

May 5, 2021

AnnaLou Tirol
Deputy Director
Financial Crimes Enforcement Network
P.O. Box 39
Vienna, VA 22183.

Re: Beneficial Ownership Information Reporting Requirements {Docket Number FINCEN–2021–0005 [RIN 1506–AB49]}

Dear Ms. Tirol:

I am pleased to provide these comments regarding the beneficial ownership information reporting requirements imposed on small businesses by the Corporate Transparency Act.¹

Introductory Comments

The Corporate Transparency Act (CTA) is targeted squarely at small businesses with fewer than 20 employees or \$5 million or less in gross receipts. Firms larger than this are exempt, as are firms in a large number of well-connected lines of business, most of which are vastly more able to abuse the financial system than are the Main Street small businesses targeted by the CTA. It will affect approximately 11 million small firms and can be expected to impose costs exceeding \$1 billion annually.²

Small firms are the least able to deal with regulatory compliance costs because regulatory complex costs do not increase linearly with size. Whether measured by gross revenues, number of employees, number of customers or some other metric, regulatory compliance costs have a disproportionate adverse impact on smaller firms and create a competitive advantage for larger firms. Imposing high regulatory costs on small firms now when many are struggling to survive due to COVID-19 is particularly ill-advised. Even if they survive, it will take years for many in the small business community to recover.

FinCEN is used to dealing primarily with large firms. It does not have a history of paying a great deal of attention to the costs it imposes on the private sector. This rulemaking needs to be different. In crafting the rules governing implementation of the CTA it needs to take special care that the rules governing beneficial ownership reporting are simple to understand and simple to comply with. Small businesses with fewer than 20 employees or \$5 million or less in gross receipts do not have compliance departments and they do not have in-house counsel. They have very limited resources.

¹ “Beneficial Ownership Information Reporting Requirements,” Financial Crimes Enforcement Network, Treasury Department, *Federal Register*, Vol. 86, No. 63, April 5, 2021, Advance Notice of Proposed Rulemaking, pp. 17557-17565.

² David R. Burton, “The Corporate Transparency Act and the ILLICIT CASH Act,” Heritage Foundation Backgrounder No. 3449, November 7, 2019, p. 9 https://www.heritage.org/sites/default/files/2019-11/BG3449_0.pdf. See also the discussion in the Response to Request for Comment (39).

FinCEN needs to do the hard work of writing the definition of beneficial ownership *in plain English in terms any normal small business person can understand*. It needs to provide examples. To fail to do so would be an abdication of FinCEN's duty to responsibly administer this law. FinCEN needs to clearly define terms in the rulemaking and systematically avoid weasel words like "substantially" and "significant" and "effectively." It needs to particularly focus on defining undefined and deeply ambiguous terms in the centrally important definition of "beneficial owner" including "indirectly," the phrase "arrangement, understanding, relationship, or otherwise," "substantial control" and "entity."

It is always tempting for a regulatory agency to leave terms ambiguous and unclear so as to provide itself room to change its mind retroactively and to provide itself freedom of action or practical discretion so it can launch enforcement actions when it wants to do so. Given the class of persons who must comply with this rule (the smallest businesses in the country) and the stakes (large fines and criminal penalties), that is entirely inappropriate in this rulemaking.

Besides clarity, I also propose two cost mitigation strategies that will both reduce costs for small businesses and for FinCEN. They would enable FinCEN to collect information relevant to law enforcement goals rather than being buried in an avalanche of irrelevant reporting from law-abiding Main Street small businesses. The first is a "small operating company exemption." The second is an "alternative compliance method safe harbor."

Responses to Specific Requests for Comment

Request for Comment: (3) The CTA defines the "beneficial owner" of an entity, subject to certain exceptions, as "an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise" either "exercises substantial control over the entity" or "owns or controls not less than 25 percent of the ownership interests of the entity." Is this definition, including the specified exceptions, sufficiently clear, or are there aspects of this definition and specified exceptions that FinCEN should clarify by regulation?

a. To what extent should FinCEN's regulatory definition of beneficial owner in this context be the same as, or similar to, the current CDD rule's definition or the standards used to determine who is a beneficial owner under 17 CFR 240.13d-3 adopted under the Securities Exchange Act of 1934?

