

## Is the Use of Nominees in Any Form Illegal? Ariawan Gunadi<sup>1</sup> Indah Siti Aprilia<sup>1\*</sup> Suwinto Johan<sup>1</sup> Lou Yuan Yuan<sup>2</sup> Moody Rizqy Syailendra<sup>1</sup>

<sup>1</sup>Faculty of Law, Universitas Tarumanagara, West Jakarta - 11440, Indonesia

<sup>2</sup>China-ASEAN Legal Research Center, Southwest University of Political Science and Law, Yubei, Chongqing, People's Republic of China

\*Corresponding author. Email: [indahsitiaprilia@gmail.com](mailto:indahsitiaprilia@gmail.com)

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### ABSTRACT

*The use of nominees in investment has occurred in daily business activities. The nominee is deemed to have violated the existing regulations. Several incidents of the use of nominees have taken the world by storm. The use of nominees has involved several world leaders. The purpose of this study is to ascertain the history of the use of nominees in investment and to determine whether the use of nominees can be classified as money laundering or tax evasion. This study employs a normative juridical methodology. This study concludes that the use of nominees is motivated by money laundering and tax evasion. A nominee may be a trustee or a special purpose vehicle. However, using nominees may result in criminal sanctions if the funds are obtained through criminal acts. Investors and the names used can be considered perpetrators of criminal law violations. The resolution of nominee and money laundering problems must accompany the standardization of population data and tax data. Banning the use of nominees does not solve the problem.*

**Keywords:** Investment, Money Laundering, Nominee

### 1. PREFACE

The Panama Papers scandal rocked the world in 2016. The Panama papers are a collection of 11.5 million classified documents that are the property of a Panama-based law firm called Mossack Fonseca [1]. This document contains data on shell companies and their owners located in tax haven jurisdictions. Shell companies are owned by elites from a variety of countries [2].

The Pandora Papers shocked the world once more in 2021. The Pandora Papers contains 2.95 terabytes of information on the businesses of 200 of the world's elites. The information is available on the International Journalists of Investigative Consortium's official website (IJIC). The Pandora Papers contain the names of several world leaders, including Pakistani Prime Minister Imran Khan; Czech Prime Minister Andrej Babus; and Russian President Vladimir Putin [3]. IJIC compiles data on tax haven jurisdictions, including the British Virgin Islands, Seychelles, Hong Kong, Panama, and South Dakota [4].

This study discusses the use of nominees in investment. Research is unique in discussing the nominees. The discussion of this research focuses on the source of funds, not only on the nominee structure. Research contributes in a different way from the others. Research with a focus on funding sources is still rare. The source of investment is funds. The fund that created the idea of using nominees.

The source of funds is the source of the nominee structure in business investment. Business investment is the takeover of shares by investors. Funds are a source of violation of state law. This fund must be regulated, not the nominee structure that is regulated. Funding should be the key to problem solving, not the nominee structure.

Following that, governments in a number of countries implemented new policies aimed at combating money laundering and increasing the transparency of controlling shareholders [5]. Between the controlling shareholder and the party whose name is used as the shareholder is a nominee agreement [6] [7]. In a nominee agreement, the controlling owner or controlling shareholder does not have complete ownership rights. Owners of control may reap financial rewards [8]. Nominee agreements can also cause complications during the inheritance process [9]. On the other hand, Presidential Regulation Number 10 of 2021 does not prohibit the use of nominee shareholders (PP) [10]. The Presidential Regulation merely restricts the beneficiary's ability to take certain actions [11]. On the other hand, shareholders must be held accountable for criminal violations committed by corporations in accordance with the corporate veil piercing principle [12].

Foreign investors' use of nominees can result in an increase in national assets held by foreign parties [13]. Foreign investors are permitted to invest in sectors that are off-limits to them [14]. The prohibition of foreign investors from entering specific industries is intended to protect domestic businesses [15],[16]. National businesses have been unable to compete with the multinational corporation [17].

A private equity firm or equity holding is another type of nominee agreement [18]. Private equity or equity holding has not been extensively regulated in China [19]. Private equity or equity holding is a new form of investment [20].

The corporate world also recognizes nominee directors in addition to nominee shareholders [21]. Numerous legal issues confront the nominee directors. Before being appointed, nominee directors must be aware of their responsibilities and obligations. [22]. The nominee director has a corporate governance issue. If the shareholders are involved in managing the company, then the company owners have a potential conflict of interest [23].

The purpose of this research is to examine the history of investors' use of nominees in investment. Using nominees entails numerous risks. There have been few discussions about the use of nominees, particularly when it comes to money laundering and tax evasion.

The research questions are as follows: What is the rationale for investing through nominees? Why is the use of nominees classified as a money laundering and tax evasion criminal act?

### 3. RESEARCH METHODS

The research methodology used is either normative legal or literature research, depending on the research questions. This research analyzes primary and secondary sources of information [24]. Legal research on legal literature or normative law encompasses examination of contemporary legal philosophies and standards. The statutory method is used in this study. Additionally, the systematics of prevailing rules and policies are investigated [25].

