in the past as well as in the Panama Leaks along with the involvement of their head of States. It cannot be denied that the role of FATF has tilted towards terrorist financing post 9/11 attacks. Apart from FATF there are regional bodies such as EU and OECD and others which have tried to address the prevent money laundering.

Pragmatically it is difficult to imagine a competent international body and framework to deter financial crimes particularly money laundering since a large number of such crimes have been found to involve world leaders, heads of states, high ranking public officials, high net worth individuals with significant influence in the powerful circles, relatives of the aforementioned etc. The short life span of the international stir of Panama Papers could be argued to be because of the involvement of the powerful people in high stake posts. It is not an overstretched argument that there might be the involvement of a section of media in financial crimes traceable through the Panama Papers.

In contrast to the international bodies, the domestic agencies entrusted with the task of curbing money laundering, have achieved, though not unblemished but better success in some countries. The agencies now monitor the money market and financial institutions with unforeseen scrutiny. For example in India the Prevention of Money Laundering Act, 2002 was passed by the parliament to specifically deal with the issue. Enforcement side there are various agencies cooperating and working such as the RBI, Enforcement Directorate and SEBI. The mechanism exercised by these agencies comprises of reporting of transactions and their trails, keeping records, monitoring of suspicious entities. Despite the number of measures taken, money laundering accounts for close to half of the tax arrears in India. A large portion of this laundered money is believed to belong to politicians and corporations. In the United States the anti-money



laundering steps involve the legislation imposing duty on financial institutions of reporting of transactions to the Treasury to create database for the Financial Crimes Enforcement Network, an intelligence unit which studies these reports to determine trends and initiate investigations.

There is apparent lack of determination on the part of those who are entrusted with the power, to curb and prevent money laundering. This assumption is supported by the fact that all sphere and systems have beneficial participation in the financial crimes. The stance against money laundering and financial crime is also weakened by certain pro-free market advocates from the corporate and legal sectors. Another attempt by the benefactors of such crimes is to classify them as victimless crimes, which is largely demolished solely by the Panama leaks itself. A real problem behind curbing these crimes is the significant cost of tracing the crime and the perpetrators but the low recovery of the laundered money. Almost never has been the full amount recovered and largely the laundered wealth and wrongdoers remain outside the clutches of justice.

The victims of financial crimes are both the small scale individuals, comprising of investors, defrauded persons and most of all tax payer, and the system itself. As described above the financial system is a web linking different markets and economic systems, a disturbance in the form a money laundering scam or other financial crime, reverberates through the web depending on the magnitude of the disturbance. The involvement of the Prime Minister of Iceland in the Panama Papers for transfer pricing of assets to her wife and avoiding disclosure led to his resignation, the anticipation caused brought the Iceland Stock exchange OMX18 as whole fell around 1.8% just in the duration of meeting between party leaders and the companies lost over 3% of their value. Similarly the fall of Enron in November 2001 caused loss of several percentages to its creditors and other energy companies in the market estimated to be around 18 billion dollars. Apart from these market effects and diminishing of government revenue, financial crimes cause competitive pricing through shell corporations causing losses to local manufacturing or service companies. Also sudden movement of laundered money may create liquidity problems for banks at a smaller scale.

Given the magnitude of financial crimes carried out through financial services and corporations and the losses caused thereby, modern capitalist system faces serious questions of integrity check. The wheels designed to carry the economic development of the world are being used to stall it for the benefit of a few. But the larger problem remains that the stakeholders remain ignorant of the problem or actively and purposefully disregarding it. Therefore the question which befalls to observers is that, with the involvement of political, administrative, legal, corporate and social systems, who could be relied upon to take action in the face of this travesty.