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The Corporate Transparency Act and the ILLICIT CASH Act

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KEY TAKEAWAYS

Congress is seriously considering imposing a beneficial ownership reporting regime that would affect all American businesses as well as charities and churches.

The Corporate Transparency Act would create a large compliance burden on 11 million businesses with 20 or fewer employees and do little to aid law enforcement.

The ILLICIT CASH Act would make constructive reforms to the anti–money laundering laws—but also contains a destructive beneficial ownership reporting regime.

Introduction

This *Backgrounder* examines: (1) the Corporate Transparency Act of 2019 (CTA), which the House has passed;[1] (2) the Improving Laundering Laws and Increasing Comprehensive Information Tracking of Criminal Activity in Shell Holdings Act (the ILLICIT CASH Act);[2] and (3) beneficial ownership reporting more generally.

In contrast to the CTA, the ILLICIT CASH Act *does* contain significant constructive reforms that would modernize anti–money laundering (AML) laws. Both bills, however, share the same central problem: They would impose a new, burdensome beneficial ownership reporting requirement on the smallest businesses in America, while exempting those most able to abuse the financial system. The Corporate Transparency Act would also burden "exempt" entities, including not-for-profit organizations.

Moreover, both reporting regimes would be easily and lawfully avoided by criminal elements with even a rudimentary knowledge of business. Better, more comprehensive information is available from tax forms already provided to government—but jurisdictional turf jealousies in Congress have made it difficult to adopt less burdensome approaches using this tax information.

The Corporate Transparency Act in the 116th Congress

A discussion draft of the latest, somewhat amended, version of the CTA was the subject of a hearing in the House Financial Services Committee on March 13, 2019.[3] Representative Caroline Maloney (D–NY), Chairman of the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, introduced the bill on May 3, 2019.[4] The House Financial Services Committee agreed to report out an amended version on June 11, 2019.[5] The bill was passed by the House on October 22, 2019, by a vote of 249–173.[6] The bill as passed by the House incorporated the Coordinating Oversight, Upgrading and Innovating Technology, and Examiner Reform (COUNTER) Act of 2019 as Divison B of the bill.[7] As described below, the bill would establish a beneficial ownership reporting regime in the United States, administered by the Treasury Department's Financial Crimes Enforcement Network (FinCEN), and require FinCEN to amend its Customer Due Diligence regulations in light of the Act.[8]

The CTA would require each "applicant" to form a corporation or limited liability company to file a report with FinCEN containing a list of the beneficial owners of the corporation or limited liability company (LLC).[9] Partnerships, trusts, and other legal entities would be exempt.[10] The term "applicant" means any natural person who files an application to form a corporation or limited liability company.[11] The applicant and each beneficial owner would be required to provide his or her name, address, date of birth, and either a passport or driver's license number and a copy of the passport or driver's license showing a photograph of the beneficial owner.[12] He or she would be required to file annual beneficial ownership reports[13]—and would also be required to provide updates when beneficial ownership changed.[14]

These reporting requirements would apply to all existing corporations and LLCs two years after the implementing regulations are issued.[15] It is utterly unclear who would be treated as the applicant—and therefore responsible to file reports—for existing corporations. Many of these corporations or LLCs will have been created years ago, and the "applicant" may no longer have anything whatsoever to do with the business. Bearer shares are prohibited.[16]

The definition of beneficial ownership is not consistent with an ordinary understanding of ownership or the concept of ownership under state corporate or LLC laws. The term "beneficial owner" is defined as:

> a natural person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise—
>
> (i) exercises substantial control over a corporation or limited liability company;
>
> (ii) owns 25 percent or more of the equity interests of a corporation or limited liability company; or
>
> (iii) receives substantial economic benefits from the assets of a corporation or limited liability company.[17]

Thus, non-owners with an unspecified "understanding" or "relationship" who are deemed to "exercise substantial control" or "receive substantial economic benefits"[18] will be potential beneficial owners. Providing false beneficial ownership information, willfully failing to provide complete or updated beneficial ownership information, or knowingly disclosing the existence of a subpoena or other request for beneficial ownership information can result in fines of up to $10,000 and imprisonment for up to three years.[19] But businesses would not really know what weasel words like "understanding," "relationship," "substantial control," or "substantial economic benefits" actually mean until years of litigation and the associated court rulings have provided guideposts to their legal advisors.

Substantial and potentially ruinous expenses will be incurred by small businesses trying to comply. As explained below, large firms are exempt.

Certain applicants are exempt from the beneficial ownership reporting requirements, but only if they file a written certification with FinCEN and provide identifying information regarding the applicant.[20] Exempt entities include public companies, government-owned enterprises, banks and credit unions, broker-dealers, exchanges and clearing agencies, investment companies, insurance companies, commodities traders, public accounting firms registered with the Public Company Accounting Oversight Board, public utilities, churches, charities, political organizations and other not-for-profit organizations, and any business with more than 20 employees and gross receipts of more than $5 million.[21] Thus, the only *non-exempt* category is small businesses that are not in finance or allied lines of business.