The terms "critical legal resources," "supplementary legal resources," secondary and tertiary resources, and other supplementary resources refer to research materials that employ a normative legal methodology. Supplemental legal resources include book reviews, methodical law journals, seminar/proceedings conclusions, and other methodical articles. These supplementary resources include online news coverage and freely accessible additional resources [26], [27]

## 4. RESULTS AND DISCUSSIONS

### Nominee Practice

Nominees are used by investors for a variety of reasons. If regulations permit, investors will use their own names directly. The decision to use nominees has a number of unintended consequences.

Investors, on the other hand, are compelled to use nominees because laws and regulations prohibit them from investing directly. Furthermore, the source of investor funding is unknown.

Regulators, particularly the Financial Services Authority (FSA), have requested an explanation of the funding source and tax returns demonstrating that the funding source is properly reported. Regulators keep an eye on this in order to prevent money laundering and tax evasion. The regulator will request that the investment include the ultimate shareholders or shareholders with individual names.

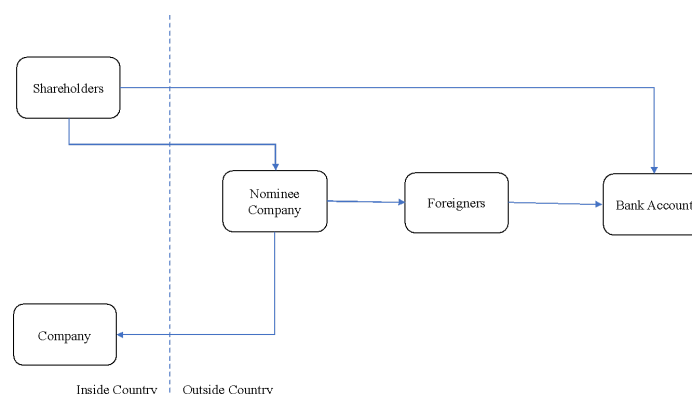
Numerous funds are derived from money laundering in various countries. Money laundering is inextricably linked to tax evasion. Money laundering funds are funds originating from business activities that are prohibited by the government. Business activities that are prohibited by the government such as trading on the black market or trading in goods are prohibited by the government. Apart from business activities, funds resulting from corruption are also classified as money laundering.

Revenues originating from business activity without paying taxes can also be used for investment, in addition to funds arising from illicit business activities and funds resulting from corruption. Using the nominee, these monies are invested in the firm. For example, a company's sales are not disclosed to the regulators. The selling earnings are placed in international banks. The assets are re-invested in the name of someone else.

Another scheme is that the company owner uses a nominee company. The owner of the company places the company's nominees abroad. Nominee sales companies do not need to report to the regulator. So the company's sales are not subject to tax. This is explained in Figure 1.

**Figure 1**

*Nominee as Shareholder*



Additionally, several countries' regulators impose limits on foreign investment. Foreign parties invest through nominees. Although the nominee is the party permitted to invest, the foreign party is the controller. Because certain sectors of a country are not open to foreign investors, foreign investors must register as investors in the nominee's name.

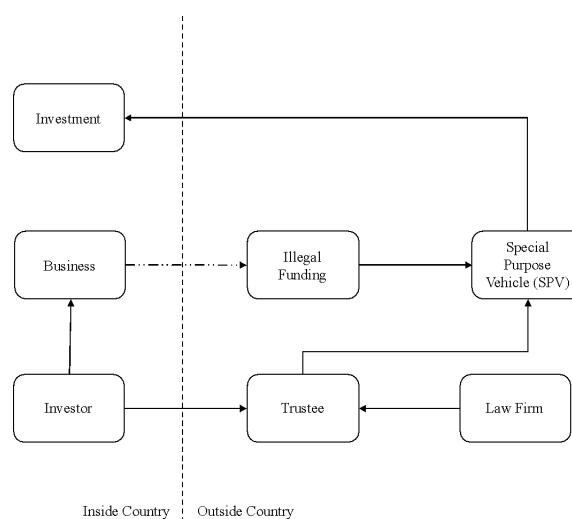
Additionally, certain investors are prohibited from investing in certain sectors. Regulators have prohibited or blocked specific investors' names from being listed. As a result, these investors require nominee names in order to invest. Indonesia once published a list of dishonorable individuals who were barred from investing in the financial sector in the aftermath of the Asian economic crisis of 1998. These investors were prohibited from investing in the financial industry for a specified period of time. Investors require a variety of factors that can result in nominee names. However, the primary reason is the regulator's prohibition on investor investments. Investors continue to seek specific industries to invest in, and as a result, they are looking for nominees to assist them in making investments.

### Nominee Use Scheme in Trustee

Investors who obtain illicit funds may invest through the use of a trustee. This trustee forms a corporation in the form of a special purpose vehicle (SPV). A law firm owns or manages the trustee.

**Figure 2**

Nominee Scheme



**Source:** *Research Results*

This SPV is owned by the trustee using funds raised from investors. The trustee, acting as a nominee, acquires ownership of the SPV. However, the funds are raised through investors. SPV invests in sectors where investors have expressed an interest. This SPV acquires ownership of the businesses in which it invests. This SPV is not registered in the name of its true owner. Rather than investors, this SPV may invest in the country of origin.

