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US tax havens: The new Switzerland

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The US is a magnet for offshore wealth, notably South Dakota, which has guaranteed secrecy for family trusts



In an old discount store hugging a corner in downtown Sioux Falls, South Dakota, the heirs to the William Wrigley chewing gum fortune have an office for their family trust. So do the Carlson family, owners of the Radisson hotel chain, and the family of John Nash, the late hedge fund giant.

They are among the 40 trust companies sharing an address at 201 South Phillips Avenue, a modest, two-storey white-brick building. Inside, \$80bn worth of trust assets are administered.

South Dakota is best known for its vast stretches of flat land and the Mount Rushmore monument, where the heads of four presidents are carved into the Black Hill Mountains. Its population of 858,469 ranks 46th in the country. Locals joke that it has more pheasants — about 1.5m — than people.

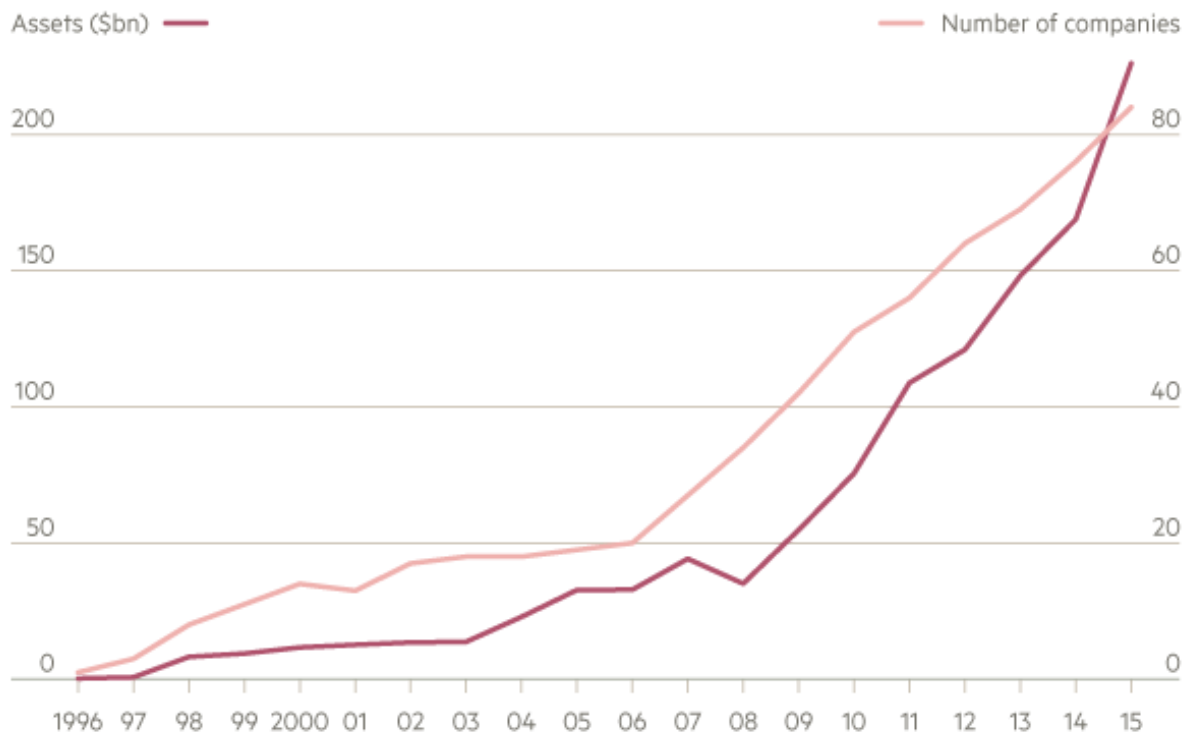
Yet despite its small town feel, Sioux Falls has become a magnet for the ultra-wealthy who set up trusts to protect their fortunes from taxes and future ex-spouses. Assets held in South Dakotan trusts have grown from \$32.8bn in 2006 to more than \$226bn in 2014, according to the state's division of banking. The number of trust companies has jumped from 20 in 2006 to 86 this year.

The state's role as a prairie tax haven has gained unwanted attention since the release of the Panama Papers, an investigation by the International Consortium of Investigative Journalists. The leak of more than 11m documents from a Panamanian law firm — some of which will be put on to a public database today — has drawn attention to the anonymity that is available in the US.

After years of threatening Swiss and other foreign banks that helped Americans hide their money, the US stands accused of providing similar services for the rest of the world. "America is the new Switzerland," says David Wilson, partner of Schellenberg Wittmer, a Swiss law firm. "In the industry we have known this for several years."

