With help from a whistleblower, Lucy Komisar follows the money trail through the offshore operations of the world's biggest bank.

Confessions of a banker

You may have read how, in 2001, Argentina defaulted on its national bonds and its economy went into meltdown. What you might not have heard is that – according to some Argentine financial critics – their government's inability to pay its debts resulted from massive evasion of taxes. Tax cheating and corruption meant that the flight of capital to secret offshore havens over the previous decade had amounted to billions of dollars. By 2002, the Investigative Commission on Capital Flight set up by Argentina's House of Deputies estimated that the amount of Argentine assets held abroad had reached $127 billion – a figure that approached the country's total recorded foreign debt. Some represented legitimate investments, but billions were illicit capital flows.

That year, TV journalist Maximiliano Montenegro caught a Citibank official in Argentina's capital, Buenos Aires, offering to help a 'businessman' cheat on taxes. Montenegro had sent in an actor to see what would happen if he told a Citibanker that he was an entrepreneur whose wife had just sold a company and didn't want to report all the profits. The Citibanker, Mr Mariano, was captured on video enthusiastically talking about how he could help the couple evade taxes: 'Eighty-five per cent of clients of the Private Bank have an offshore portfolio. Why? Because they are fed up with paying [taxes].' The banker described how he would send the money via a wire in a false name to a transit account at Citibank New York and move it from there into an International Personal Banking account. As a non-resident, the client wouldn't need to pay taxes on foreign soil. And back in Argentina, authorities would neither know about this account nor the money safely hidden within it.

Not long after the video was aired, Citibank fired Mr Mariano and – alleges the journalist Montenegro – gave him a lot of money to keep quiet. The corporation also decided to transfer its Argentine private banking customers to Chile and Uruguay.

Cooking the books

Citigroup is the largest financial services conglomerate in the world. It operates in 100 countries. It has $1 trillion in assets. In 2005 it had $120 billion in revenues and reported nearly $25 billion in net income.

Some of its revenues derive from questionable sources. For instance, last year Citigroup agreed to pay $2 billion to investor victims of the Enron collapse. The plaintiffs, led by the University of California, accused the company of helping the energy company cook the books. Citigroup had in 1993 set up a Grand Cayman shell company that pretended to buy future deliveries of gas from Enron. In practice, this allowed Citigroup to make loans totalling $4.8 billion to Enron through the shell company: indebtedness that Enron could keep off its books in order to keep stock analysts off its back.

Citigroup is also being sued by the trustees of Parmalat, the Italian food company that went bankrupt after massive accounting fraud. One of its banks set up a Grand Cayman shell company aptly named 'Buconero' (black hole) to help Parmalat executives fake their balance sheets and hide their true financial situation.

The common denominator in these accounting frauds was Citigroup's use of the offshore system of tax havens, whose chief financial product is bank and corporate secrecy. These offshore centres protect their clients from the curiosity of their countries' law enforcers and tax collectors. They even provide sham 'directors' for the shell companies that are set up to 'own' secret accounts. There are more than 70 offshore centres that hold the money of other countries' citizens. Citigroup has subsidiaries in 17 of them.

Tax havens are used widely by business, industry and very rich individuals. This article focuses solely on Citibank and its operations in Spain. This is because I've been given exclusive access to inside information about Citibank Spain. It hasn't been published before. Indeed, were it not for a disgruntled Citibank executive who sent me a stack of insider documents after he resigned, the story would still be a secret.

Bullish bravado

Citigroup, like many banks, offer a range of offshore accounts to their customers. CitiGold International Personal Banking (IPB) allows the moderately rich in Spain to hold hundreds of thousands of dollars in its banks outside Spain. While CitiGold IPB is used for legitimate purposes, the Argentine 'entrepreneur' described above used it illegitimately to evade taxes.

The very rich, with at least $1 million, but more like $5 million, are invited to open accounts in Citibank Spain's Private Bank, which moves clients' money offshore to other Citibank Private Banks or investments.

In this age of computers, the 'movement' of money offshore is often just an illusion. An account officer with a computer in Madrid, or London, or New York can manage clients' money in a place ostensibly 'offshore'. The cash doesn't really exist there; it's all a matter of allocating it to a virtual 'place' in the bank's computerized accounts. This is the nature of modern banking. But it makes it possible for the bank at home to avoid keeping account records so that there is nothing in writing that can be used by law enforcers to implicate tax cheaters. It also offers banks at home a way of not reporting as income all the commissions they make from offshore accounts – and therefore paying no tax on these amounts. Is that how Citibank Spain's Private Bank is operating? Because if it is, then it's illegal.

