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Piercing the secrecy of offshore tax havens

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Video: In this animation, see how investors can create companies and trusts in offshore jurisdictions, where an estimated one-third of the world's worth resides.

A New York hedge fund manager allegedly swindles $12 million from a prominent Baltimore family. An Indiana couple is accused of bilking hundreds of customers by charging for free trials of cosmetic products. A financial manager in Texas promises 23-percent returns but absconds with $33.5 million of his investors' money in a classic Ponzi scheme.

[Financial danger lurks in tax havens: Here's a look at the offshore world, the people who have used its secrecy to perpetrate crimes and the perils and pitfalls for investors.](#)

All three cases have one thing in common: money that ended up in offshore accounts and trusts set up in tax havens around the world.

The existence of the trusts surfaced during a joint examination of the offshore world by The Washington Post and the International Consortium of Investigative Journalists, a D.C-based nonprofit news organization. ICIJ obtained 2.5 million records of more than 120,000 companies and trusts created by two offshore companies, Commonwealth Trust Ltd. (CTL) in the British Virgin Islands and Portcullis TrustNet, which operates mostly in Asia and the Cook Islands, a South Pacific nation. The records were obtained by Gerard Ryle, ICIJ's director, as a result of an investigation he conducted in Australia.

Many people use the offshore world for legitimate purposes, for legal tax shelters or to smooth the way for international trade. Overseas havens vaulted into public consciousness last year with stories about Republican presidential nominee Mitt Romney's accounts in the Cayman Islands. Recent coverage of the Cyprus banking crisis has thrust the issue back into the spotlight.

U.S. citizens are permitted to move money offshore as long as they report their account information to the Internal Revenue Service. But there have long been concerns that much of the money is not reported and bleeds tax revenue from governments worldwide. Recently, aspects of the offshore world came under assault after whistleblowers alerted the IRS to thousands of unreported U.S. accounts in Swiss banks, resulting in an amnesty offer to violators who paid billions in fines to the U.S. government.

The records reviewed by The Post and ICIJ expose how havens in the South Pacific and Caribbean in some cases have become sanctuaries for individuals seeking to conceal their activities from investigators and investors.

Among the 4,000 U.S. individuals listed in the records, at least 30 are American citizens accused in lawsuits or criminal cases of fraud, money laundering or other serious financial misconduct.

They include billionaire hedge fund manager Raj Rajaratnam, who was convicted in 2011 in one of the biggest insider trading scandals in U.S. history, and Paul A. Bilzerian, one of the most famed corporate raiders of the 1980s, who was convicted of securities fraud.

An attorney for TrustNet, which helped create the companies and trusts for the clients, declined to comment, referring questions to senior TrustNet officials who did not respond to requests to discuss their firm.

Fraud experts say offshore bank accounts and companies are vital to the operation of complex financial crimes. Allen Stanford, who ran a $7 billion Ponzi scheme, used a bank he controlled in Antigua. Bernard Madoff, who ran the largest Ponzi scheme in U.S. history, used a series of offshore "feeder funds" to fuel the growth of his multibillion-dollar house of cards.

Michael I. Goldberg, a Fort Lauderdale, Fla., attorney who often testifies as an expert on Ponzi schemes, said it is rare to see one that does not make use of the offshore world.

"If you don't, it's usually a very parochial, Podunk type of Ponzi," he said. "But the more sophisticated ones almost always do."

The offshore world makes it hard for prosecutors pursuing complex financial crimes to follow the money, because many offshore jurisdictions refuse to recognize U.S. subpoenas and account information is hidden under layers of corporate shells.

"People were trying to hide their money from the IRS, or they were trying to hide their money from law enforcement, or they were trying to hide their money from regulators," said Paul E. Pelletier, the principal deputy chief of the Justice Department's fraud section who prosecuted Stanford before entering private practice in 2011. "As a prosecutor, it was very difficult pursuing these people."