The US has a long history of attracting funds from undisclosed foreign sources. In 2011, The Florida Bankers Association told Congress there were hundreds of billions of foreign deposits in US banks because "for more than 90 years the US government has encouraged foreigners to put their money in US banks by exempting these deposits from taxes and reporting".

South Dakota trust companies



Source: South Dakota Department of Labour Regulation

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The Boston Consulting Group estimates that there is \$800bn of offshore wealth in the US, nearly half of which comes from Latin America. That puts it well behind Switzerland's \$2.7tn, but it is expected to grow at nearly 6 per cent a year — faster than any rival except Hong Kong and Singapore.

Bruce Zagaris, a Washington-based lawyer at Berliner, Corcoran & Rowe, says the US offshore industry is even bigger than people realise. "I think the US is already the world's largest offshore centre. It has done a real good job disabling competition from Swiss banks."

The growth has been fuelled by international disclosure rules introduced in 2014 to crack down on tax havens — and adopted almost everywhere except the US, which had introduced its own regulations. But these rules have gaps that preserved the advantages of trusts such as the ones on offer in South Dakota. Rules proposed by the White House last week to force companies to disclose more information about their owners are unlikely to erode those advantages.



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A WASHINGTON-BASED LAWYER AT
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Trusts are able to avoid scrutiny under both US and international rules as long as the owner appoints a local trustee and a foreign “protector” to direct the trustees. South Dakotan companies actively promote the secrecy offered by opening a trust in the state.

“Many of the offshore jurisdictions are becoming less appealing for international families looking for secrecy”, says the website of the South Dakota Trust Company, one of the most prominent. “Consequently, the stability of the US combined with its modern trust laws . . . may be more appealing to many international families than an offshore trust based in a less powerful country.”

Trust leader

Even before the flurry of international interest, South Dakota’s trust industry was booming. With no personal or corporate income tax, no limit on “dynasty trusts” and strong asset protection laws — shielding assets from soon-to-be ex-spouses — South Dakota has leapt to the top of annual rankings for the trust industry. Nevada, Delaware and Alaska also compete for accounts.

South Dakota’s inviting legal environment can be traced to the ground floor of the old discount store on Phillips Avenue. Upstairs is the corner office of Pierce McDowell III, the man largely responsible for the state’s renaissance.

Mr McDowell is 58 with a mop of curly hair and a knack for storytelling. (His grandfather, Pierce, whom the family refers to as “P1”, was working at a small South Dakota bank when it was stuck up by John Dillinger’s gang during their crime spree in the 1930s.) He cycles to his office on a fat-tired bike, even in the snow, when he isn’t flying to New York or California to see clients and advisers.



The SDTC president stresses the importance of relationships to his business's success and says the families he serves want to protect future generations — not avoid paying taxes.

Mr McDowell has been an evangelist for South Dakota for almost 25 years. In 1993 he wrote an article for Trusts and Estates magazine. In South Dakota, he said, families could employ “the same strategy used by the Rockefellers and the Vanderbilts for generations to avoid estate tax”.

The article caught the eye of Al King, then director of Citibank's trust division in New York, and he recruited Mr McDowell to run the bank's South Dakota office. The combination of Mr King's legal contacts and Mr McDowell's local knowledge catapulted the business. In 2002 the pair struck out on their own, forming SDTC with Mr McDowell in Sioux Falls and Mr King in New York.

The firm does not manage money. They help private trusts meet state requirements, such as having someone in the state serve as a director, establishing office space and carrying out administrative work within state lines. Trust companies are required to have two board meetings a year in the state. Annual fees start at \$35,000 “on the low end” and go up.

Aspects of the trust industry attracted criticism. States like New York complained about the loss of billions of dollars in business to trust-friendly states as well as the leakage of income tax, which it estimated at \$150m in 2013.

Lawrence Waggoner, a law professor at the University of Michigan, condemns the dynasty trusts pioneered by states like South Dakota as a “folly”. He argues that over time they would be riven by disputes and very difficult to manage. After a few hundred years there would be tens of thousands of beneficiaries. Arranging a meeting would be impossible: even the Rose Bowl football stadium in California would not be large enough to hold them all.

Some analysts question whether the state receives enough from the benefits it provides. In the 2015

fiscal year, South Dakota collected \$1.79m from trust companies. The legislature passed a \$4.3bn state budget last year.



