Testimony
of
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I appreciate the opportunity to testify before this distinguished committee about some of the money laundering and tax evasion schemes we see at the New York County District Attorney's Office. These cases run the gamut from simple tax frauds to international money laundering with links to international terrorism. Our experience shows that, if we intend to put a dent in large scale tax evasion and the financing of other criminal activities, we need to tighten the controls on the U.S. money system considerably.

In the past year, my office has convicted four New York stockbrokers of laundering more than three-quarters of a million dollars in profits from fraudulent stock deals through offshore credit card accounts to avoid New York City, State and federal taxes. More than $1.6 million from the stock fraud was paid to the brokers, over a two-year period, into accounts at the Leadenhall Bank & Trust in Nassau the Bahamas. The brokers, who have since been barred from the securities industry, withdrew $790,000, using MasterCard debit cards at ATM machines in New York City and Atlantic City, New Jersey, among other places.

Only last week, we convicted a New York doctor for evading taxes on $300,000 of income, $126,000 of which he put into an account at Leadenhall in the form of checks, ostensibly in payment of rent for his office. In fact, he owned the building in which he had his office. Like the crooked brokers, the doctor used a MasterCard to withdraw money at ATMs and to make purchases with the offshore funds. The doctor also used offshore accounts and a shell company to shelter another $76,000 of the income he failed to report.

Regrettably, these are not isolated cases. My office's investigation has disclosed that 115, 000 separate offshore MasterCard accounts were used in the New York, New Jersey and Connecticut area in a single year, 2001. The MasterCards were used in 2001 to access over $100 million deposited in banks located in at least 17 tax haven jurisdictions, including the Bahamas, Barbados, Belize and the Cayman Islands. It is highly unlikely that U.S. taxes were paid on any of this money. These figures – from just one of the major credit card companies – suggest that there is enormous wealth being hidden offshore by U.S. citizens that is neither being reported nor taxed.

In fact, as of December 2003, there was over 1 trillion in U.S. dollars on deposit in banks in the Cayman Islands alone. This staggering amount of money – reflecting an increase of about $500 million over the past five years – is twice the amount that is currently on deposit in all the banks in New York City and more than double the annual budget of the United States Department of Defense. The Caymans boasts that there were a total of 349 banks licensed there at the end of 2003, including 43 of the 50 largest banks in the world. Not surprisingly, a substantial portion of the dollar deposits in the Caymans is booked to subsidiaries and branches of banks in the United States.

Although some money may be in the Caymans and other tax havens for legitimate purposes, there is no doubt that much of it is deposited there to avoid taxes and responsible regulation in the United States and other developed countries. It is no coincidence that the Caymans, widely known for its strict bank and corporate secrecy laws, has figured in many recent major financial scandals. Enron Corporation, for example, used 441 Cayman affiliates to hide $2.9 billion in losses. Parmalat Finanziaria used Cayman subsidiaries to falsely claim $4.9 billion in bank deposits that it did not have. The Caymans was also the nominal home of Long Term Capital, the giant hedge fund that collapsed in 1998.

One reason so much in potential tax revenue is being lost to offshore tax evasion and fraud is that ATMs, electronic transfers and the Internet have made it easier to take advantage of the strict bank and corporate secrecy provided by the Caymans and other tax havens. Today, anyone who wishes to deposit cash offshore can open a bank account, accessible by credit card, and even charter a shell company in a tax haven, simply by logging on to the Internet. It has been estimated that offshore tax frauds alone cost the U.S. government about $70 billion in tax revenues every year. Considering the revenues lost to state and local governments, the amount lost is actually much higher.

In the course of tracing money deposited into the correspondent bank for Leadenhall Bank & Trust (the Bahamas bank used in the offshore credit card scam) my office came across Beacon Hill Service Corporation. Beacon Hill was an unlicensed money transmitting business, run out of offices on the seventh floor of a midtown Manhattan office building. It had about a dozen employees. Beacon Hill was open for business from 1994 to February 2003, when we executed a search warrant on the premises. In the last six years of its operation, this small company moved $6.5 billion, by wire transfers alone, through the 40 accounts it maintained at a major New York bank. This does not include checks, payable-through drafts or cash transactions. Beacon Hill was convicted in February 2004 of operating as a money transmitter without a license.

We can reasonably conclude that very little, if any, of this money was moved through Beacon Hill for legitimate purposes. Legitimate clients moving that amount of money would have dealt directly with a bank, rather than pay the extra fees required to deal with Beacon Hill. What the clients got for the extra money they paid is secrecy. Because Beacon Hill did not keep proper records and because of the nature of its clients – which included numerous offshore shell corporations and "casas de cambio," or exchange houses, in Brazil and Uruguay – it is nearly impossible to identify the real parties in interest behind Beacon Hill's transactions or to trace the money through these accounts. Some of the money was no doubt

linked to narcotics traffickers from South America. Records also show that Beacon Hill transmitted $31.5 million to accounts in Pakistan, Lebanon, Jordan, Dubai, Saudi Arabia and elsewhere in the Middle East.