Response: The SEC definition is fine for its purpose, which is to define beneficial ownership in the context of reporting beneficial ownership of more than 5 percent of a class of registered securities³ within the meaning of section 12 of the Exchange Act. It will be indecipherable to most lawyers who are not securities lawyers let alone an ordinary small business person. FinCEN can determine rapidly that this is the case by asking law firms that are not securities law specialists how much they would charge to give an opinion on whether a few common situations are beneficial owners or not under 17 CFR 240.13d-3. The proposed fee will reflect many hours of research (assuming they are willing to take on the task at all).

³ I.e. the securities of public companies.

FinCEN needs to do the hard work of writing the definition of beneficial ownership *in plain English in terms any normal small business person can understand*. After all, it is only small business people that are subject to this reporting requirement. This will not be particularly easy since the CTA is so exceptionally poorly drafted. But the work needs to be done. To fail to do so would be an abdication of FinCEN's duty to responsibly administer this law.

b. Should FinCEN define either or both of the terms “own” and “control” with respect to the ownership interests of an entity? If so, should such a definition be drawn from or based on an existing definition in another area, such as securities law or tax law?

Response: Again, FinCEN needs to do the hard work of writing the definition of beneficial ownership in plain English in terms any normal small business person can understand. The concepts and attribution rules in Internal Revenue Code §318 (and the regulations and Revenue Rulings thereunder) could be a useful place to start for corporate stock. Alas, they will be close to useless with respect to LLC membership interests (which are typically partnership interests for tax purposes). The Internal Revenue Code Subchapter K (§761(b)) definition of partner is of little help. The task becomes more challenging still when it is realized that LLC operating agreements routinely create what in a corporate context would be considered multiple classes of stock but are in fact LLC “partnership” interests (for tax purposes) that also commonly have changing rights and obligations over time. For example, an investor may initially have a larger share of the income and more control until the investor has received his original investment back plus some agreed return.

FinCEN's task becomes more “interesting” still to the extent that FinCEN incorporates “other similar entities” into the reporting. Business trusts, limited partnerships, limited liability partnerships and similar entities raise similar issues to partnerships although neither conventional trusts (as opposed to statutory business trusts) nor general partnerships require filing with the state for formation (which is an element of the definition of reporting company).⁴ Close corporations, where the shareholders function as the board of directors, raise control issues different from regular corporations.

Cooperatives and mutual companies, although typically corporations, may be employee-owned, customer-owned, producer-owned or some combination of these and any earnings are returned to the employees, customers or producers, respectively or retained by the cooperative. It is exceedingly unclear who would count as a beneficial owner of a cooperative or mutual company. Some of these are very large operations (utilities, mutual insurance, certain farming co-ops) and would be exempt from the CTA beneficial ownership reporting requirements. But there are also many very small cooperatives (farmers, artisans, housing, booksellers), homeowners associations, credit unions and so on. Cooperatives and mutual companies are generally taxed as a special form of pass-through entity although some are tax-exempt.⁵

⁴ “... created by the filing of a document with a secretary of state or a similar office under the law of a State or Indian Tribe ...”

⁵ Very generally, profits from doing business with members are not taxed at the entity level and profits from doing business with non-members is. See Internal Revenue Code Subchapter T (§§1381-1388) and, for farmers' cooperatives, see Internal Revenue Code §521. Credit Unions are tax-exempt under Internal Revenue Code §501(c)(14). Some farming cooperatives are exempt under Internal Revenue Code §501(c)(16). Various other cooperatives may be exempt under Internal Revenue Code §501(c)(12). Cooperative health insurers may be exempt

If FinCEN staff finds addressing all of this to be daunting, imagine what a typical small business owner must feel like when faced with CTA compliance.

c. Should FinCEN define the term “substantial control”? If so, should FinCEN define “substantial control” to mean that no reporting company can have more than one beneficial owner who is considered to be in substantial control of the company, or should FinCEN define that term to make it possible that a reporting company may have more than one beneficial owner with “substantial control”?

