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BUSINESS DAY

How Delaware Thrives as a Corporate Tax Haven

By **LESLIE WAYNE** JUNE 30, 2012

WILMINGTON, Del.

NOTHING about 1209 North Orange Street hints at the secrets inside. It's a humdrum office building, a low-slung affair with a faded awning and a view of a parking garage. Hardly worth a second glance. If a first one.

But behind its doors is one of the most remarkable corporate collections in the world: 1209 North Orange, you see, is the legal address of no fewer than 285,000 separate businesses.

Its occupants, on paper, include giants like American Airlines, Apple, Bank of America, Berkshire Hathaway, Cargill, Coca-Cola, Ford, General Electric, Google, JPMorgan Chase, and Wal-Mart. These companies do business across the nation and around the world. Here at 1209 North Orange, they simply have a dropbox.

What attracts these marquee names to 1209 North Orange and to other Delaware addresses also attracts less-upstanding corporate citizens. For instance, 1209 North Orange was, until recently, a business address of Timothy S. Durham, known as "the Midwest Madoff." On June 20, Mr. Durham was found guilty of bilking 5,000 mostly middle-class and elderly investors out of $207 million. It was also an address of Stanko Subotic, a Serbian businessman and convicted smuggler — just one of many Eastern Europeans drawn to the state.

Big corporations, small-time businesses, rogues, scoundrels and worse — all have turned up at Delaware addresses in hopes of minimizing taxes, skirting regulations, plying friendly courts or, when needed, covering their tracks. Federal authorities worry that, in addition to the legitimate businesses flocking here, drug traffickers, embezzlers and money launderers are increasingly heading to Delaware, too. It's easy to set up shell companies here, no questions asked.

"Shells are the No. 1 vehicle for laundering illicit money and criminal proceeds," said Lanny A. Breuer, assistant attorney general for the criminal division of the Justice Department. "It's an enormous criminal justice problem. It's ridiculously easy for a criminal to set up a shell corporation and use the banking system, and we have to stop it."

In these troubled economic times, when many states are desperate for tax dollars, Delaware stands out in sharp relief. The First State, land of DuPont, broiler chickens and, as it happens, Vice President Joseph R. Biden Jr., increasingly resembles a freewheeling offshore haven, right on America's shores. Officials in other states complain that Delaware's cozy corporate setup robs their states of billions of tax dollars. Officials in the Cayman Islands, a favorite Caribbean haunt of secretive hedge funds, say Delaware is today playing faster and looser than the offshore jurisdictions that raise hackles in Washington.

And international bodies, most recently the World Bank, are increasingly pointing fingers at the state.

Of course, business — the legal kind — has been the business of Delaware since 1792, when the state established its Court of Chancery to handle business affairs. By the early 20th century, the state was writing friendly corporate and tax laws to lure companies from New York, New Jersey and elsewhere. Most of the businesses incorporated here are legitimate and many are using all legal means to reduce their tax bills — something that most stockholders applaud.

President Obama has criticized outposts like the Caymans, complaining that they harbor giant tax schemes. But here in Wilmington, just over 100 miles from Washington, is in some ways the biggest corporate haven of all. It takes less than an hour to incorporate a company in Delaware, and the state is so eager to attract businesses that the office of its secretary of state stays open until midnight Monday through Thursday — and until 10:30 p.m. on Friday.

Nearly half of all public corporations in the United States are incorporated in Delaware. Last year, 133,297 businesses set up here. And, at last count, Delaware had more corporate entities, public and private, than people — 945,326 to 897,934.

One Delaware company was used last year to make an anonymous $1 million donation to Restore Our Future, a super PAC that favors Mitt Romney for president. Restore Our Future ultimately disclosed that the money came from a former Bain Capital executive. The Romney campaign declined comment, and Restore Our Future did not return calls.