Among the foreign authorities that have contacted the New York County District Attorney's Office about the Beacon Hill accounts are Brazilian prosecutors and police and representatives of a special commission established in Brazil to investigate the movement of some $30 billion out of Brazil. The $30 billion is thought to be the proceeds of official corruption, government fraud, organized crime activities and weapons and narcotics trafficking. At least $200 million of this money – funds alleged to belong to a prominent public official in Brazil – moved through Beacon Hill's accounts.

Commercial check cashing businesses are another major vehicle for money laundering and tax fraud schemes. In a typical scheme, a business will write checks to vendors or suppliers for purported business purchases and then cash them at a commercial check casher. The business person then has the use of the cash, which is never reported as personal income, and the benefit of a phony tax deduction.

In May of this year, the District Attorney's Office concluded an investigation of medical management and supply companies which evaded taxes by cashing customers' checks through Manhattan commercial check cashers. We convicted six individuals of using check cashers to evading taxes on a total of $41 million that never appeared on the company books and was never reported on tax returns. In another recent case we convicted 11 companies of evading $4.4 million in income through a check casher.

In a long-running securities fraud case, my office convicted 43 brokers from the securities firm, Meyers Pollock Robbins. Among other schemes, the Meyers Pollock brokers generated fictitious sales between offshore shell corporations in the Isle of Man in so-called "pump and dump" operations. Millions of dollars earned

offshore every year in these frauds were wired to the bank account of City Check Cashing, once a major check-cashing business in the New York metropolitan area. A bagman paid by Meyers Pollock would arrange to pick up the cash from the check casher and deliver it to the crooked brokers in New York and elsewhere.

Commercial check cashing is big business. City Check Cashing did $175 million in business every year; another notorious New York operation cashed $250 million in checks a year.

Like any other U.S. businesses, check cashers and money transmitters need access to the U.S. banking system to transmit funds. For that reason, we rightly expect our banks to be the first line of defense against the abuse of the system for tax evasion and other illegal purposes. Of course, the Patriot Act requires them to perform that function by, among other things, taking measures to know their customers, and in some instances their customers' customers. However, our experience at the District Attorney's Office shows that, all too often, banks are failing to live up to these obligations.

One case in point concerns the major New York bank where Beacon Hill maintained its accounts. In the course of its nine year relationship with Beacon Hill, the bank ignored numerous red flags for money laundering: many of Beacon Hill's clients were themselves in the business of moving money in South America, and the identities of their customers were unknown to the bank. Other clients were offshore shell corporations. Documents often identified the ultimate beneficiaries of transfers only as a "customer" or "valued customer." A large portion of Beacon Hill's business was run out of a pooled account which served many customers, making it impossible to connect deposits to transfers out of the account. The London office of the New York bank had shut down Beacon Hill's accounts in 1994, and Beacon Hill did not have a license to operate in the State of New York. In this case, the bank's New York compliance department completely fell down on the job.

A related investigation disclosed that a branch of Hudson United Bank in Manhattan was conducting an international money service business through certain accounts it had purchased from the Federal Deposit Insurance Corporation, following the liquidation of the Connecticut Bank of Commerce. This business had a high risk for money laundering. In a 16 month period, $1.4 billion dollars flowed through these accounts, some of it transmitted on behalf of foreign exchange houses and black market currency dealers from South America. Pursuant to a settlement my office reached with Hudson United in March, the bank has initiated significant anti-money laundering and compliance reforms and closed the international money service business at its Manhattan branch.

Our investigation is continuing into other banks in Manhattan that are providing similar money transmittal services with little apparent regard for the type of activities – including international terrorism – they may be facilitating. In the course of our banking investigations, we have seen millions of dollars transmitted on behalf of parties from the tri-border region of Brazil, Argentina and Paraguay, which is notorious for supplying funds to terrorist groups in the Middle East. We have also seen substantial amounts transferred from shell companies in the British Virgin Islands to a Middle Eastern bank long suspected of funding Hizballah and other terror groups. In other cases, we are investigating systematic frauds being committed by ethnic groups from the Middle East and the Asian sub-continent; the proceeds from these crimes are being sent back to their home countries, and some of the proceeds are clearly earmarked for terrorist activities.

The banks need to do a better job. Some oversight failures at the banks may be due to ignorance or simple negligence. But it is difficult to discount the influence of the considerable fees that banks can earn through the international money transmittal business. In one case currently under investigation, a major U.S. bank brought in revenues of $280 million, in just one year, from its relationship with a large South American money service business. It is not unreasonable to believe that, in many cases, self-interest has played a role in the banks' overlooking suspicious activities, which if scrutinized, might require them to shut down the

accounts involved. Obviously, it is important for banks to look beyond the fees they earn and to get serious about know your customer requirements. Regulators must get tougher on those institutions that fail to live up to their obligations.

Criminal investigations and prosecutions are not a substitute for the application of strict anti-money laundering procedures at U.S. banks. Even under the best conditions, law enforcement will have only limited success in combating money laundering and related crimes, such as tax evasion. We see only a small number of the crimes that actually occur, and the time and resources needed to mount a successful prosecution limit the number of cases we can handle. There are also many obstacles to successful criminal investigations in this area, especially when money moves internationally.