Response: Absolutely yes. This is one of the most problematic provisions in the CTA. Congress failed to define the term, which can mean almost anything. So FinCEN absolutely must. Congress behaved irresponsibly by failing to define such a central term even in the broadest sense. For FinCEN to also fail to do so would be an abdication of FinCEN’s duty to responsibly administer this law.

“Substantial control” should be defined as actual legal control of the business in question, to wit, the ability and authority to take or dictate an action by the entity or authoritatively instruct management to take a course of action. That is control rather than influence, real or imagined. Typically, there would be only one such person but one can conceive of contractual arrangements where a majority of shares or other ownership interests are held by a block that in turns agrees to vote as a unit. Such arrangements are exceedingly uncommon in a small business context.

Moreover, as any corporate lawyer will tell you, control and ownership are not the same thing.⁶ Whatever FinCEN decides, the definition should absolutely not be full of weasel words like “substantial” and “significant” and “effectively.” That is a means of not addressing the question. It will provide no meaningful guidance to small businesses and result in litigation that small firms can ill afford if they guess wrong.

Request for Comment: (4) The CTA defines the term “applicant” as an individual who “files an application to form” or “registers or files an application to register” a reporting company under applicable state or tribal law. Is this language sufficiently clear, in light of current law and current filing and registration practices, or should FinCEN expand on this definition, and if so how?

Response: This is another example of poor drafting. The term applicant is left over from when the CTA was structured with state secretaries of state or state corporation division directors as the main administrators of the beneficial ownership reporting system. It is of relatively little

under Internal Revenue Code §501(c)(29). Various mutual companies are exempt under Internal Revenue Code §501(c)(12)-(15) and §501(c)(27). For larger mutual insurance companies, see Internal Revenue Code Subchapter L.
⁶ This is, of course, obviously true of large public corporations where no single shareholder controls the corporation (except in the rarest of circumstances). The Board of Directors is in formal control and management is in practical control. In the case of small firms, the ownership and management are often the same people or there is substantial overlap. See, e.g., Adolfe A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (1933) and the voluminous scholarship on the separation of ownership and control in modern corporations.

importance in the CTA as enacted. Nevertheless, it could be clarified by describing who is included (incorporators, authorized person filing an LLC certificate of formation and so on.)

Request for Comment: (5) Are there any other terms used in the CTA, in addition to those the CTA defines, that should be defined in FinCEN’s regulations to provide additional clarity? If so, which terms, why should FinCEN define such terms by regulation, and how should any such terms be defined?

Response: Definitely, yes. They are:

(1) Entity. This word (or its plural) is used throughout the CTA in many important contexts. It should be made explicitly clear which forms of business or other association are considered an entity and which are not. For example, presumably a sole proprietorship (i.e. a natural person) using a “doing business as” trade name (e.g. “Joe’s Plumbing Service”) is not an entity. Under traditional legal principles, a general partnership would not be either. Unincorporated associations need to be addressed. Most do not have owners in a conventional sense. Trusts (other than business trusts formed under state law) need to be addressed. Trust beneficiaries are not owners under normal legal principles. And it should be made clear whether limited partnerships, limited liability partnerships, limited liability limited partnerships are or are not entities. Presumably they are. There is also the issue of cooperatives and mutual companies discussed above.

If something is not deemed an entity, then it cannot be a reporting company and whether it has beneficial owners is irrelevant for purposes of the CTA. But there presumably will be “entities” that are the non-corporate equivalent of non-stock corporations and therefore have no owners. For that matter, there will corporations and LLCs that have no beneficial owners (although they will have “applicants.” This should all be clarified by the rulemaking.