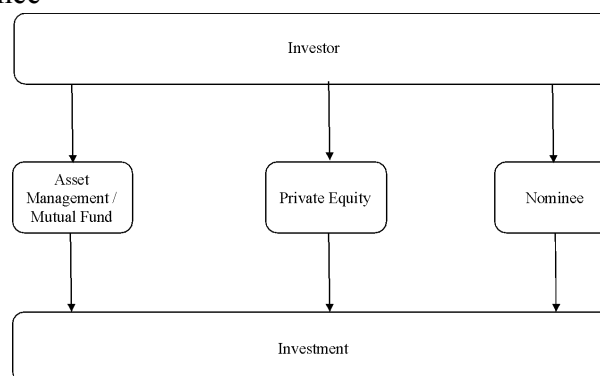
The investor's investment funds are derived from his or her business income. This business is derived from domestic activities. Due to the fact that these investment funds are located outside

of the country, the funds are not returned to the country. These funds are used exclusively for international investment. Figure 2 illustrates this scheme.

The law firm's role is to appoint a Trustee and form a SPV. Trustees are looked after by law firms. The trustee is responsible for the SPV. The trustee is the SPV's owner.

**Figure 3**

Investment Using Nominee



**Source:** Research Results

According to the 1995 Capital Markets Law No. 8, investors may invest in mutual fund companies or asset management firms. Asset management firms or mutual fund companies invest in accordance with the investor's risk tolerance. Numerous wealthy investors are also investing in private equity firms at the moment. Private equity firms invest in early-stage businesses. Asset management companies, mutual funds, and private equity firms are all examples of nominees. The open source nature of investment funds is what differentiates nominees in a special purpose vehicle from the other three types. The scheme is shown in Figure 3.

Fund owners can entrust their funds to an asset management firm or fund manager. The capital owner data is owned by this investment firm. The asset management firm or fund manager will invest in accordance with the agreed policies. In addition, investors can also entrust their funds to private equity firms. The manager of the private equity firm will determine the investment. The owner of the fund is unknown to the public or regulators. The regulator only knows the fund manager. The investment structure with a fund manager, asset management firm or private equity has the same structure as the nominee form. So, the nominee structure is not the main issue in preventing money laundering.

### **The Use of Nominees is a Criminal Act of Money Laundering if The Source of Funds Comes from Criminal Acts**

The incorporation of an entity for investment purposes is expected. However, using an entity whose ownership and funding are unknown presents a problem. Uncertain funding sources will raise concerns with regulators. Regulators will also look at unaccountable owners or shareholders. This regulation is applicable to the financial services sector. The Financial Services Authority (OJK) regulates all financial transactions, including the controlling owner of a publicly traded company

Suspicious financial transactions include investments with unknown sources of funding, as defined by the Republic of Indonesia's Law No. 8 of 2010 on the Prevention and Eradication of the Crime of Money Laundering (UU TPPU). The second point is that if the investment is made through criminal acts such as corruption, bribery, narcotics, human trafficking, illegal weapon trafficking, kidnapping, embezzlement, fraud, kidnapping, counterfeit money, or gambling, it is classified as a criminal act under the Money Laundering Law.

If the investment funds originate from one of the prohibited sources listed in the Money Laundering Law, the perpetrator or investor may be charged with a criminal act. Similarly, if the purpose is tax avoidance, the same thing will occur. Transferring funds from one country to another or to another territory in order to avoid taxes creates a new issue of tax evasion.

Regulators focus on illegal business activities. Regulators focus on funds originating from illicit business activities. The nominee is a derivative structure of the illicit fund. If there are no illicit funds, the nominees will not be an issue. Nominees have no impact as long as the funds are funds from the right business activities.

In addition to business activities, regulators need to have complete tax reporting data and citizen funds. With complete data, the source of the funds will be easily traced. If any funds transferred do not match the owner's profile, the regulator can track it down. The Know Your Customer (KYC) Banking system needs to be socialized to the public [28].

In addition, this supervision can function as a control over terrorism funds. Terrorism funds are also an issue of funds from illicit business activities. Funds originating from illicit business activities such as gambling proceeds, human trafficking and narcotics trafficking [29].

## **5. CONCLUSION AND RECOMMENDATIONS**

The use of nominees by investors is intended to conceal the true identity of the fund's owner. Investors retain legal counsel to establish nominee companies. Trustees can be established by legal advisory firms. This trustee is involved in the investment of Special Purpose Vehicles. SPV will invest in accordance with the investor's instructions. Using nominees may be considered a crime if the investment funds were obtained through criminal activity in violation of the Money Laundering Law. Regulators need to regulate regulations regarding population data and tax reporting data. With neat population data and neat tax reporting, transactions using nominees or illicit funds will be easy to track. This study has a limitation in that it does not discuss the normative qualitative approach in detail. Additional research can be conducted by interviewing business owners, regulators, and legal counsel. Additionally, additional research can be conducted to determine the nominee's economic impact on a country.

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