Beneficial ownership information would be retained by FinCEN until five years after the corporation or LLC terminates.[22] Because corporations and LLCs may exist indefinitely, this means FinCEN would often retain the information for very long periods of time. Beneficial ownership information would be shared by FinCEN with local, tribal, state, or federal law enforcement agencies, the law enforcement agencies of foreign countries[23] or with financial institutions, with customer consent, as part of the institution's compliance with due diligence requirements.[24] The information provided to local, tribal, state, or federal law enforcement agencies may only be used for law enforcement, national security, or intelligence purposes.[25] There is no comparable statutory limitation on information provided to foreign governments.

Twenty million dollars are provided to administer the beneficial ownership reporting system.[26] Given that roughly 11 million businesses will be making reports, and roughly two million more businesses and not-for-profits will need to seek exemption from the regime, this will undoubtedly prove inadequate, particularly if enforcement against actual criminals is meant to be an objective.

The proposal contains poorly drafted "look through" rules and the application of these rules is not clear. In the absence of such rules, however, the entire reporting regime could be easily avoided through the simple of expedient of having a corporation or LLC own a corporation or LLC. Because of the "directly or indirectly" language, the "arrangement, understanding, relationship" language, and the "substantial control" language, the legislation and implementing rules presumably would require corporations and LLCs with owners that are also corporations or LLCs to report on the beneficial ownership (as defined) of the corporation or LLC that has ownership interest in, directly or indirectly exercises substantial control over, or receives substantial economic benefit from the reporting corporation or LLC.

H.R. 2513 was originally the stand-alone Corporate Transparency Act.[27] As passed by the House, however, the bill includes as Division B the Coordinating Oversight, Upgrading and Innovating Technology and Examiner Reform Act (the COUNTER Act).[28] The bill would require that each financial regulator appoint a Civil Liberties and Privacy Officer to "consult" with respect to regulations and information-sharing programs and to "develop metrics of program success."[29] It would also establish a Civil Liberties and Privacy Council composed of those officers.[30] These would be welcome developments. The bill would create a Treasury Attachés program under which FinCEN-nominated officials would serve in U.S. embassies abroad to coordinate with foreign governments on AML efforts.[31] The Act would require numerous studies and reviews.

The ILLICIT CASH Act

The ILLICIT CASH Act has both counterproductive and constructive provisions. It is generally drafted better and has less ambiguity than the CTA.

Counterproductive Provisions. The bill would create a beneficial ownership reporting regime that would impose potentially large costs on small firms.[32] The bill applies to corporations, limited liability companies, or "other similar" entities.[33] It is therefore broader in scope than the CTA, which applies only to corporations and LLCs. The ILLICIT CASH Act, like the CTA, exempts the businesses most able to abuse the financial system, including public companies, government-owned enterprises, banks, credit unions, broker-dealers, exchanges, clearing agencies, investment companies, insurance companies, commodities traders, public accounting firms registered with the Public Company Accounting Oversight Board, public utilities, churches, charities, political organizations and other not-for-profit organizations, and business with more than 20 employees and gross receipts of more than $5 million.[34] Thus, the only non-exempt category are small businesses. Unlike in the CTA,[35] however, the exemptions are self-effectuating. A local church, for example, would be exempt without having to petition FinCEN for the exemption. This is major improvement over the CTA.

Initially, beneficial ownership reporting would only be required of newly created entities. After two years, the requirement would be imposed on *all* existing small businesses.[36] Reports would be required at the time of formation and any ownership changes would have to be reported within 90 days.[37] Unlike with the CTA, which requires "applicants" to report, the the ILLICIT CASH Act places the obligation on "reporting companies." This is an improvement since, as discussed above, it is extremely unclear who the CTA "applicant" might be except in the context of newly formed entities. The reports would require that entities report the legal name, business or residential address, and unique identification number from a passport, driver's license or other identification of beneficial owners.[38]

Like the CTA, the bill does not define "beneficial owner" consistent with normal legal principles or an ordinary person's conception of owner. The bill defines a beneficial owner of an entity as a natural person who "directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise (i) exercises *substantial control* over such entity; or (ii) owns 25 percent or more of the equity interests of such entity or receives *substantial economic benefits* from the assets of such entity."[39] "Substantial control" is not defined.[40] "Substantial economic benefits" means a person "has access" to 25 percent or more of the funds or assets of an entity.[41] It is manifestly unclear what "substantial control" or "has access" really means. Small business owners and their lawyers will have to try to figure it out.

As with the CTA, the "look through" rules are poorly drafted, and the application of these rules is not clear. In the absence of such rules, the entire reporting regime could be easily avoided through the simple expedient of having a corporation or LLC own a corporation or LLC. As with the Corporate Transparency Act, such rules are clearly implied by the use of "indirectly" and other language, but there is little to go on to determine how they might work. There is, for example, no mechanism for a firm to obtain information about an investing entity's beneficial ownership, and that entity (a venture-capital fund or business development company, for example) will likely be exempt from the reporting requirements. Thus, the reporting company may have no means of obtaining information that it is required to report, and the investing firm may well not have the information, either. Congress should not require the impossible—particularly when failing to do so would be a felony involving prison sentences up to four years and subjecting the firm and its management to fines as high as $500 *per day*.[42]