The records reviewed by The Post and ICIJ include tax filings, internal memoranda and e-mails kept by CTL and TrustNet.

The CTL records contain information on at least 23 companies linked to an alleged $230 million tax fraud in Russia, a case that was being investigated by a Moscow-based lawyer named Sergei Magnitsky, who died in prison under suspicious circumstances. One of the companies was used to set up Swiss bank accounts into which the husband of a Russian tax official deposited millions in cash, according to legal filings in Switzerland.

The Magnitsky Affair has created tensions between the United States and Russia. Russia last year blocked hundreds of foreign adoptions after Congress passed the Sergei Magnitsky Act, barring Russian officials believed to be involved in the lawyer's death from entering the United States or using its banking system.

There's no evidence that CTL participated in fraud or other crimes. Internal records suggest, however, that the firm often did little to screen its clients to make sure they weren't involved in illicit activities.

CTL co-founder Thomas Ward blamed many of the firm's problems on "the law of large numbers." Anytime you form thousands of companies for thousands of people, he said, it's likely that a few of them are going to be up to no good.

"I regard myself as an ethical person. I don't think I intentionally did anything wrong," said Ward, an entrepreneur from Canada who has worked as a consultant for CTL since selling it to new owners in 2009. "I certainly didn't aid and abet anybody doing anything illegal."

In late 2005, CTL's general manager, Sandy Holburn, warned about the firm's Russian clients: "There's obviously a lot going on that we don't really know or understand concerning the users of the companies we form for these clients."

Ward agreed that such clients might "cause some difficulty," but told Holburn there was "little we can do about that unless we wish to stop growing," according to an e-mail exchange at the time.

Ward said he does not recall Holburn's warning and added that the firm's client-screening procedures were consistent with standard practices in the offshore industry. He said the firm often relied for its vetting on intermediaries in other countries who usually employed lawyers and accountants and did a good job of collecting information about would-be clients.

But he said such measures can't always protect firms from "being duped by dishonest clients" or signing on "someone who appears, to all historical examination, to be honest" but "later turns to something dishonest."

Cordishes lose $12 million

In the spring of 2006, New York financial planner Brian Callahan and a TrustNet attorney toured the United States with a sales pitch that urged wealthy Americans to invest their money through trusts set up in the Cook Islands. Among the clients that Callahan and the attorney approached was a family that runs a large commercial real estate and casino development company in Baltimore, the Cordish Cos.

At the time, the Cordishes were already in the process of creating four trusts in the Cook Islands through TrustNet and the family eventually placed $116 million worth of assets in them, a transfer they disclosed to the IRS. They invested some of the money with Callahan, but instead of protecting their investment, he allegedly swindled the Cordishes out of nearly $12 million, according to previously confidential documents and a civil lawsuit brought by the Securities and Exchange Commission.

The SEC sued Callahan this past May, alleging that he diverted investor money to help pay for his home in a fashionable Long Island enclave and to underwrite his brother's oceanfront real estate project in Montauk, N.Y.

Callahan's attorney declined to comment, citing the SEC case and a criminal investigation into his client by federal prosecutors.

The Cordishes also declined to comment.

Callahan raised $90 million from at least 45 investors who reported losing nearly $68 million, according to a recent filing by Steven Weinberg, a court-appointed receiver in the case.

The U.S. Attorney's Office for the Eastern District of New York has opened a criminal investigation and initiated forfeiture proceedings of Callahan's Long Island home and the Montauk real estate project.

For the better part of a century, the U.S. government has been trying to rein in the offshore world. In 1937, Treasury Secretary Henry Morgenthau Jr. wrote to President Franklin D. Roosevelt to warn that millions of tax dollars were being kept in offshore accounts and limited partnerships, including one $3 million account in the Bahamas.

"The companies are frequently organized through foreign lawyers, with dummy incorporators and dummy directors, so that the names of the real parties in interest do not appear," Morgenthau wrote.