(2) Indirectly. The term “indirectly” is used in the CTA four times, most importantly in the definition of beneficial owner.⁷ It needs to be defined. In the absence of a definition, there will be massive ambiguity in determining what a beneficial owner is for purposes of the CTA. Such ambiguity is inappropriate in any context involving potentially large fines and criminal sentences but is particularly inappropriate when the class of persons who must comply are non-specialist small business persons who do not have the time or resources to research and follow the case law and various lesser guidance documents that FinCEN may issue over time. On something so central as the definition of beneficial owner, FinCEN needs to step up to the plate and define the term.

Obviously, as discussed elsewhere, it could mean tiered ownership. But it could (but should not) also involve attribution of ownership (family members, for example) when actual ownership does not exist. It could involve many other things in light of the “arrangement, understanding, relationship” language discussed below. FinCEN has an obligation to clarify these terms *in plain English in terms any normal small business person can understand*. Examples should be

⁷ “The term ‘beneficial owner’ — (A) means, with respect to an entity, an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise ...”.

provided. The people who are going to be trying to understand and comply with these rules are not specialists and do not have the resources to employ legions of lawyers and compliance personnel.

(3) Arrangement, Understanding, Relationship, or Otherwise. Similarly, the phrase “arrangement, understanding, relationship, or otherwise” is used in the definition of beneficial owner.⁸ It too, introduces massive ambiguity into the definition of a beneficial owner. I know what a contract is. But I must confess that I am certainly not sure what is meant by the terms “arrangement, understanding, relationship or otherwise.” FinCEN has an obligation to clarify these terms in plain English in terms any normal small business person can understand. Examples should be provided.

Request for Comment: (7) In addition to the statutory exemptions from the definition of “reporting company,” the CTA authorizes the Secretary, with the concurrence of the Attorney General and the Secretary of Homeland Security, to exempt any other entity or class of entities by regulation, upon making certain determinations. Are there any categories of entities that are not currently subject to an exemption from the definition of “reporting company” that FinCEN should consider for an exemption pursuant to this authority, and if so why?

Response: §5336(a)(11) provides that the term ‘reporting company’ — ... (B) does not include — ... (xxiv) any entity or class of entities that the Secretary of the Treasury, with the written concurrence of the Attorney General and the Secretary of Homeland Security, has, by regulation, determined should be exempt from the requirements of subsection (b) because requiring beneficial ownership information from the entity or class of entities — (I) would not serve the public interest; and (II) would not be highly useful in national security, intelligence, and law enforcement agency efforts to detect, prevent, or prosecute money laundering, the financing of terrorism, proliferation finance, serious tax fraud, or other crimes.

The reason the CTA is drafted as it is — targeting small businesses and only small businesses — is that its proponents opined that “shell companies”⁹ were a central AML/CFT problem but were unable to write a definition of “shell company.” Ergo, we are stuck with a statute that imposes a large administrative burden and regulatory uncertainty on 11 million of the smallest firms in the country.

I submit that U.S. Main Street restaurants, retailers and service providers are a small AML/CFT threat. Gathering beneficial ownership information on the local diner or hardware store would “not be highly useful in national security, intelligence, and law enforcement agency efforts to detect, prevent, or prosecute money laundering, the financing of terrorism, proliferation finance, serious tax fraud, or other crimes.” It would be in the public interest to exempt these small operating businesses since it would save millions of businesses hundreds of millions of dollars. It would also avoid burying FinCEN in a massive amount of useless information about law-abiding businesses. Granting, *arguendo*, that shell companies are a major problem, the challenge becomes separating them from Main Street operating companies. This could be done by defining a “small operating company” and then exempting them under §5336(a)(11)(B)(xxiv).

⁸ Ibid.

⁹ See NDAA §6002(5)(B).

Such an exemption could be accomplished by defining an operating company as a company where the sum of (1) cost of goods sold, (2) employee payroll or partner guaranteed payments and (3) rent exceeds a specified percentage (perhaps 65 percent) of gross receipts or gross sales on the most recent tax return. This approach would only exempt existing operating companies or new companies *after* they had filed a tax return.