The bill would raise FinCEN salaries to the level of the Federal Reserve.[43] While it is unsurprising that FinCEN personnel want a raise, this is warranted only if it is established that FinCEN is systematically having difficulty attracting qualified, competent personnel. Since only five individuals out of 285 (1.8 percent) quit the agency in fiscal year 2018, it is unlikely that its compensation packages are uncompetitive.[44] In contrast, the annual quit rate in the private sector in 2018 was 30 percent; it was 13 percent in the finance and insurance sector.[45]

Constructive or Potentially Constructive Provisions. The bill would require the Treasury Secretary, when promulgating regulations, to consider, in addition to tradition law enforcement concerns,[46] factors such as:

1. that financial institutions are spending private dollars for a public and private benefit;
2. the extension of financial services to the underbanked; and
3. that programs should be risk-based, including that more financial institution attention and resources should be directed at higher risk customers and activity.[47]

No method for weighting these various concerns is provided, and no enforcement mechanism is provided. While welcome, these provisions of the bill are aspirational and of little, if any, legal consequence.

The bill would require the establishment of various teams, reports, priorities, and interagency consultations to implement "risk-based policies."[48] In principle, this, too, is a laudatory development. Enforcement and monitoring resources should flow toward those activities, firms, and persons that constitute a higher risk of violating the law. There is, however, no definition of what constitutes risk in the legislation.[49] Since one would hope that law enforcement and financial regulators already do allocate resources rationally based on their understanding of risk, it is not clear what difference this emphasis on "risk-based" policies will make in practice.

The ILLICIT CASH Act would establish an independent Office of the Financial Institution Liaison within FinCEN to receive feedback from financial institutions regarding their examinations, act as a liaison between financial institutions and their regulators, analyze the potential impact on financial institutions of proposed regulations, and produce an annual report for Congress.[50] In principle, such an office could introduce some skepticism and critical thinking into the FinCEN policymaking process. To date, FinCEN has always sought more information and more regulation without any serious cost-benefit analysis, concerns over costs imposed on the private sector, or acknowledgement of the ineffectiveness of any of its programs or reporting regimes.[51] Such an office should also be charged with addressing the impact of FinCEN and its program on financial privacy and the broader public—particularly those that, in practice, lose access to the banking system or money transfer services because of FinCEN rules.[52]

The bill would require that the Attorney General provide an annual report providing statistical information.[53] As there is a notable lack of hard information about the federal AML programs, this is laudable.[54] There are, however, many notable gaps in the information that is to be reported, and without that information, it would be impossible to rationally evaluate the effectiveness of the programs.[55] The bill requires that FinCEN report internally what actions, if any, have been taken due to suspicious activity reports.[56] Unfortunately, the Attorney General, under the bill, is afforded virtually unlimited discretion about what is reported to Congress and the public in the annual report.[57]

The ILLICIT CASH Act would create an interagency staff rotation program so that AML and counter-terrorist financing staff would gain experience and learn across agencies.[58] The bill requires a formal review of the current financial institution reporting requirements examining 11 different issues and would provide for public comment and require a report to Congress.[59] With exceptions, the bill would require different agencies to develop a single comprehensive or coordinated order or action with respect to the same or similar conduct and to coordinate their fines, civil money penalties, or other enforcement orders or action to avoid duplicative fines, penalties, and other orders or actions.[60]

A highly constructive idea incorporated into the legislation is to create a process under which FinCEN and other regulators can issue no-action letters with respect to AML laws. A regulated person could explain to regulators what actions it intends to take and determine whether the regulators would take enforcement action in response.[61] The Securities and Exchange Commission, for example, uses no-action letters routinely to provide guidance to regulated persons.[62] It would also be similar to an Internal Revenue Service private letter ruling.[63]

Problems the Proposed Beneficial Ownership Reporting Regime Would Cause

The primary burden created by the proposed reporting regime is on firms with 20 or fewer employees or less than $5 million in gross receipts. These are the firms *least able* to absorb yet another increase in the regulatory burden imposed by the federal government. As should be evident from the descriptions above, determining who is and is not a "beneficial owner" under either bill would be complex, highly ambiguous, and would often require hiring legal counsel or a compliance expert. In fact, it would probably take a decade or more of prosecutions and litigation before the meaning of "beneficial owner," "substantial control," "substantial economic benefit," and "directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise" are reasonably well established. Defending these cases would be expensive—and often economically destroy the small businesses and business owners who must defend themselves against the federal government.

Under the CTA (but not the ILLICIT CASH Act), even "exempt" entities would be required to file a certification with FinCEN establishing why they are exempt and providing specified information. Otherwise, they would be non-compliant and subject to fines and imprisonment. Large firms and governments have the resources to know how to comply and to accurately file these certifications with FinCEN: Small charities and religious congregations do not. The typical church treasurer or pastor does not keep up with the latest AML laws and regulations any more than does the local baker, restauranteur, or Main Street store owner.

Once two years has elapsed, the requirements would apply to all existing corporations and LLCs. Thus, under the CTA, a local church or charity that is incorporated (as most are) would be required to file with FinCEN a certification establishing that it is exempt by asserting the exemption provided in legislation. Churches and most other religious organizations do not have to file a Form 990 annually with the IRS. But they would be required to file an exemption certification with FinCEN and update the relevant personnel changes—or face fines or imprisonment. It is extremely unclear who would be treated as an "applicant" for existing incorporated churches since applicant is not defined and is not a legal concept under state corporate or association law, especially with respect to existing entities.