Today, there are between 50 and 60 offshore financial centers around the world holding untold billions of dollars at a time of historic U.S. deficits and forced budget cuts. Groups that monitor tax issues estimate that between $8 trillion and $32 trillion in private global wealth is parked offshore.

For most investors in the United States, the first step to open an offshore account is to contact one of the hundreds of law firms specializing in "asset protection." These firms then call on a sprawling industry of offshore-based middlemen, such as CTL and TrustNet. They set up companies and arrange trusts and hard-to-trace bank accounts.

Sen. Carl M. Levin (D-Mich.) has been holding hearings and conducting investigations into the offshore world for nearly three decades. In 2010, Congress passed the Foreign Account Tax Compliance Act requiring that U.S. taxpayers report foreign assets to the government and foreign institutions alert the IRS when Americans open accounts.

In February, Levin introduced legislation that would permit the Treasury Department to penalize offshore financial institutions that "significantly" impede U.S. tax enforcement and put an end to accounting practices that enable corporations to evade billions in taxes.

"We can't afford to lose tens of billions of dollars a year to tax-avoidance schemes," Levin said. "And many of these schemes involve the shift of U.S. corporate tax revenues earned here in the U.S. to offshore tax havens."

The efforts by Levin and other lawmakers have been opposed by powerful lobbying interests, including the banking and accounting industries and a little-known nonprofit group called the Center for Freedom and Prosperity. CF&P was founded by Daniel J. Mitchell, a former Senate Finance Committee staffer who works as a tax expert for the Cato Institute, and Andrew Quinlan, who was a senior economic analyst for the Republican National Committee before helping start the center.

In filings with the IRS, the center says it has "met with more than 175 Capitol Hill offices on benefits of tax competition." The center argues that unfettered access to offshore havens leads to lower taxes and more prosperity.

According to records reviewed by The Post and ICIJ, the organization's fundraising pleas have been circulated to offshore entities that make millions by providing anonymity for wealthy clients, many of them U.S. citizens.

In May 2007, one director of a Hong Kong company that creates offshore trusts sent a CF&P solicitation to contacts in the Cook Islands, pointing out that CF&P was trying to raise $250,000 for a lobbying campaign to "stop the bleeding, build allies and go on the offensive" against efforts in Washington to regulate the industry.

"I personally think the efforts of CF&P should be supported by the Cook Islands given the impact [that] passage of current bills being considered in the USA Congress would have on the jurisdiction and industry," the director said.

Attached to the e-mail was the proposal from CF&P to "work with Congress and the White House" and explain the "legitimate role that low-tax countries play in protecting financial privacy."

Quinlan, the president of CF&P, declined to disclose his donors or say how much of the $200,000 his organization raises each year comes from the offshore world.

"I don't think it matters what percentage of the money comes from which donor," Quinlan said. "There are huge offices on K Street that lobby on behalf of interests that are outside the United States. We're just trying to be as effective as we can be."

Mitchell, the co-founder of CF&P, added that nations shouldn't be telling other countries how to conduct their affairs and noted that the United States is one of the worst offenders in the world when it comes to corporate secrecy.

"The United States is one of the biggest tax havens in the world," Mitchell said. "In general, the United States is impervious to fishing expeditions here, and then the United States turns around and says, 'Allow us to do fishing expeditions in your country.' "

Bankrupt couple's $3 million

In 2003, hundreds of U.S. consumers complained that they had been bilked by an online health and beauty supply company operating out of the home of Wayne and Anita Phillips in Evansville, Ind. The Indiana attorney general's office stepped in, accusing the couple of civil fraud and demanding refunds in excess of $1 million.

The attorney general's office alleged that companies controlled by the couple had promised "free trial" offers for their products, including vitamin supplements and "fat buster" beauty creams, but customers ended up paying for the products without receiving their free trials.

When requests for refunds began to mount, the couple filed for bankruptcy protection in October 2003. A month later, they opened a company on the Caribbean island of Nevis, records show.