Delaware's tax laws are a bonanza for the state. At a time when many states are being squeezed by a difficult economy, Delaware collected roughly $860 million in taxes and fees from its absentee corporate residents in 2011. That money accounted for a quarter of the state's total budget.

"Companies choose our state and we are proud of it," said Richard J. Geisenberger, Delaware's chief deputy secretary of state and its leading ambassador to business. "We spend a lot of time in the United States and traveling internationally to let people know that Delaware is a great place to do business."

It is also a great place to reduce a tax bill. Delaware today regularly tops lists of domestic and foreign tax havens because it allows companies to lower their taxes in another state — for instance, the state in which they actually do business or have their headquarters — by shifting royalties and similar revenues to holding companies in Delaware, where they are not taxed. In tax circles, the arrangement is known as "the Delaware loophole." Over the last decade, the Delaware loophole has enabled corporations to reduce the taxes paid to other states by an estimated $9.5 billion.

State lawmakers in Pennsylvania are now trying to close the loophole, arguing that their state is being robbed of its tax dollars. Of particular concern is that many companies involved in drilling for natural gas in the Marcellus Shale region of Pennsylvania are, in fact, incorporating in Delaware instead.

"Delaware is an outlier in the way it does business," said David E. Brunori, a professor at George Washington Law School and an expert on taxation. "What it offers is an opportunity to game the system and do it legally."

WHAT does it take to incorporate a company in Delaware? Not a lot, tax experts say. Shell companies — those with no employees, no assets and, in fact, no real business to speak of — are remarkably easy to establish here, and it doesn't always matter who you are or what business you are in. Viktor Bout, the Russian arms dealer known as "the merchant of death," used two Delaware addresses. In April he was sentenced to 25 years in prison on terrorism charges resulting from an American sting operation.

Jack Abramoff, the former Washington lobbyist jailed on corruption charges, set up a sham Delaware corporation to hide millions in payments and circumvent federal laws. Mr. Subotic, the Serbian businessman who was tried in absentia last October for his role in a cigarette smuggling scheme and sentenced to six years, used three airplanes that were registered in Delaware, including two at 1209 North Orange. Mr. Subotic lives in Geneva and denies the charges.

The Organized Crime and Corruption Reporting Project, an international group based in Sarajevo, has identified other Eastern Europeans with Delaware links. Among them is Laszlo Kiss, an Romanian accountant and author of "United States, Tax Heaven — Uncle Sam Will Fight Your Taxes!" that praised the state's lax rules. He is now awaiting trial in Bucharest on charges of helping embezzle and launder $10 million through Delaware shells.

"Delaware is the state that requires the least amount of information," says David Finzer, the chief executive of Capital Conservator, a registration agent that sets up accounts in Delaware and elsewhere for non-United States citizens. "Basically, it requires none. Delaware has the most secret companies in the world and the easiest to form."

Mr. Finzer, an American based in Novi Sad, Serbia, advertises his services online. “Tax-Free Havens for Non-U.S. Citizens,” his Web site, says. It goes on: “More than 50 percent of the major corporations in the world are incorporated in Delaware. Why? Because in provides the anonymity that most offshore jurisdictions do not offer.”

That is exactly what troubles law enforcement agencies and some in Congress who are trying to rein in Delaware. The state is seen as an onshore alternative with regulations more lax than such well-known offshore tax havens as the Isle of Man, Jersey and the Caymans, which require greater disclosure. Even more, a Delaware registration allows a business, legitimate or not, to open a bank account anywhere in the world with the patina of an American address.

“You can have companies in Delaware that have no U.S. bank accounts, no requirements for documentation and no one knows who owns them,” says Anthony B. Travers, chairman of the Cayman Islands Stock Exchange and former chairman of that country’s Financial Services Association. “There should be a level playing field and Delaware should have to comply with the same standards as the Caymans.”