Ideally, the IRS would provide a list to FinCEN of companies that met this requirement based on the data from the companies' Form 1120, Form 1120S or Form 1065. Presumably, a Treasury Secretary Directive could so provide. If it is felt that an amendment to Internal Revenue Code section 6103 is required in order for the IRS to provide such a list to FinCEN,¹⁰ then I am confident that Congress in consultation with the small business community could provide for such an amendment with alacrity. Alternatively, FinCEN could simply allow small firms to provide their tax return to FinCEN. Either the business or FinCEN could do the arithmetic with the four numbers, to wit, the sum of (1) cost of goods sold, (2) employee payroll or partner guaranteed payments, and (3) rent divided by (4) gross sales.

Request for Comment: (9) How should a company's eligibility for any exemption from the reporting requirements, including any exemption from the definition of "reporting company," be determined?

c. Should exempt entities be required to file periodic reports to support the continued application of the relevant exemption (e.g., annually)?

Response: For companies where the continued registration as an exempt entity can be determined by a quick look at a public database (such as broker-dealers, banks, public accounting firms, etc.), such periodic reporting is a waste of time and money both for the Company and for FinCEN.

Request for Comment: (10) What information should FinCEN require a reporting company to provide about the reporting company itself to ensure the beneficial ownership database is highly useful to authorized users?

Response: The statute is clear about what information is required. No more information should be sought.

Request for Comment: (11) What information should FinCEN require a reporting company to provide about the reporting company's corporate affiliates, parents, and subsidiaries, particularly given that in some cases multiple companies can be layered on top of one another in complex ownership structures?

Response: This is another example of sloppy drafting by the authors of the CTA. Rather than actually address this issue, Congress simply inserted the word "indirectly" into the definition of beneficial owner. Internal Revenue Code §1563 (relating to controlled groups) provides a template but it would have to be reworked for purposes of this rule and reflect tiered non-corporate

¹⁰ It depends on the interpretation of Internal Revenue Code § 6103(i).

ownership. This is probably less of an issue than it seems since complex capital structures are overwhelmingly found in larger firms that are exempt. It would also be solved by letting FinCEN look at business tax returns since the information is already there.

Request for Comment: (13) What information, if any, should FinCEN require a reporting company to provide about the nature of a reporting company's relationship to its beneficial owners (including any corporate intermediaries or any other contract, arrangement, understanding, or relationship), to ensure that the beneficial ownership database is highly useful to authorized users?

Response: If any, FinCEN needs to define in detail "arrangement, understanding, or relationship." See Response to Request for Comment (5) above.

Request for Comment: (14) Persons currently obligated to file reports with FinCEN overwhelmingly do so electronically, either on a form-by-form basis or in batches using proprietary software developed by private-sector technology service providers.

- a. Should FinCEN allow electronic filing of required information about reporting companies (including the termination of such companies), beneficial owners, and applicants under the CTA?
- b. Should FinCEN allow or support any mechanisms other than direct electronic filing?
- c. Should FinCEN allow or support direct batch filing of required information?
- d. Should there be any differences among the mechanisms used for different types of information or different types of filers?
- e. Should any additional or alternative reporting system involve the collection of information from the states and Indian tribes, and if so how?
- f. Should the filing mechanisms for reporting companies be different for entities that were previously exempt for one reason or another (including exempt subsidiaries and exempt grandfathered entities under section 5336(b)(2)(D) and (E)) and lose that exemption? If so how?

Response: The filing mechanism needs to be simple and not require any specialized knowledge or software. The people making these filings are going to be ordinary small business people with no specialized IT skills, limited resources, limited time and no specialized knowledge of AML rules or FinCEN requirements.

Request for Comment: (16) What burdens do you anticipate in connection with the new reporting requirements? Please identify any burdens with specificity, and estimate the dollar costs of these burdens if possible. How could FinCEN minimize any such burdens on reporting companies associated with the collection of beneficial ownership information in a manner that ensures the information is highly useful in facilitating important national security, intelligence, and law enforcement activities and confirming beneficial ownership information provided to financial institutions, consistent with its statutory obligations under the CTA?