It's difficult to establish the truth. There is no assessable paper trail. But information contained in documents sent to me by a whistleblower means that it's time to ask some questions... and closely investigate the responses.

That information comes from memos written in 2001 by José-Miguel Alfayate, reputed then to be Citibank Spain Private Bank's most successful account salesperson and manager. According to an official in the bank's human resources department, the bank reneged on severance payments that it had previously agreed to pay to Alfayate around the time that he was about to leave. The official said that Alfayate became angry. So he wrote several memos that ostensibly provided departing advice to his colleagues, but which also subtly laid out how Citibank may be violating the law. These memos apparently encouraged the bank to pay Alfayate his previously negotiated entitlements.

Unpaid taxes could be as much as $255 billion a year – much more than the estimated $195 billion needed to halve world poverty in a decade

One memo – addressed to Javier Herreros de Tejada, one of the managers of the Private Bank – describes how his aim was to establish a strategy 'with respect to the offshore business booked in Jersey and Geneva, but obtained and overseen for many years by bankers located in Spain.' In other words, the business that Alfayate is discussing was officially located offshore, but had a continuing relationship to bankers in Spain.

The Alfayate memo says: 'For a long time, the growth of offshore business has depended to an extraordinarily high degree on bankers located in Spain.' He says that he understands and agrees with the idea that the bank should 'take extreme measures to guarantee the total opacity [meaning lack of transparency] of said business from the point of view of the client as much as the bank.'

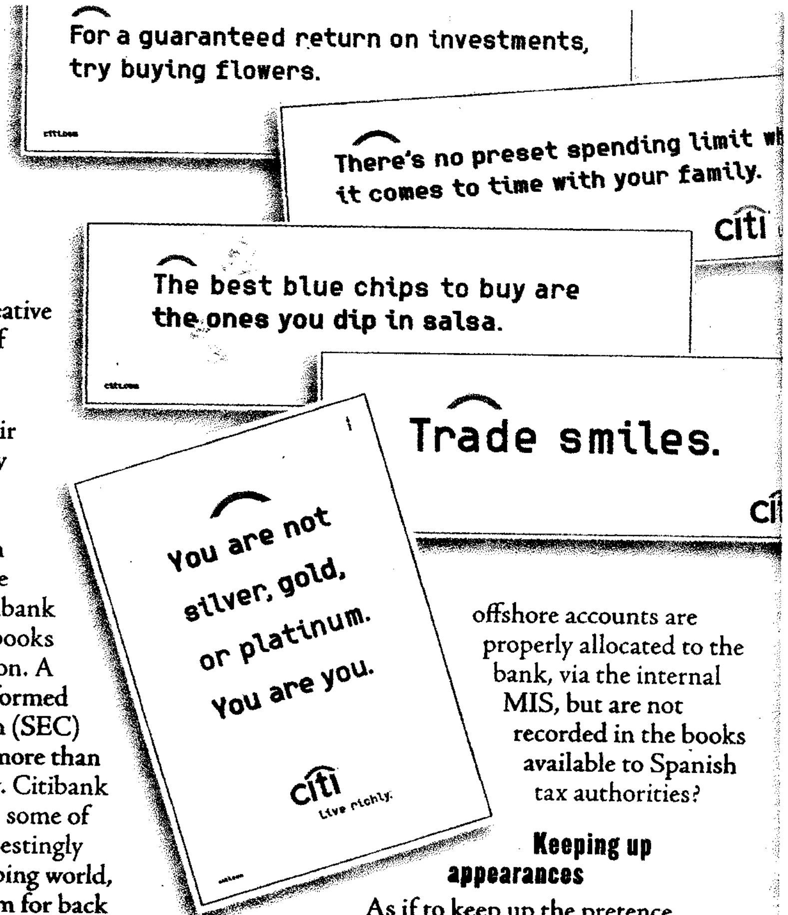
He writes with enthusiasm that offshore accounts in the past, present and future would be more profitable than onshore accounts as they reported twice the profits. Outlining the reasons why, he explains that customers can buy bank products in tax havens that for tax reasons could not be offered onshore. These descriptions seem

Citigroup's 2003 *Live Richly* advertising campaign produced these posters, which adorned buildings, bridges and subway stations in six US cities.

to be a reference to the main by-product of all tax havens: the ability for customers to avoid paying taxes. As for the profits that Alfayate refers to, he recommends that 'due to the importance of the high profit of these accounts, I consider that ... 50 per cent of the profits of these accounts should be included [for Spain] via MIS.'