Delaware isn’t the only state that has gone this route. Three others — Nevada, Wyoming and Oregon — have also been cited by the Financial Crimes Enforcement Network, a division of the United States Treasury Department, as “particularly appealing” for the formation of shell companies. Of those four states, Delaware stands out as the one offering the least transparency and the most secrecy, this group says.

“What is so galling about secrecy in the United States is that there is no attempt to document who owns a corporation,” said Richard Murphy, a senior adviser at the Tax Justice Network, an independent organization based in London that researches tax havens. “Two million corporations are formed each year in the United States, more than anywhere else in the world. Delaware, in turn, is the biggest single source of anonymous corporations in the world.”

Mr. Murphy adds: “Why go to the Caymans when you can just go down the street?”

In 2009, the Tax Justice Network named the United States as No. 1 on its Financial Secrecy Index, ahead of Luxembourg and Switzerland. It cited Delaware as one of the reasons.

That, Mr. Murphy says, elicited howls in Wilmington. "The reaction was: 'This cannot be true.' Not only can it be true, it is true." (The United States has since fallen to fifth place, behind Switzerland, the Caymans, Luxembourg and Hong Kong, after the group changed its method.)

For years, Senator Carl Levin, a Michigan Democrat, has been leading a quixotic effort to adopt legislation that would require states to collect information on the "beneficial ownership" of companies incorporated within their borders.

That would require states to add the name of the person standing behind the corporation — its beneficial owner — on incorporation papers. To sweeten the pot, the legislation would exempt public companies, hedge funds and other large corporations, along with mom-and-pop businesses where ownership is clear. In addition, the federal government would pick up the tab for putting the law into effect.

Senator Levin has long complained that it takes more information to get a driver's license than to set up a corporation in America. Three times since 2000, he has introduced his legislation — once co-sponsored by Barack Obama when he was a senator from Illinois — and each time the effort has been rebuffed. He has never even been able to get the measure out of committee.

Law enforcement agencies, human rights groups and the administration are on his side. Last month, a letter supporting Mr. Levin's measure and signed by 41 different groups was sent to every member of Congress.

But that has been no match for the opposition. Most vocal is the National Association of Secretaries of State, a politically powerful group. It is backed up by the Chamber of Commerce, the American Bar Association and the state of Delaware, which is the lone state to have hired a lobbyist to work on the matter.

Senator Thomas R. Carper, a Delaware Democrat, is in line to be the next chairman of the Senate Homeland Security and Government Affairs Committee, which has jurisdiction over the measure. Mr. Carper has expressed concerns about the measure but has taken no formal position on it.

"Levin is hitting a brick wall," said Heather Lowe, director of government affairs for Global Financial Integrity, an anticorruption research group. "It's frustrating. Delaware is playing a significant role in the committee. Senator Carper is well liked and well respected and he's not moving on this issue."

The secretaries of state, along with Delaware, argue that the Levin measure would be costly and burdensome, and would discourage business incorporation and capital formation. They add that their offices are generally ill-equipped to process the additional data that would be required. Even more, determining beneficial ownership may not be a simple matter.

"This would be a sea change in how things are done," said Ross Miller, Nevada's secretary of state and president-elect of the National Association of Secretaries of State. "It would add red tape and increasing processing time. And if you had a money launderer and asked for his name, he probably wouldn't be truthful."

Mr. Geisenberger, the chief deputy secretary of state of Delaware, said of the Levin measure: "This would be a massive inhibitor to starting a business. It would end up taking weeks or months to get a business started. And I think a lot of them would move underground and into the black market and just not form a legal entity."

COMPANIES that are incorporated in Delaware need someone on the ground here — an agent or go-between to act on their behalf. That is where the CT Corporation comes in.

CT, a subsidiary of the Dutch information services company Wolters Kluwer, is the largest registered agent in Delaware and, it turns out, the registered agent for 1209 North Orange Street. CT is authorized to transact business at that address, and its main duty is to accept legal notices on behalf of the businesses incorporated here and to pass them along.

