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South Dakota—the new Liechtenstein? What the Pandora Papers Say about US Fiscal Paradises

In mythology, Pandora opened her box and released all manner of evil into the world. Just as Prometheus warned against what might come, the recent revelations of the Pandora Papers — a leak of millions of documents from 14 offshore service providers, including law firms and trust companies — were presaged by previous leaks from the International Consortium of Investigative Journalists, most notably the Panama Papers and the Paradise Papers.

The Pandora Papers revealed the offshore activities of hundreds of public officials — including 35 current and former national leaders — from nearly 100 countries and territories. Documents show how the Panamanian law firm Alcogal set up shell companies for Latin America's political and economic elite, all the while complaining of being compared to the star of the Panama Papers leak, Mossack Fonseca. Sebastián Piñera, Chile's billionaire president, has been impeached and faces an investigation into potential tax and bribery offenses in the weeks since the Pandora Papers revelations. The list of the implicated political elite continues to grow: Jordan's King Abdullah, the Czech prime minister, the family of the Kenyan president, the Qatari ruling family.

Ugland House, in the Cayman Islands, "home" to over 12,000 companies, was described by President Obama in January 2008 as either "the biggest building or the biggest tax scam on record." But the number of companies registered at Ugland House pales in comparison to the hundreds of thousands registered at 1209 North Orange Street in Wilmington, Delaware. While Delaware has long been known for its financial secrecy, the Panama Papers leak in 2016 highlighted how Nevada and sparsely-populated Wyoming have also become popular jurisdictions for the world's elite seeking to incorporate shell companies. With the latest revelations, South Dakota and Alaska have joined the lineup of mostly small or sparsely-populated states that have embraced these specialized financial services, often as a means to generate desperately need economic activity.

South Dakota started deregulating its trusts in the early 1980s, after it had attracted credit card companies because the state did not limit the interest rate the companies could charge customers. Just a few years later, the state abolished limits on how long trusts can last — known as the law against perpetuities, dating to legal precedents from 1600s England. An intended result of so-called "dynasty trusts" is to allow families to pass on wealth without owing estate or gift taxes. Decades later, a culture of secrecy combined with no state income, capital gains, or inheritance taxes, broad protections for trusts against creditors, and an accepting political class, has allowed South Dakota to position itself as one of the most attractive — off- or onshore — fiscal paradises in the world.

Of the 206 US trusts identified in the Pandora Papers, 81 of them are based in the Mount Rushmore state. South Dakotan trusts hold $360 billion, more than six and a half times the state's 2019 GDP, according to recent reporting. Federico Kong Vielman, a member of one of the most powerful families in Guatemala and the head of companies in the developing country that have been accused of labor, health and safety and environmental wrongdoing, has a trust there. Further, the descendants of the Dominican Republic's former vice president, Carlos Morales, whose sugar company has been accused of labor abuses, and of José Douer-Ambar, the Colombian textile tycoon who forfeited $20 million as part of a deferred prosecution agreement less than a decade before opening his South Dakota trust, call the state their fiscal home.

Other than a data leak, how can one get behind companies set up to conceal ownership? Trained investigators may be able to lift the veil of secrecy.

A necessary first step is to obtain and thoroughly analyze all available corporate documents, including historical filings. While this documentation may be sparse, not available online, and seemingly insignificant to the untrained eye, it can contain important clues to taking apart the structure of shell companies. These documents may identify the individuals who incorporated the entity or signed interim filings, or reveal an address or telephone number not affiliated with a corporate services firm that can be linked to data from other open sources.

A comprehensive review of the public domain, including research in litigation and real property records as well as media sources, is also key. Shell companies and trusts may be used to park money, but they also are often used to buy tangible assets like real property. Once an address is connected to an entity, recorded documents like deeds or mortgage filings can reveal the individuals behind the entity. Entities may also have ties, either through investment or corporate structures, to other entities or individuals in jurisdictions with greater reporting requirements. Accordingly, corporate filings from those jurisdictions could contain clues to the identity of the ultimate beneficial owners.

Litigation records should also be reviewed. A thorough dig through litigation filings can uncover a treasure trove of information derived from, among other things, depositions or other discovery materials. A company might also be referenced in filings or media reports about related entities. Armed with that information, an investigator can extrapolate details about the original shell company. Shared nominees, corporate service firms, or dates of registration, while not conclusory, can support important inferences when combined with other findings.

Although relying on mistakes or accidental disclosures by others makes it challenging to get behind companies registered in jurisdictions with limited reporting requirements a thorough investigation can result in success. In one case, members' names were found on historical interim filings with the Delaware corporate registry — filings which are not available online and, since they are not readily available, could have been overlooked.

In an investigation to find the assets of a commercial real estate professional, the subject operated through layers of limited liability companies, some of which were named after addresses. Although no ownership information was identified in the corporate filings for those companies, a review of historical annual reports found references to certain owners. Additionally, mortgages associated with the properties at the addresses for which the companies were named had been signed by other owners. Municipal permitting records named the owner of the entity and connected him to other companies.

On another occasion, the ultimate beneficial ownership of an entity registered in the Channel Island of Jersey, a known tax haven, was proven to have links to a Cayman Islands company in turn linked to a senior Middle Eastern government official. Despite a recent rebranding by the Jersey company, a thorough mapping of its affiliated entities in Europe eventually led to multiple Delaware shell companies under its previous name. Although Delaware has limited state reporting requirements, certain sectors have strict federal disclosure requirements, particularly in the finance industry, and trudging through dozens of pages of dry disclosure language revealed a subsidiary of one of the Delaware entities was a registered investment advisor and required to file annual Forms ADV with the US Securities and Exchange Commission. As the Form ADV requires disclosure of beneficial ownership, data from that filing traced ownership from the investment advisor, through multiple US holding companies, to the Jersey and Cayman Island companies and, ultimately, to a senior official in the Middle East.

The US may be slowly moving toward more transparency. The Treasury Department's Financial Crimes Enforcement Network, popularly known as FinCEN, has begun establishing a federal beneficial ownership database, although it will not be public and exempts certain entities, like non-profits. While the database may be helpful for law enforcement, much remains to be done to diminish the reputation of the US as the biggest fiscal paradise in the world. The Pandora Papers have shed more light on South Dakota and other US onshore fiscal paradises, but the question remains whether these revelations will lead to broader reforms or push other, lesser-known jurisdictions into the light.

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