Every small business in America would need to either file the beneficial ownership report or, if the business is in an exempt category, file a certification with FinCEN asserting the exemption. Most would not be exempt. In the case of small firms that have other entities as investors or have anything other than entirely conventional corporate governance, the reporting burden may be quite high. An entire army of compliance experts and lawyers would likely develop to explain these rules and how to file with FinCEN.

According to the IRS Statistics of Income, there are about 5.9 million C corporation tax returns (about 5.6 million of which had gross receipts under $5 million);[64] 4.3 million S corporation tax returns;[65] and 2.6 million LLC tax returns filed annually.[66] About 270,000 501(c) organizations[67] filed Form 990 tax information returns.[68] In addition, there are other tax-exempt organizations and about 350,000 religious congregations;[69] these are not required to file annual Form 990s.[70] So, roughly 13 million corporations or LLCs would likely be subject to the new reporting regime and required to either report or seek an exemption.[71] Of those, about 11.2 million are small businesses that are not exempt. If even 9 percent were unaware of this new requirement and fail to file with FinCEN, two years after enactment there would be *over 1 million* small business owners, religious congregations, and charities in non-compliance, subject to fines and imprisonment.

These figures also give a sense of the scale of the compliance industry that would develop and the costs that would be incurred. Assuming, probably heroically, that a small business owner can, *on average*, read and familiarize himself or herself with these rules and file the relevant form in one hour, then the number of compliance hours would be 11 million hours. Monetized at $50 per hour (which is a very low, fully burdened rate for management), the annual compliance costs would be $550 million. If, more realistically, you assume a greater compliance time or a higher hourly rate—or that individuals engage outside counsel or compliance experts or have litigation costs (which is likely for many given the ambiguities discussed above)—then the likely cost will be over $1 billion annually, and perhaps many billions of dollars each year. The National Federation of Independent Business has estimated that compliance with the Corporate Transparency Act would cost covered small businesses $573 million annually.[72] Importantly, this estimate does not include the costs to LLCs or to exempt firms or not-for-profits who would be required to apply for an exemption under the CTA.

Financial Privacy Concerns

Privacy, both financial and personal, is a key component of life in a free society. Unlike in totalitarian or authoritarian regimes, individuals in free societies have a private sphere free of government involvement, surveillance, and control. The United States Constitution's Bill of Rights, particularly the Fourth, Fifth, and Ninth Amendments, together with structural federalism and separation of powers protections, is designed to further that end by protecting individual rights.

In general, individuals should have control over who has access to information about their personal and financial lives. Individuals should be free to lead their lives unmolested and unsurveilled by government—unless there is a reasonable suspicion that they have committed a crime or conspired to commit a crime.

Many government agencies, in both the U.S. and other countries, are currently involved in collecting and disseminating private individuals' information for the purpose of conducting their national security, law enforcement, and tax administration functions. The unique requirements for fulfilling each of these purposes dictate certain policy choices for designing an optimal financial-privacy regime. The current U.S. framework is overly complex and burdensome, and its ad hoc nature has likely impeded efforts to combat terrorism, enforce laws, and collect taxes.

The proposed beneficial ownership reporting regime would add substantially to the complexity and burden of the existing AML and tax information reporting regime. It would, however, do little to further law enforcement objectives.

Financial privacy is especially vital because it can be the difference between survival and the systematic suppression of an opposition group in a country with an authoritarian government. Many businesses, dissidents, and human rights groups maintain accounts outside the countries where they are active for precisely this reason. Any information-sharing regime must include serious safeguards to protect the privacy of individuals and businesses.

There are *no* meaningful privacy rights protections in the congressional beneficial ownership proposals, and, if the information was shared with hostile or corrupt foreign governments, it could do real harm. Given the information-sharing arrangements in the CTA and that the U.S. government is currently contemplating, this harm is quite possible.[73]

An Alternative Approach

The alternative approach would require the Internal Revenue Service to compile a beneficial ownership database (based on information already provided to the agency in the ordinary course of tax administration) and to share the information in this database with FinCEN. The database would be compiled from information provided on six Internal Revenue Service forms:

1. SS-4 [Application for Employer Identification Number];
2. 1065 (Schedule K-1) [Partner's Share of Income, Deductions, Credits, etc.];[74]
3. 1120S (Schedule K-1) [Shareholder's Share of Income, Deductions, Credits, etc.];[75]
4. 1041 (Schedule K-1) [Beneficiary's Share of Income, Deductions, Credits, etc.],[76]
5. 1099 DIV [Dividends and Distributions]; and
6. (6) 8822-B [Change of Address or Responsible Party — Business].

With this information, the ownership of every business in America and each business' responsible party would be available to FinCEN, with the exception of non-dividend-paying C corporations.