CT represents nearly a third of all companies registered in Delaware and 60 percent of Fortune 500 companies. It says that before accepting clients, it screens them against the government's "Specially Designated Nationals," a list of people barred from doing business in the United States.

Mainly, however, CT says it acts as a middleman. "We check names and addresses against various federal agency lists," says Timothy Hall, a spokesman for the company, which has no position on the Levin measure. "We will comply with whatever law is passed," he added.

(The New York Times Company has seven corporate subsidiaries registered at 2711 Centerville Road in Wilmington. The registered agent for that address is the Corporation Service Company, which is the second-largest agent in the state.)

For corporate tax planners, Delaware is a dream. The state helps companies legitimately reduce their United States taxes and, sometimes, obscure profits in other countries.

"Companies are able to turn taxable income into tax-exempt income in Delaware and then use it to reduce their tax bills in other states," said Bradley P. Lindsey, an accounting professor at North Carolina State University and one of three authors of a 2011 study titled "Exploring the Role Delaware Plays as a Domestic Tax Haven." Delaware does not tax certain profit-making intangible items — like trademarks, royalties, leases and copyrights. Yet those same intangibles can be part of a tax strategy that allows them to be classified as deductions in other states, reducing a company's tax bill there.

"Delaware serves as a domestic tax haven, much like the Cayman Islands serves as an offshore foreign tax haven, and offers a similar level of tax avoidance," the report states.

American corporations find the Caymans alluring for many reasons. There, they can operate in relative secrecy, attract more foreign customers, avoid regulation and enjoy a low tax rate. In one respect, however, Delaware is even better than the Caymans. At some point, American companies have to bring back their foreign profits from the Caymans and pay federal taxes. But in Delaware, the state tax savings through the Delaware loophole are permanent.

And on the reputational front, "Delaware doesn't carry the same stigma as the Caymans or Bermuda," Mr. Lindsay said, adding, "Why not attract business to my little state and get something at the expense of the other states?"

WorldCom, the telecom giant that collapsed into bankruptcy after an accounting scandal, could be a symbol for the Delaware loophole. Bankruptcy court filings showed that the company had cut $20 billion from state taxes thanks to an intangible asset it called "management foresight."

Delaware subsidiaries are especially popular with global energy and mining companies like Exxon, Chevron and Rio Tinto. Among the top 10, some 915 subsidiaries have been set up in Delaware, compared with 51 in Switzerland and 49 in the Caymans, according to a report last September by the Norway chapter of Publish What You Pay, a London-based group that studies natural resources. The study said that this allows these resource extraction companies to put up a "wall of silence" about their far-flung operations and profits, especially from poor countries that may want a greater slice of the revenue. Exxon, Chevron and Rio Tinto declined to comment.

STATES like Pennsylvania are increasingly fed up. More than 400 corporate subsidiaries linked to Marcellus Shale gas exploration have been registered in Delaware, most within the last four years, according to the Pennsylvania Budget and Policy Center, a nonprofit group based in Harrisburg that studies the state's tax policy.

In 2004, the center estimated that the Delaware loophole had cost the state $400 million annually in lost revenue — and that was before the energy boom.

More than two-thirds of the companies in the Marcellus Shale Coalition, an industry alliance based in Pittsburgh, are registered to a single address: 1209 North Orange Street, according to the center.

“So many of these Marcellus Shale companies have figured out that it is fairly easy to siphon profits from Pennsylvania, so that they don’t pay taxes here,” said Michael Wood, research director at the Harrisburg center.

The center is urging Pennsylvania to try to close the Delaware loophole. But it is running into opposition from Pennsylvania companies that want to retain the break. And, in Delaware, state officials say that their approach to business is good for America.

“We have a system that is the greatest creator of wealth in the history of the world,” said Mr. Geisenberger, the Delaware official. “We will not support any changes that change the friendliness of American business and close our doors to capital formation and the ease of doing business.”

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