Rethinking the Path to Corporate Transparency

by Michael J.A. Karlin

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In this article, Karlin questions the administrative burden created by the Corporate Transparency Act and considers alternative ways to meet the act's goals.

As attacks on the Corporate Transparency Act (CTA) mount, I am driven to wonder what might have happened if the responsibility for implementing it had fallen not to the Financial Crimes Enforcement Network but to, say, the Department of Commerce. I am skeptical about the constitutional challenges to the CTA — the arguments, whether based on federalism principles or alleged violations of various provisions of the Bill of Rights or some notion that the act goes beyond the powers of Congress under the commerce clause, all seem to me to be stretched. I think the government is entitled to the information it is asking for, and I expect the challenges to fail.

The challengers are trying to deal with a problem with the CTA that has little to do with constitutionality and more to do with common sense. Can Congress — can the administration — do what has been done? Can they require compliance with the act and the regulations? I think so. But should they?

The statistics provided, and not provided, by FinCEN itself help provide the answer.[1] An estimated 32 million pre-2023 entities are covered by the CTA. There will be an estimated 5 million annual entity formations, meaning the number of entities covered will double in about six years. What is missing is FinCEN's estimate of how many of these entities are in fact being used for money laundering and concealing ownership by sanctioned individuals, corruption, and other financial crimes. One percent (300,000 entities)? More? Fewer? Surely not many more and probably a whole lot fewer. And so we have a gigantic sledgehammer aimed at a tiny nut, with a massive amount of expensive collateral damage to the surrounding victims, wildly underestimated, as the sledgehammer crashes indiscriminately down on them.

The starting point for reducing the costs of compliance is the many more than 31 million entities (and the vast majority of the annual 5 million new entrants onto the field of battle) that are *not* engaged in money laundering or other financial crimes. Switching metaphors, FinCEN is imposing an absurdly costly burden on a huge number of perfectly legitimate businesses in its pursuit of a few needles in a vast haystack.

FinCEN provided the following estimates of the cost of compliance for affected entities. Rather than dollar amounts, we got hours: During year 1, the annual burden will be 8,743,781 hours; in year 2 and onward, the estimate is that the annual burden will be 3,616,964 hours. In other words, about a quarter of an hour per entity in year 1 and about six minutes per entity in year 2. These numbers don't require analysis — they simply invite derision.

What if, instead, we had started by looking for ways to reduce this burden? It doesn't take long to think of a few. I am throwing spaghetti against a wall here, but how about all the information the government already has? Take S corporations and partnerships. Their ultimate owners are all reported to the government each year on Schedules K-1. All we had to do was amend section 6103 of the Internal Revenue Code and

[1] All numbers in this article are from FinCEN's final rule (31 CFR Part 1010, RIN 1506-AB59), Beneficial Ownership Information Access and Safeguards, 88 F.R. 88,732 (Dec. 22, 2023).

make that information available to law enforcement. That would knock out separate filing requirements for most of the entities. How about releasing information provided about corporations with 25 percent foreign owners that file Form 5472? Make that available to law enforcement. What about regulated professional firms, such as law firms or architects or medical practices? Their information is available from their regulators. Simply require that those regulators release the information if FinCEN asks for it.

Suppose that an entity is an object of concern. Another solution would be to impose heavy penalties for failing to disclose beneficial ownership information when it is requested, rather than asking for it upfront.

These are just a smattering of ideas about how we could use the information already available that is required to be provided by the heavy-handed FinCEN regulations.

I go back to my original question. What if, instead of FinCEN, the Department of Commerce had been charged with implementing the CTA? Surely, or at least hopefully, its approach would have been: How do we reduce or eliminate the burden on small businesses and make sure the act reaches its real intended targets? In other words, the starting point should not be that a small number of bad actors can use our system of cheap entity formation and therefore everyone must forgo its benefits and spend a lot of money providing information to the government that will never be used. We rightfully have strict requirements to be allowed to board an aircraft, but this is not a comparable situation in which human lives are directly at risk. Instead, the approach should recognize that the overwhelming majority of users of our business entity formation and maintenance systems are not bad actors. We can surely use more finely targeted ways of finding those bad actors.

And wait until the government gets hacked and all the data obtained by invading the privacy of all those millions of entities gets released to the world, including all those other sorts of criminals who will know how to abuse it.

Congress and the executive branch: It's time to go back to the drawing board. ■