Specifically, line 7a of Form SS-4 requires the applicant to identify the "responsible party," which the IRS defines as

> the person who ultimately owns or controls the entity or who exercises ultimate effective control over the entity. The person identified as the responsible party should have a level of control over, or entitlement to, the funds or assets in the entity that, as a practical matter, enables the person, directly or indirectly, to control, manage, or direct the entity and the disposition of its funds and assets.[77]

This, of course, is similar to one of three prongs (the substantial economic benefit prong) of the beneficial ownership definition in the proposed reporting regime. Form 8822-B requires this information to be updated. Schedule K-1s require S corporations and partnerships (including LLCs and business trusts) to report their owners and the owners' tax numbers and addresses. Any C corporation that pays dividends to shareholders would need to report the payment along with the shareholders' tax numbers and addresses on Form 1099-DIV.[78] If policymakers felt that reporting by non-dividend-paying C corporations was required, such a provision could be adopted.[79]

This alternative approach would also enable FinCEN to look through entities that had ownership in other entities. The only exception to this would be where foreign entities owned interests in U.S. entities. Tax reporting and withholding, as well as various statutes governing foreign investments in the United States, provide substantial information that could be added to the database, but policymakers, after careful consideration, may determine that this information needs to be augmented.

This approach would provide more comprehensive information to FinCEN than the proposed reporting regime. Furthermore, the social cost of this approach—creating a database based on information already provided to the IRS—would be a very small fraction of the approach contemplated in the proposed reporting regime. The increase in private compliance costs would be negligible since the information is currently reported for tax purposes,[80] and the alternative approach outlined here would not create a large class of inadvertent felons out of small business owners and church treasurers or pastors.

It almost certainly *would* reduce federal administrative costs compared to those contemplated in the discussion draft.[81] Reformatting and sharing existing information should require dramatically fewer resources than creating, administering, and enforcing an entirely new reporting system.

To implement this approach, Internal Revenue Code § 6103(i) [Disclosure to Federal Officers or Employees for Administration of Federal Laws Not Relating to Tax Administration] would need to be amended to allow the IRS to share the information with FinCEN and to govern what FinCEN could then do with the information.[82]

The revised approach should also place a moratorium on implementation of the FinCEN "Customer Due Diligence Requirements for Financial Institutions" rule. The database authorization and other changes should sunset after a specified period (e.g., five years) and require congressional reauthorization after a review of the program. Specifically, there should have to be a rigorous demonstration by FinCEN that the costs are justified by the benefits of the program before it is renewed.

Because this approach involves changes to the tax law (notably Internal Revenue Code § 6103), it falls with the jurisdiction of the House Ways and Means and Senate Finance Committees. The beneficial ownership reporting regimes discussed above, however, fall within the jurisdiction of the

House Financial Service Committee and the Senate Banking Housing and Urban Affairs Committee. Because the primary congressional proponents of beneficial ownership reporting are on the Financial Services and Banking Committees and are not willing to relinquish control of the issue, the less burdensome, more effective approach has not moved forward.[83]

Limited Effectiveness of the Proposed Beneficial Ownership Reporting Regime

Successful money launderers are typically sophisticated. They can lawfully avoid the requirements of the proposed reporting regime quite easily. The CTA does not apply to partnerships (general partnerships, limited partnerships, or limited liability partnerships) and business trusts. Therefore, to avoid the application of these rules, persons need only form a partnership or a business trust instead of a corporation or LLC. Alternatively, they could buy a business that meets one of the exemption requirements (e.g., gross receipts over $5 million and/or 21 or more employees) and file a certification of exemption with FinCEN to lawfully not report. As discussed above, the look-through rules applicable when entities own entities are opaque, extremely unclear, potentially unworkable, and highly burdensome. But if it is ultimately determined that a non-exempt entity can have another entity own it without reporting on the beneficial ownership of the owning entity (as appears to be contemplated in the ILLICIT CASH Act), then the requirements could be lawfully avoided by simply having a two-tier corporate structure.

Money launderers and others could also illegally evade the system rather easily by simply filing partial but false beneficial ownership reports—or not filing at all. Unless FinCEN is going to start routinely auditing firms (expending a great many federal tax dollars and imposing large costs on law-abiding firms), then this is a low-risk evasion strategy. The maximum of $20 million in funding contemplated in the legislation is vastly too low to support non-trivial audit rates on roughly 13 million entities.

In fiscal year 2018, the Internal Revenue Service audited 16,116 C-corporation tax returns, 8,945 partnership tax returns, and 10,575 S-corporation tax returns.[84] The IRS audit rate for C corporations was 0.9 percent, and for pass-through entities it was 0.2 percent.[85] The IRS has an enforcement budget of approximately $4.7 billion, although only a portion of this relates to business tax returns.[86] The contemplated $20 million budget is less than 1 percent of the IRS enforcement budget, and the bulk of the $20 million would not be spent on enforcement but on simply administering the system and maintaining the database. Thus, unless the FinCEN budget is dramatically increased, the chance of FinCEN detecting inaccurate filings would be extremely low.

The only gain to be had for the U.S. from the proposed regime is with respect to non-tax law enforcement. To the author's knowledge, there is no actual evidence (as opposed to bare assertions or anecdotes) that the beneficial ownership reporting regimes in other countries have had any material effect on money laundering or terrorism. The tax information is already available to the IRS (to the extent firms are compliant with the U.S. tax-reporting requirements). Therefore, the relevant question is not whether they have had *any* impact but whether they have improved *non-tax* law enforcement in a cost-effective manner. In other words, could the public and private resources devoted to this new beneficial ownership reporting regime be better spent elsewhere? The answer to that question is almost certainly yes.