MIS stands for Management Information System. It's the bank's internal accounting system. Citibank used its MIS in a rather creative way 30 years ago when its offices in dozens of countries (both in Europe and in developing countries such as the Philippines, India and Mexico) cheated on the tax liability from their currency trading. Profits made from currency trading by the Citibank offices in higher-tax countries – including the UK, France and Germany – were recorded as if they had been 'booked,' or ordered, by employees in offshore Nassau, the Bahamas. But there were no Citibank currency traders in Nassau. A second set of books – Citibank's MIS – recorded the true situation. A whistleblower stationed in Citibank Paris informed the US Securities and Exchange Commission (SEC) of the scam, which the SEC investigated for more than a year. There was also a congressional inquiry. Citibank had to pay millions of dollars in back taxes to some of the European countries it had cheated. (Interestingly the SEC didn't document cases in the developing world, so these countries were unable to make a claim for back taxes.) The scandal made headlines around the world.

Alfayate's memos beg the question – has Citibank Spain been pulling the same trick again? Is it possible that profits earned by the Spanish bank from the offshore accounts are properly allocated to the bank, via the internal MIS, but are not recorded in the books available to Spanish tax authorities?

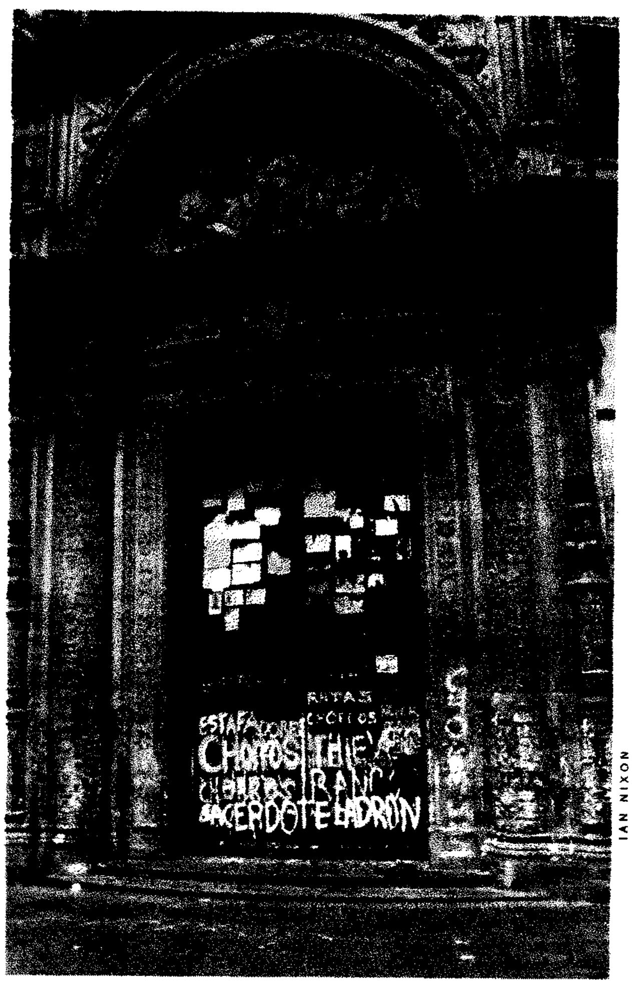


Keeping up appearances

As if to keep up the pretence that this 'offshore' money has no important connection to 'onshore', Alfayate's memo says that he wants to avoid communication by existing clients with the Private Bank in Spain. He recommends assigning accounts in such a way that clients communicate with Citibank in Switzerland or Jersey: only offshore interlocutors should receive clients' communications. He notes that some of his accounts had a 'fantastic relationship' with their banker in Switzerland. With some satisfaction he points out that it was 'impossible to detect any kind of anomaly in opacity.'

But even though Alfayate favours cutting offshore clients' communications with Spanish bankers, he makes it clear that internally it should be recognized that it's Spanish bankers like him who generated the profit: 'With respect to the acknowledgment of revenue, of course it is necessary to maintain it at 100 per cent since they are accounts that are sought out, secured and overseen for many years by the banker in question. To break this concept would lead to causing grave damage to the bankers since the present situation is nothing more than the shining achievement of [their] work following the norms and strategies established by the bank many years ago.'