Response: See Response to Request for Comment (7) and (39).

Request for Comment: (17) Section 5336(e)(1) requires the Secretary to take reasonable steps to provide notice to persons of their reporting obligations.

- a. What steps should be taken to provide such notice?
- b. Should those steps include direct communications such as mailed notices, and if so to whom should notices be mailed?
- c. What type of information should be included in such a notice, for example, the purposes and uses of the data, and how to access and correct the information?
- d. Should the notice be followed by an explicit acknowledgement of the reporting company, or consent of the beneficial owner or applicant if the owner or applicant is submitting the information, to the handling of beneficial ownership information as stated in the notice and applicable law?

Response: All reporting companies must file tax returns so the logical means of providing notice is to mail information to all companies that have filed a Form 1120, Form 1120S or Form 1065 or indicated on their SS-4 that they plan to file these tax returns.

Request for Comment: (20) Should reporting companies be required to affirmatively confirm the continuing accuracy of previously submitted beneficial ownership information on a periodic basis (e.g., annually)? How should such confirmation be communicated to FinCEN?

Response: Many family-owned or closely-held businesses stay in the same hands for decades. Requiring annual filing if there is no change in ownership wastes both small business and FinCEN resources. If FinCEN decides to require annual filing, it should send a pre-populated form to the business allowing the business to simply check a box saying there were no ownership changes since the last filing and then click submit.

Request for Comment: (22) Section 5336(h)(3)(C) contains a safe harbor for persons who seek to correct previously submitted but inaccurate beneficial ownership information pursuant to FinCEN regulations. How should FinCEN's regulations define the scope of this safe harbor? Should the nature of the inaccuracy (e.g., a misspelled address versus the complete omission of a beneficial owner) be relevant to the availability of the safe harbor?

Response: The relevant factor should be whether *mens rea* existed when the original filing was made. If not, the substitute filing should be accepted without penalty. As a policy matter, if FinCEN wants accurate information, it should not punish people for correcting mistakes.

Request for Comment: (25) Should a reporting company be required to report information about a company's "applicant" or "applicants" (the individual or individuals who file the

application to form or register a reporting company) in any report after the reporting company's initial report to FinCEN? Why or why not?

Response: No, because after the initial filing such information would be irrelevant to anything. The continuing reporting obligations are on the reporting company not the applicant. Such a reporting requirement would serve no law enforcement purpose but would increase costs, potentially requiring the reporting company to track an individual who had and has virtually nothing to do with the company for long periods.

Request for Comment: (34) As a U.S. Government agency, FinCEN is subject to strict security and privacy laws, regulations, and other requirements that will protect the security and confidentiality of beneficial ownership and applicant information. What additional security and privacy measures should FinCEN implement to protect this information and limit its use to authorized purposes, which includes facilitating important national security, intelligence, and law enforcement activities as well as financial institutions' compliance with AML, CFT, and CDD requirements under applicable law? Would it be sufficient to make misuse of such information subject to existing penalties for violations of the BSA and FinCEN regulations, or should other protections be put in place, and if so what should they be?

Response: Privacy is extremely important. Purposeful or negligent disclosure of reported beneficial ownership information should be seriously punished. Serious data security protocols should be in place.

Request for Comment: (37) One category of authorized access to beneficial ownership information from the FinCEN database involves "a request made by a Federal functional regulator or other appropriate regulatory agency." How should the term "appropriate regulatory agency" be interpreted? Should it be defined by regulation? If so, why and how?

Response: Yes, it should be defined by rule to prevent abuse and limit the disclosure of the information to important law enforcement purposes.

Request for Comment: (38) In what circumstances should applicant information be accessible on the same terms as beneficial ownership information (i.e., to agencies engaged in national security, intelligence, or law enforcement; to non-federal law enforcement agencies; to federal agencies, on behalf of certain foreign requestors; to federal functional regulators or other agencies; and to financial institutions subject to CDD requirements). If financial institutions are not required to consider applicant information in connection with due diligence on a reporting company opening an account, for example, should a financial institution's terms of access to applicant information differ from the terms of its access to beneficial ownership information?