The existing AML regime is extraordinary expensive. The AML regime costs an estimated $4.8 billion to $8 billion annually.[87] Yet this AML system results in fewer than 700 convictions annually, a substantial proportion (probably most) of which are simply additional counts against persons charged with other predicate crimes. It costs at least $7 million *per conviction*—and potentially many times that.[88] Yet a serious cost-benefit analysis of the AML has never been undertaken by the U.S. government.

There is a need to engage in a serious cost-benefit analysis of the AML regime and its constituent parts before adding yet another poorly conceived requirement that burdens the smallest businesses in the country.

Conclusion

Unlike the CTA, the ILLICIT CASH Act contains provisions that meaningfully modernize and streamline AML laws. Both bills would create a large compliance burden on approximately 11 million businesses with 20 or fewer employees (the only non-exempt category) and would create as many as a million inadvertent felons.

Under the CTA (but not the ILLICIT CASH Act), religious organizations, charities, other exempt entities, and their employees would be subject to fines and imprisonment unless they file the proper certification of exemption with the Financial Crimes Enforcement Network. The beneficial ownership reporting rules in both bills are easily and lawfully avoided by the sophisticated, so they would do virtually nothing to achieve their stated aim of protecting society from terrorism or other forms of illicit finance.

Furthermore, the vast majority of the information that the proposed reporting regime would obtain is already provided to the IRS. Allowing the IRS to share this information with the Treasury Department's Financial Crimes Enforcement Network would better meet the needs of law enforcement by providing more comprehensive information and better enforcement than would the proposed reporting regime.

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Endnotes

1. Corporate Transparency Act of 2019, H.R. 2513, 116th Cong., 1st Sess., https://www.congress.gov/bill/116th-congress/house-bill/2513/text/eh (accessed October 24, 2019). The discussion throughout this *Backgrounder* refers to the version of the bill passed by the House.
2. Improving Laundering Laws and Increasing Comprehensive Information Tracking of Criminal Activity in Shell Holdings Act (hereafter "ILLICIT CASH Act"), S. 2563, 116th Congress, 1st Sess., https://www.congress.gov/bill/116th-congress/senate-bill/2563/text (accessed October 21, 2019). Senators Mark Warren (D–VA); Tom Cotton (R–AR), Doug Jones (D–AL), Mike Rounds (R–SD), Robert Menendez (D–NJ), John Kennedy (R–LA), Catherine Cortez Masto (D–NV), and Jerry Moran (R–KS) are original cosponsors.
3. Hearing, *Promoting Corporate Transparency: Examining Legislative Proposals to Detect and Deter Financial Crime*, Subcommittee on National Security, International Development, and Monetary Policy, Committee on Financial Services, U.S. House of Representatives, March 13, 2019, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=402387 (accessed October 24, 2019).
4. Corporate Transparency Act of 2019, H.R. 2513.
5. U.S. House of Representatives, Committee on Financial Services, Markup, June 11, 2019, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403829 (accessed October 21, 2019).
6. "Final Vote Results For Roll Call 577," October 22, 2019, http://clerk.house.gov/evs/2019/roll577.xml (accessed October 29, 2019).
7. COUNTER Act of 2019, H.R. 2514, 116th Cong., 1st Sess., https://www.congress.gov/bill/116th-congress/house-bill/2514/text?q=%7B%22search%22%3A%5B%22HR+2514%22%5D%7D&r=1&s=2 (accessed October 29, 2019).
8. *Federal Register*, Vol. 81, No. 91 (May 11, 2016), pp. 29398–29458. The rule became effective May 11, 2018.
9. Proposed § 5333(a)(1)(A).
10. Section 4(b) of the bill requires a study be conducted by the Comptroller General (i.e., the Government Accountability Office) within two years with respect to these entities.
11. Proposed § 5333(d)(1).
12. Proposed § 5333(a)(1)(A).
13. Proposed § 5333(a)(1)(B)(i).
14. Proposed § 5333(a)(1)(B)(ii). The amount of time the applicant would have to provide the information is to be decided by the Treasury Department in its implementing rule. It was 60 days in previous versions of the CTA.
15. Proposed § 5333(a)(3)(B).
16. Proposed § 5333(b). Bearer shares are shares that are owned by their "bearer" (i.e., the person who physically possesses the stock certificate or other indicia of ownership instead of a holder of record listed in the records of the company).
17. Proposed § 5333(d)(3)(A).
18. Proposed § 5333(d)(3)(C) provides that "a natural person receives substantial economic benefits from the assets of a corporation or limited liability company if the person has an entitlement to more than a specified percentage of the funds or assets of the corporation or limited liability company, which the Secretary of the Treasury shall, by rule, establish." Such a bright line rule, if properly and clearly drafted, is welcome and should be provided by statute. Such a rule was not included in previous versions of the legislation, and there is no comparable provision governing the definition of "substantial control."
19. Proposed § 5333(c).
20. Proposed § 5333(a)(3)(A) and § 5333(d)(4).
21. Proposed § 5333(d)(4)(C).
22. Proposed § 5333(a)(5)(A).
23. Under an international treaty, agreement, or convention, and in certain other circumstances. See proposed § 5333(a)(4)(B)(ii).
24. Proposed § 5333(a)(5)(B).
25. Proposed § 5333(a)(5)(C)(ii).
26. Section 3(b) of the bill.
27. Corporate Transparency Act of 2019, H.R. 2513, 116th Cong., 1st Sess., https://www.congress.gov/bill/116th-congress/house-bill/2513?q=%7B%22search%22%3A%5B%22HR+2513%22%5D%7D&s=1&r=1 (accessed October 29, 2019).
28. The COUNTER Act was originally H.R. 2514. See footnote 7, *supra*, for more information.
29. Section 103 of Division B.
30. Section 104 of Division B.