The next month, Fifth Third Bank, which had sustained heavy losses, filed a lawsuit in the case against the Phillipses. Two weeks later, the Phillipses opened a trust in the Cook Islands.

The couple transferred millions in assets into the offshore accounts, according to court documents and the internal records. Within three years, one offshore company formed by the couple held $3 million, assets that were beyond of the reach of the U.S. judge overseeing the bankruptcy case.

"They were moving funds offshore and there was nothing we could do," said Andrew C. Ozete, a lawyer hired by Fifth Third Bank, which claimed it lost more than $1 million in the case. "The judge was not happy. Judges don't want to hear that people have moved millions of dollars offshore so they don't have to pay settlements."

The bankruptcy judge appointed attorney R. Stephen LaPlante as the trustee to recover as much money as he could for the creditors.

"I thought to myself, how are we going to get this money back?" LaPlante said. "We didn't know anything other than that these accounts existed. For someone like me, I can't do my job when people are able to create these kinds of trusts."

When LaPlante learned that the Phillipses were planning to move to Costa Rica, he asked the judge to order them to surrender their passports.

The couple eventually settled the lawsuit without admitting wrongdoing and repaid some of the money to the bank, but Ozete said his client was not able to recover much. The Indiana attorney general's office also settled with the couple, dropping its lawsuit in return for their promise to refund $130,000 to customers and pay a $20,000 fine.

"I really can't say anything about this," Wayne Phillips told The Post recently.

“It was stunning to see how the laws are written in these places to create these havens,” said Justin G. Hazlett, the deputy attorney general in Indiana who investigated the case. “It presents a significant uphill battle to pierce through these accounts.”

Secrecy cuts both ways

In 2005, Dennis Kittler, the president of a Houston-based oil company, thought he had found a sound investment opportunity after hearing a sales pitch by a businessman named Robert Watson.

Watson, who told clients he was a former military intelligence officer and a professor of finance at Texas A&M University, said he had developed an algorithm for trading in foreign currencies. He promised returns as high as 23 percent.

“He came out of A&M with an accounting degree. He was in Special Operations in the Army; he had gone on all these covert operations around the world; he knew all these generals,” Kittler recalled in a recent interview. “He went to my daughter’s graduation. He always seemed to remember everyone’s birthday. I thought he was one of the greatest guys in the world.”

The first sign of trouble came in 2008, when Kittler received a monthly report that was identical to the one he had received the month before. Kittler called Watson, who apologized for what he called an oversight.

“He said he was sorry and he said, ‘I guess I owe you another $50,000.’ ”

The following summer, Kittler received a call from his attorney.

“He said, ‘You know that guy you’ve been investing with? He’s been arrested.’ ”

Kittler soon learned that Watson was a fraud. When investors withdrew money, Watson simply transferred funds from other investors to cover the withdrawals, using two British Virgin Islands companies set up by the offshore firm CTL, court records and internal documents show.

“He should have won an Academy Award,” Kittler said.

According to previously confidential documents reviewed by The Post and ICIJ, the nominal directors of Watson’s companies were a husband-and-wife team in the Caribbean who had served as directors of other companies with thousands of wealthy clients seeking to shield their assets.

Watson used his investors’ money to pay for a high-flying lifestyle, including a $500,000 annual salary and a $33,000 diamond ring.

In February 2012, a federal judge sentenced him to 20 years in prison and ordered him to pay restitution and a $10 million fine.

Kittler lost nearly $2 million, among 132 investors who lost an estimated $33.5 million.

“Once your investment ends up in a place that bills itself as a secrecy haven, your money is offshore and you have no legal standing to go get it,” said David L. Peavler, an associate regional SEC director in Texas who worked on the case. “You’re basically putting your faith in another country’s process and there’s a high degree of risk. You have to ask yourself, why in the world would you send your money there?”

Magda Jean-Louis contributed to this article. Hudson and Walker are reporters for the International Consortium of Investigative Journalists, a nonprofit group that fosters investigative reporting worldwide.