Records of our domestic financial institutions are often incomplete and are seldom sufficient in themselves to prove international crimes. Beacon Hill, for example, kept no record linking deposits into its accounts with withdrawals. And, surprisingly, in the investigation of the offshore credit cards, we found that MasterCard kept no record of the identity of its cardholders; each credit card account was identified only by number. The sole repository of customer identifying information was Leadenhall Bank & Trust in the Bahamas and other banks in secrecy jurisdictions.

In general, obtaining records from foreign jurisdictions is a frustrating process. Mutual Legal Assistance Treaties [MLATs] are effective only when foreign law enforcement authorities and financial institutions wish to be cooperative, which is seldom the case with the tax havens. Many MLATs do not provide for the exchange of information in tax cases; and may provide only for disclosure to federal authorities, leaving state and local prosecutors out in the cold. This is particularly short-sighted on the part of the United States government, as state and local prosecutors handle 98 per cent of the criminal cases that are prosecuted in this country.

The MLAT process is also painfully slow; it routinely takes six months to a year to successfully subpoena records from a foreign jurisdiction. In a current investigation, my office has been waiting for bank records requested by treaty from Shanghai, China for nearly two years. As you can imagine, when the same funds have been transmitted through multiple jurisdictions, the MLAT process may take so long as to be useless.

There has been improvement in the attitude of some foreign jurisdictions over the years. For example, we have had excellent cooperation from the Channel Islands, Jersey and Guernsey, and the Isle of Man, in several cases. To assist our investigation of the role of J.P. Morgan Chase and Citigroup in the Enron collapse, the Attorney General and the Financial Services Commission in the Isle of Jersey were able to arrange for our investigators to obtain records and interview witnesses concerning the offshore entities used by Chase; this was all done pursuant to Jersey law in response to a letter of request sent directly to the Jersey authorities. In another recent investigation, we even got help from some private lawyers in the Caymans, who were eager to do what they could to create a more favorable image for that jurisdiction.

This sort of expeditious access to foreign evidence should be the rule rather than the exception in an age when access to foreign banks and offshore entities in financial transactions is becoming routine. Hopefully, the Patriot Act, by requiring foreign banks with correspondent accounts in the U.S. to appoint an agent for service of process in this country, will help to circumvent some of the current complexities and obstacles in the MLAT process, as it applies to foreign banks. The federal government and the other G-8 nations need to put more pressure on the offshore tax havens to allow access to banking and corporate records on a reasonable basis. Jurisdictions that refuse to act responsibly should be denied access to the U.S. money system. A tougher stance against secrecy in the tax havens would be a great help to law enforcement and would, in the long run, significantly increase U.S. tax revenues.

Vigorous law enforcement is nowhere more important than in the area of tax fraud and evasion. As Justice Oliver Wendell Holmes said, "Taxes are what we pay for a civilized society." We all benefit from the money expended on vital infrastructure, national defense and security, and the other costs of government, which are increasing every year. For example, it is estimated that the costs to the cities of New York and Boston of providing security at this year's Republican and Democratic party conventions will exceed $125 million, much of which will be subsidized by the federal government. Every citizen should a pay a fair share of the taxes that support these expenditures.

Regrettably, not everyone sees it that way. In some quarters, evasion has become the norm. In a continuing investigation of tax cheating in the sale of fine art, my office has convicted more than a dozen dealers in fine art of colluding with customers to avoid sales taxes by falsely reporting transactions as out of state sales. In the past two years, we have collected $24.6 million in back sales and use taxes and fines in the fine art industry alone. Actually, a partner at a major accounting firm told me that this figure is low – that the back taxes paid as a consequence of this investigation probably exceed $100 million.

Although investigating these cases is difficult and time-consuming, it is important that we undertake them. In a democratic society such as ours, where we rely largely on voluntary compliance with the tax laws, the tax system must not only be fair, it must be perceived to be fair. People will pay their taxes so long as they believe others are also paying their share. For that reason, tough enforcement against those who do not pay is essential.

Of course, criminal enforcement is only part of the solution to keeping tax evasion and fraud in check. Enforcement by the Internal Revenue Service as well as

state and local tax authorities is equally important. And the work of the Congress in making certain the U.S. Tax Code allocates the tax burden fairly is also critical.

In recent years, we have seen one interest group after another seeking to take unfair advantage by manipulating provisions of our tax laws. I know members of this committee have done some important work in regard to corporate tax inversions, which have come into vogue in recent years. As it happens, the chairman of a major U.S. company who is currently under indictment in Manhattan for a corporate fraud boasted that he saved his company $400 million in taxes by establishing a nominal headquarters for the company in Bermuda. Corporate inversions and other major tax dodges – such as so-called "skimming" practices which reduce corporate profits onshore and abusive tax shelters – not only deprive the federal government of needed tax revenues, but also reduce revenues in New York and other states which have tax systems tied to the federal system.

Addressing these inequities is as important as any other step we can take to increase confidence in the tax system. If we want to minimize the financial burden on honest taxpayers, we must ensure that every U.S. citizen and corporation pays a fair share of taxes.