31. Section 106 of Division B.
32. See § 401 of the ILLICIT CASH Act, creating in Title 31 a new § 5334 (Transparent Incorporation Practices).
33. It would presumably apply to limited partnerships, limited liability partnerships, limited liability limited partnerships, and business trusts since these are created "by the filing of a document with a secretary of state or similar office." Ordinary trusts and general partnerships would presumably not be covered. See Proposed § 5334(a)(6).
34. Proposed § 5334(a)(6)(B)(i)-(xviii).
35. Corporate Transparency Act, proposed § 5333(a)(3)(A).
36. ILLICIT CASH Act, Proposed § 5334(b)(1)(B).
37. ILLICIT CASH Act, Proposed § 5334(b)(1)(C) and Proposed § 5334(b)(1)(D).
38. ILLICIT CASH Act, Proposed § 5334(b)(2)(B).
39. ILLICIT CASH Act, Proposed § 5334(a)(2)(A) (emphasis added).
40. The discussion draft provided: "A person has "substantial control over an entity if that person (i) has an entitlement to the funds or assets of the entity that, as a practical matter, enables the person, directly or indirectly, to control, manage, or direct the entity, or (ii) is otherwise able to control the entity as defined by the Secretary." This provision was dropped in the version as introduced. See *Promoting Corporate Transparency: Examining Legislative Proposals to Detect and Deter Financial Crime*, Discussion Draft.
41. ILLICIT CASH Act, Proposed § 5334(a)(8).
42. ILLICIT CASH Act, Proposed § 5334(g).
43. See § 102 of the bill.
44. Office of Personnel Management, "FedScope Datacubes," https://www.fedscope.opm.gov/ (accessed October 21, 2019). Search Parameters: Separations, FY 2011–2018, Cabinet Level Agency, Treasury Department, Financial Crimes Enforcement Network and Employment, September 2018, Cabinet Level Agency, Treasury Department, Financial Crimes Enforcement Network
45. Bureau of Labor Statistics, "Table 18: Annual Quits Rates by Industry and Region, Not Seasonally Adjusted," https://www.bls.gov/news.release/jolts.t18.htm (accessed October 21, 2019).
46. For a list of traditional law enforcement concerns, see 31 U.S.C. § 5311 ("Declaration of Purpose") as amended by § 101(a) of the bill.
47. Section 101(b) of the bill would amend 31 U.S.C. § 5318.
48. See § 101(c) of the bill.
49. The closest thing to a definition of "risk" would be the admonition in proposed § 5318(h)(2)(iv) that anti-money laundering and combating the financing of terrorism programs "should be risk-based, including that more financial institution attention and resources should be directed at higher risk customers and activity consistent with the risk profile of a financial institution, rather than lower risk customers and activities."
50. See § 104 of the bill.
51. David R. Burton and Norbert J. Michel, "Financial Privacy in a Free Society," Heritage Foundation *Backgrounder* No. 3157, September 23, 2016, http://thf-reports.s3.amazonaws.com/2016/BG3157.pdf.
52. See Burton and Michel, "Financial Privacy"; Mariano-Florentino Cuellar, "The Tenuous Relationship Between the Fight Against Money Laundering and the Disruption of Criminal Finance," *Journal of Criminal Law and Criminology*, Vol. 93, No. 2 (Winter 2003), pp. 312–466, http://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=7123&context=jclc (accessed October 21, 2019); and Clay Lowery and Vijaya Ramachandran, *Unintended Consequences of Anti–Money Laundering Policies for Poor Countries*, Center for Global Development, November 9, 2015, https://www.cgdev.org/sites/default/files/CGD-WG-Report-Unintended-Consequences-AML-Policies-2015.pdf (accessed October 21, 2019).
53. See § 201 of the bill.
54. Burton and Michel, "Financial Privacy."
55. See ibid. for information about what should be reported.
56. See § 202 of the bill.
57. See § 201(a) of the bill.
58. See § 105 of the bill.
59. See §§ 203, 204, and 205 of the bill.
60. See § 206 of the bill.
61. See § 304 of the bill.
62. U.S. Securities and Exchange Commission, "Staff No Action, Interpretive and Exemptive Letters," https://www.sec.gov/interps/noaction.shtml (accessed October 21, 2019).