Response: Financial institutions should only have access to that information necessary to satisfy their CDD requirements. Anything more is an entirely unwarranted, federally facilitated invasion of privacy.

Request for Comment: (39) What specific costs would CTA requirements impose—in terms of time, money, and human resources—on small businesses? Are those costs greater for certain

types of small businesses than others? What specifically can FinCEN do to minimize those costs, for all small businesses or for some types in particular?

Response:

Costs

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);¹¹ 4.3 million S corporation tax returns;¹² and 2.6 million LLC tax returns filed annually.¹³ There are also other partnership tax returns filed and tax returns of cooperatives and mutual companies. About 270,000 501(c) organizations¹⁴ filed Form 990 tax information returns.¹⁵ In addition, there are other tax-exempt organizations and about 350,000 religious congregations;¹⁶ these are not required to file annual Form 990s.¹⁷ 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.¹⁸ 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 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, heroically, that a small business owner can, on average, read and familiarize himself or herself with the 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 costs¹⁹ (which is likely for many given the ambiguities discussed above) — then the likely cost will be well over \$1 billion annually, and

¹¹ Internal Revenue Service, “Corporate Income Tax Returns, Tax Year 2013,” <https://www.irs.gov/pub/irs-soi/13CorporateReturnsOneSheet.pdf> 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>.

¹² 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>.

¹³ Internal Revenue Service, “Partnership Returns, 2015–2016,” 2016 data, <https://www.irs.gov/pub/irs-soi/16pa08.xlsx>.

¹⁴ Internal Revenue Code, §501(c). The data provided by the IRS is for §501(c)(3)-(9) organizations. There are other organizations exempt under §501(c).

¹⁵ 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>.

¹⁶ Association of Statisticians of American Religious Bodies, “U.S. Religion Census 2010,” May 1, 2012, http://www.usreligioncensus.org/press_release/ACP%2020120501.pdf

¹⁷ 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>.

¹⁸ Approximately, 88 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. Calculation: 87.8 percent x (5.9 million C corps + 4.3 S corps + 2.6 LLCs) = 11.2 million.

¹⁹ Litigation for a small firm is not just a cost of doing business but potentially ruinous.

quite probably 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.²⁰ *Importantly, the NFIB estimate does not include the costs to LLCs or other unincorporated entities, to exempt firms or not-for-profits who may be required to apply for an exemption under the CTA regulations.*

Cost Mitigation Strategies

There are three primary cost mitigation strategies.

First, FinCEN needs to make a serious effort to provide clarity in the definitions and requirements. FinCEN needs to clearly define terms in the rulemaking and systematically avoid weasel words like “substantially” and “significant” and “effectively.” It needs to use plain English that ordinary small business people can understand. It needs to provide examples.

It is always tempting for a regulatory agency to leave terms ambiguous and unclear so as to provide itself room to change its mind retroactively and to provide itself freedom of action or practical discretion so it can launch enforcement actions when it wants to do so. Given the class of persons who must comply with this rule (the smallest businesses in the country) and the stakes (large fines and criminal penalties), that is entirely inappropriate in this rulemaking.

Second, FinCEN should implement the small operating company exemption proposed in the Response to Request for Comment (7) above.

Third, FinCEN should implement the alternative compliance method safe harbor proposed in the Response to Request for Comment (40) below.

Request for Comment: (40) Are there alternatives to a single reporting requirement for all reporting companies that could create a less costly alternative for small businesses?

Response: Yes. FinCEN should implement an “alternative compliance method safe harbor” that would permit reporting companies to simply submit a copy of ownership information already provided to the Internal Revenue Service. This would be simpler for the reporting company AND provide more comprehensive ownership information to FinCEN. Ownership and control information is 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.];
3. 1120S (Schedule K-1) [Shareholder’s Share of Income, Deductions, Credits, etc.];
4. 1041 (Schedule K-1) [Beneficiary’s Share of Income, Deductions, Credits, etc.];
5. 1099 DIV [Dividends and Distributions]; and
6. (6) 8822-B [Change of Address or Responsible Party — Business].