Bernie Hunhoff, a Democratic state senator, has proposed imposing a corporate income tax. “We’ve had a lot of trust legislation and a lot of money is moving into South Dakota and they’re benefiting from our tax law,” he says. “That’s one reason I thought we needed a corporate income tax.”

Taking advantage

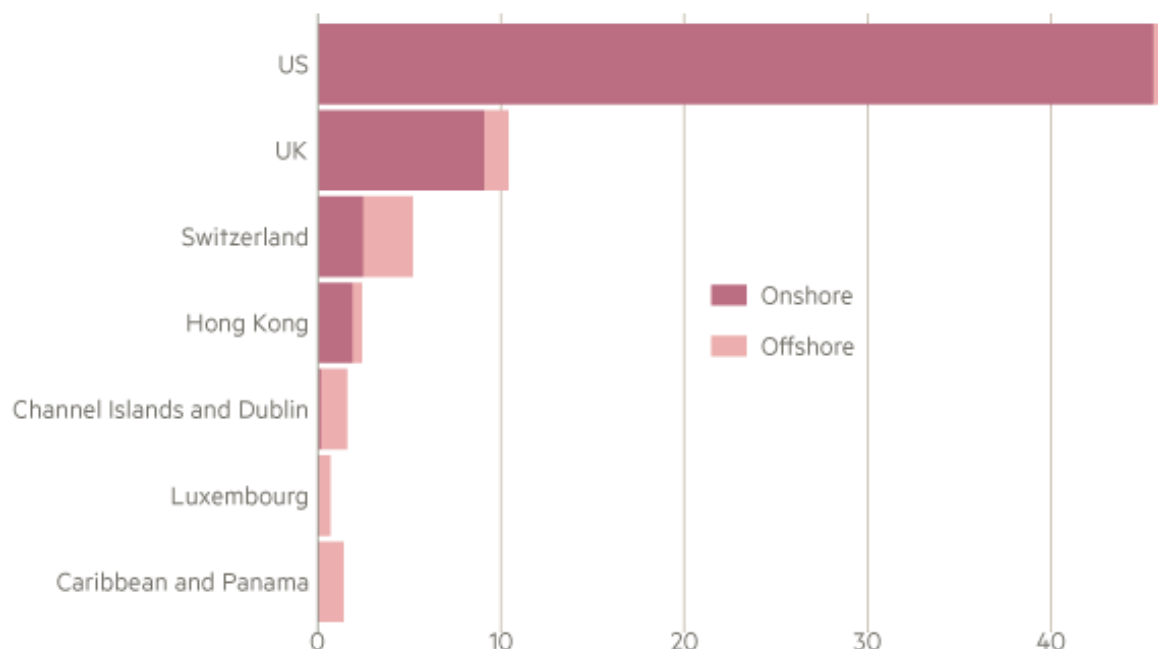
Andy Holmes relocated from Kansas City last year to help his firm, the Great Plains Trust Company, increase its presence in South Dakota after clients, including celebrities and famous athletes, asked about the state’s benefits.

Great Plains worked with SDTC to learn the ropes, but last year leased a windowless office in a brick and glass building for its two employees. Down the hall is Maroon Trust, which manages the money of Chicago’s Pritzker family. Elsewhere on the floor is a roofing company. They share a receptionist.

Mr Holmes estimates that 90 per cent of the registered trusts in the state “are what I call shell companies where you basically have a PO box or an office and somebody will come here twice a year to have board meetings and meet regulatory requirements. But there’s nobody here with feet on the ground to serve Sioux Falls. We’re trying to take advantage of that.”

Total wealth booked in financial centers

2014 (\$tn)



Source: Boston Consulting Group

FT

For now, the biggest challenge for the industry, Mr McDowell says, is criticism of the secrecy it can offer. “So much that has been written about this stuff appears to be so sinister,” he says. “All of these tax laws are there for a reason. It’s not about tax dodging, it’s planning.”

Bret Afdahl, director of the state’s banking division, says the requirements to qualify for a trust have increased, such as having more of a physical presence. Applicants are often turned away. “We’re the chartering authority so if we approve it and something goes wrong we own it,” he says. “From a reputational standpoint no one benefits from having something bad happen.”