Knowing the background to Alfayate's situation and these memos, I wanted to know if Citigroup had a logical explanation for all this. Their responses were limited. I sent the documents that I received to top Citigroup officials and asked for their comments, but they declined to speak. At the invitation of Citibank public relations officers, I had a preliminary conversation in New York with a lawyer representing



IAN NIXON

When Argentina's economy haemorrhaged in 2001, its people took to the streets in protest to express their disgust for the Government, the capitalists and the banks that had supported them. Here, graffiti on the closed doors of the Bank of Boston in Buenos Aires hides the people still working inside.

Citibank Spain but – at Citibank's request – that discussion was 'off the record' and so it cannot be quoted. However the lawyer provided me with no answers to the questions raised in this article.

Alfayate also refused to speak with me, directing me instead to the corporation's public affairs department. Citigroup's public affairs officer in Madrid is Gabriela Sebastián de Erice. She said that I should feel free to send questions in writing. But when I did, she said that agreeing to receive the questions didn't mean that she would answer them. After declining an opportunity to register objections or make corrections to specific items in the text, she instead sent a declaration: 'We operate a wide range of businesses in 100 countries, and in each of our businesses we have strict policies and procedures in place to prevent any unlawful or inappropriate activities. Our customers come to us for the quality of our products, service and advice, our global presence and commitment to our customers and communities. Suggestions that our businesses are based on inappropriate activities are wrong and irresponsible.'

Are such suggestions and questions wrong and irresponsible? The only way really to judge is to examine the books of Citibank Spain and its internal MIS and see if it is properly reporting profits that Alfayate suggests are being made from work done by bankers in Spain. I don't have access to those books. Spanish authorities do. They should examine the books and report.

YURIKO NAKAO / REUTERS

Citigroup Chief Executive Officer Charles Prince (right) gives a deep bow at a news conference in Tokyo in October, 2004 after manipulativ sales and lending practices and lax controls against money-launderin were uncovered in Citigroup's private banking operations in Japan.

Balancing the books

Companies pay taxes in the countries where their subsidiaries make profits. However individuals must pay taxes where they are resident no matter where income is earned. And the facilitation by banks of offshore accounts for their clients has led to massive tax evasion by the rich. In the late 1990s European Union (EU) law and policy makers started talking about an accord to end tax evasion by citizens who are not reporting income from accounts they hold in other countries. This accord would include the accounts that Citibank Spain set up for its clients in Jersey, Luxembourg and other offshore centres.

The first proposal was to implement a withholding tax on interest paid to European citizens holding bank accounts in participating countries. Opposition came from Britain. The second alternative – eventually adopted – allows participating countries to choose either to institute the withholding tax and send 75 per cent to depositors' home countries, or to exchange information with other countries about interest payments made to their citizens. The accord extends to five non-EU European countries and ten Channel Islands and Caribbean tax havens. Most pay a withholding tax; a few share information. The US committed to exchanging information on request, but not to automatic exchange of information or a withholding tax. Canada was not invited to be part of the process.

The EU Savings Directive came into effect in July 2005 and EU countries this year began receiving information about their citizens' accounts abroad.

Switzerland, for example, reported that Spanish residents have at a minimum $432.6 million in Swiss bank accounts alone. They also have deposits of $5.2 billion in fiduciary accounts: money invested in the name of Swiss banks (including the Swiss subsidiaries of Citibank) on behalf of Spanish clients. [This is just part of the picture. Although Spanish residents are required to report their accounts abroad, the very rich still hide their money in shell companies that are registered offshore so as to cover up the account owners' citizenship and identities.]

Citibank Switzerland, of course, would not be the only haven for unreported Spanish wealth. The story is no doubt repeated worldwide. Figures provided by the Tax Justice Network show that the result is a potentially mind-boggling shortfall in taxes hidden from public view. International banking and investment statistics show that the ultra-rich have $11.5 trillion in assets offshore. The income from these assets alone would earn $860 billion. If none of this was declared, the unpaid tax could be as much as $255 billion a year – much more than the estimated $195 billion needed to halve world poverty in a decade. In these terms, tax justice is not just some concept that may make entertaining dinner conversation amongst progressive accountants. If properly targeted, it has the very real potential of starting to redress the massive imbalance between rich and poor around the world.

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