²⁰ 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.

The reporting company would be deemed compliant if it simply filed with FinCEN a copy of any of these forms that were filed with the IRS. With this information, the complete ownership of every business using the method and each business' responsible party would be available to FinCEN, with the exception of non-dividend-paying C corporations.²¹ This approach would provide more comprehensive information to FinCEN than the proposed reporting regime. All owners would be reported. Tracing tiered ownership structures would be straightforward.

Request for Comment: (41) How can FinCEN best reach out to members of the small business community to ensure the efficiency and effectiveness of the filing process for entities subject to the requirements of the CTA?

Response: The three leading small business associations are the National Federation of Independent Business, the National Small Business Association and the Small Business & Entrepreneurship Council.

In addition, FinCEN should reach out to the following associations that have expressed concern about the CTA: The Air Conditioning Contractors of America, the American Hotel and Lodging Association, the American Rental Association, the Asian American Hotel Owners Association, the Associated Builders and Contractors, the Auto Care Association, the International Franchise Association, the National Association for the Self-Employed, the National Association of Home Builders, National Association of Wholesaler-Distributors, the National Restaurant Association, the National Retail Federation, the National Roofing Contractors Association, the National Tooling and Machining Association, the Precision Machined Parts Association, the Precision Metalforming Association, the Service Station Dealers of America and Allied Trades, the S-Corporation Association, the Specialty Equipment Market Association, the Real Estate Roundtable, and the Tire Industry Association.

FinCEN should also reach out to *actual* small business people, most of whom will be entirely unaware that these requirements are soon to be imposed on them and who will be surprised, if not overwhelmed, at the complexity and ambiguity of the requirements. A random sampling of a few dozen actual small business people – the people who will be actually grappling with the regulations promulgated by your agency – should be enough to give FinCEN a sense that this is not FinCEN's typical constituency. These are people actually running a business, top to bottom, already swamped by regulatory paperwork from the local, state and federal alphabet soup and they will typically not be attorneys, accountants or finance or AML compliance professionals.

Request for Comment: (47) How can FinCEN collect the identity information of beneficial owners through existing Federal, state, local, and tribal processes and procedures?

- a. Would FinCEN use of such processes or procedures be practicable and appropriate?
- b. Would FinCEN use of or reliance on existing processes and procedures help to lessen the costs to state, local, and tribal government agencies, or would it increase those costs?

²¹ Thus, non-dividend paying C corporations that were not exempt would not be eligible to use this method. A large majority of small businesses are not C corporations.

c. Would FinCEN use of existing Federal, state, local, and tribal processes and procedures help to lessen the costs to small businesses affected by CTA requirements, or would it increase those costs?

Response: See response to Request for Comment (40).

Request for Comment: (48) The process of forming legal entities may have ramifications that extend beyond the legal and economic consequences for legal entities themselves, and the reporting of beneficial ownership information about legal entities may have ramifications that extend beyond the effect of mobilizing such information for AML/CFT purposes. How can FinCEN best engage representatives of civil society stakeholders that may not be directly affected by a beneficial ownership information reporting rule but that are concerned for such larger ramifications?

Response: In general, FinCEN has absolutely no business engaging “representatives of civil society stakeholders that may not be directly affected by a beneficial ownership information reporting rule but that are concerned for such larger ramifications.” NDAA §6402 makes it clear that the purpose of the CTA is to “facilitate important national security, intelligence, and law enforcement activities.” There are those that want access to this information so that they can put political pressure on businesses and their owners to achieve social or political ends unrelated to national security or law enforcement. The original CTA bills would have made the beneficial ownership reporting databases public for that purpose. Those bills gained no traction. They were not enacted into law.

Sincerely,

A handwritten signature in black ink, appearing to read 'D.R. Burton', with a long horizontal flourish extending to the right.

David R. Burton
Senior Fellow in Economic Policy
The Heritage Foundation