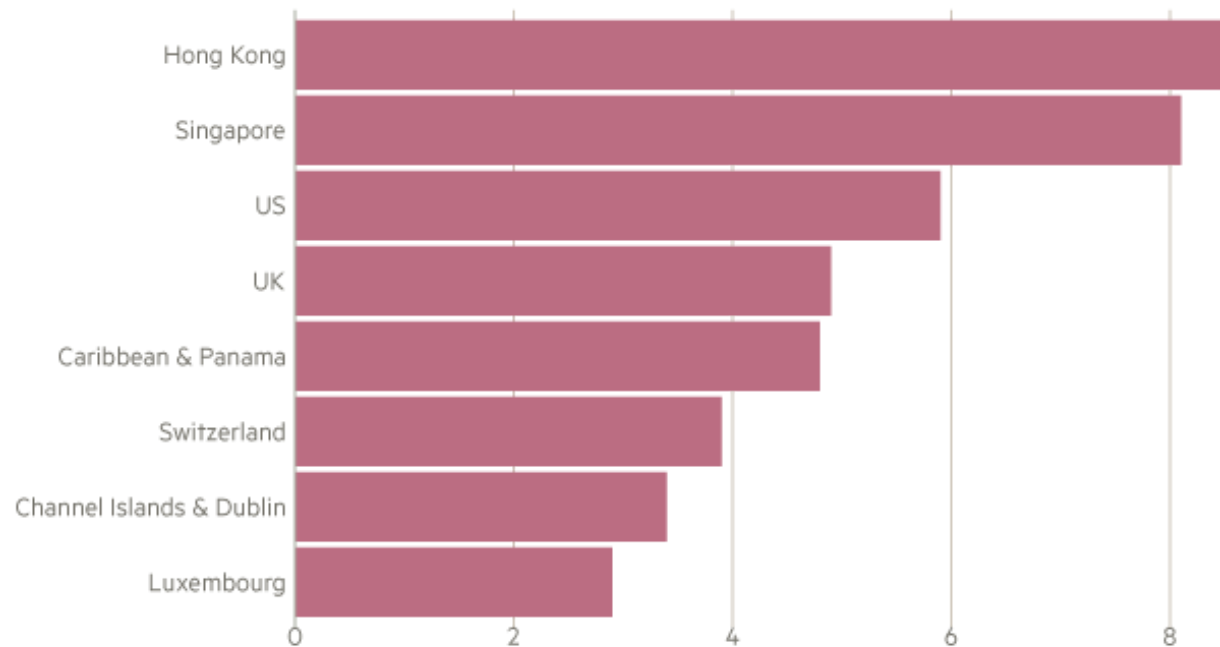
There are legitimate reasons to seek secrecy, according to Roderick Balfour, founder of Virtus, a Guernsey-based trust company that opened in South Dakota in 2009. He says people have a right to privacy, especially if corruption in their home countries means their data would not be secure. Concerns are overblown, he says: “America is never going to be a Panama.”

France and other countries have introduced tough disclosure rules on trusts. In many others there are suspicions that trusts are illegally used to evade tax. Gabriel Zucman, a French economist, estimates that governments lose at least \$200bn a year in evaded taxes from the \$7.6tn of the world’s financial wealth that is held offshore.

The respite from new reporting rules gained by moving to the US could prove temporary. On Thursday the White House called on Congress to act on “long overdue” proposals to ensure the US is in line with international standards. This Thursday, David Cameron, the British prime minister, is hosting a summit where world leaders will be asked to sign a global declaration promising to expose corruption.

Projected growth in offshore wealth

Annual % change*



*Average annual growth over five years from 2014

Source: Boston Consulting Group

FT

There might be big risks in using the US to hide money for illegitimate reasons. Mr Wilson likens it to “sitting in the dragon’s mouth”. One law firm that used to promote the benefits of “hiding in plain sight” says its clients are now convinced the US will adopt international standards and do not wish to be “tarnished by association”.

The appeal of moving structures to the US is that it buys time, says Peter Cotorceanu, counsel for Anaford, a Zurich law firm. Any change in US law would depend on the Republicans losing control of the House, he says. He predicts that hundreds of billions of dollars will move to the US. “Most of the money will move this year”, he says, noting that individuals in Switzerland, Hong Kong and Singapore have until the end of the year to “yank their money out”.

In South Dakota, there is a mixed reaction to the trust industry’s appeal to foreigners. “In a world where it’s very hard to hide ownership or hide assets sometimes the easiest place [is one] no one would normally think of, which is the US,” says Christopher Holtby, co-founder of the Wealth Advisors Trust Company, in Pierre, the state capital.

Since establishing an office in South Dakota in 2009, he has seen signs of change. In 2014 Trident, a Swiss trust company, opened an office in Sioux Falls, he notes. “Why is an international firm setting up in South Dakota?,” says Mr Holtby. “I don’t like that international lawyers want to come to South Dakota. Generally international lawyers never bring anything that’s simple.

“And we like simple.”

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