63. Internal Revenue Service, "Rev. Proc. 2017–1," § 2.01, https://www.irs.gov/irb/2017-01_IRB#RP-2017-1 (accessed October 21, 2019).
64. Internal Revenue Service, "Corporate Income Tax Returns, Tax Year 2013," https://www.irs.gov/pub/irs-soi/13CorporateReturnsOneSheet.pdf (accessed October 21, 2019), and Internal Revenue Service, "Returns of Active Corporations: Table 5; Selected Balance Sheet, Income Statement, and Tax Items, by Sector, by Size of Business Receipts, Tax Year 2013," https://www.irs.gov/pub/irs-soi/13co05ccr.xls (accessed October 21, 2019).
65. Internal Revenue Service, "Returns of Active Corporations: Form 1120S, Table 2.4; Balance Sheet, Income Statement, and Selected Items, by Size of Total Assets, Tax Year 2014," https://www.irs.gov/pub/irs-soi/14co24ccr.xlsx (accessed October 21, 2019).
66. Internal Revenue Service, "Partnership Returns, 2015–2016," 2016 data, https://www.irs.gov/pub/irs-soi/16pa08.xlsx (accessed October 21, 2019).
67. Internal Revenue Code, § 501(c). The data provided by the IRS is for § 501(c)(3)-(9) organizations.
68. Internal Revenue Service, "Table 3: Form 990 Returns of 501(c)(3)-(9) Organizations: Balance Sheet and Income Statement Items, by Code Section, Tax Year 2015," https://www.irs.gov/pub/irs-soi/15eo03.xlsx (accessed October 21, 2019).
69. Association of Statisticians of American Religious Bodies, "U.S. Religion Census 2010," May 1, 2012, http://www.usreligioncensus.org/press_release/ACP%2020120501.pdf (accessed October 21, 2019).
70. Internal Revenue Code §6033(a)(3). See also, Internal Revenue Service, "Annual Exempt Organization Return: Who Must File," https://www.irs.gov/charities-non-profits/annual-exempt-organization-return-who-must-file (accessed October 21, 2019).
71. As of this writing, 87.8 percent of businesses have fewer than 20 employees. Business Dynamics Statistics, "Firm Size," http://www2.census.gov/ces/bds/2016/firm/bds_f_sz_release.xlsx (accessed October 21, 2019). Calculation: 87.8 percent x (5.9 million C corps + 4.3 S corps + 2.6 LLCs) = 11.2 million.
72. Michael J. Chow, "Economic Costs to Small Businesses Due to the Corporate Transparency Act," NFIB Research Center, September 18, 2019, https://www.nfib.com/assets/NFIB_Corporate_Transparency_Act.pdf (accessed October 21, 2019).
73. David R. Burton, "Two Little Known Tax Treaties Will Lead to Substantially More Identity Theft, Crime, Industrial Espionage, and Suppression of Political Dissidents," Heritage Foundation *Backgrounder* No. 3087, December 21, 2015, http://thf-reports.s3.amazonaws.com/2015/BG3087.pdf, and Burton and Michel, "Financial Privacy."
74. Form 1065 is the annual tax return filed by partnerships, including limited liability companies.
75. Form 1120A is the annual tax return filed by S corporations.
76. Form 1041 is the annual tax return filed by trusts.
77. Internal Revenue Service, "Form S-4 Instructions," p. 3, https://www.irs.gov/pub/irs-pdf/iss4.pdf (accessed October 29, 2019).
78. There would be an issue in connection with stock held in street name by broker-dealers. 1099-DIVs provided by broker-dealers to their customers and the IRS could be made part of the database.
79. Non-dividend-paying C corporation stock held in street name by broker-dealers would have to be part of such a requirement if the aim were comprehensive coverage. Of course, under the Congressional proposals, C corporations with more than 20 employees would be exempt.
80. Compliance costs associated with the tax system are quite high—an estimated $409 billion annually. About two-thirds of these costs are borne by businesses. See Scott A. Hodge, "The Compliance Costs of IRS Regulations," Tax Foundation *Fiscal Fact* No. 512, June 2016, https://files.taxfoundation.org/legacy/docs/TaxFoundation_FF512.pdf (accessed October 21, 2019).
81. See § 9(b)(3).
82. International information sharing with foreign governments is an issue of particular concern. The information should not be shared with hostile or corrupt governments or governments that maintain inadequate protection of their databases from hackers.
83. For example, an amendment in the nature of a substitute by Representative French Hill (R–AR) offering a tax-based approach was ruled non-germane in the House Financial Services Committee markup. See Corporate Transparency Act of 2019, H.R. 2513, 116th Cong., 1st Sess., "Substitute Amendment to the Amendment in the Nature of a Substitute to H.R. 2513 Offered by Mr. Hill of Arkansas," https://financialservices.house.gov/uploadedfiles/bills-116-hr2513-m000087-amdt-2.pdf (accessed October 21, 2019).
84. Internal Revenue Service, *2018 Data Book*, https://www.irs.gov/pub/irs-soi/18databk.pdf (accessed October 21, 2019). See "Table 9a: Examination Coverage: Recommended and Average Recommended Additional Tax After Examination by Type and Size of Return, Fiscal Year 2018."
85. Ibid.
86. Internal Revenue Service, *2018 Data Book*. See "Table 28: Costs Incurred by Budget Activity, Fiscal Years 2017 and 2018."
87. Burton and Michel, "Financial Privacy."
88. Ibid.