Negative: Shell Corporations – not a problem

By “Coach Vance” Trefethen

***Resolved: The United States Federal Government should substantially reform its banking, finance, and/or monetary policy***

Summary: A “shell” corporation is a registered corporate entity that really exists only on paper. It might have no assets, no business location, no headquarters and no employees. Its purpose is to own or control other corporations and maintain secrecy for the owners who registered it. Shell corporations, with their anonymity, can be misused to hide nefarious financial activities (drug sales, money laundering, weapons dealing, tax evasion). The AFF plan will require more disclosure and naming of the individuals who register shell corporations (sometimes called in the literature “beneficial owners”) to deter their misuse. FYI, corporations are formed under State law, not federal, and the inherency to this case is that State laws are not strict enough and have too many loopholes.

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Negative: Shell Corporations

MINOR REPAIR

1. Use existing data

Putting existing data into a database would solve without AFF plan

David Burton 2018 (Senior Fellow in Economic Policy at Heritage Foundation) 5 Mar 2018 “Beneficial Ownership Reporting Regime Targets Small Businesses and Religious Congregations” <https://www.heritage.org/economic-and-property-rights/report/beneficial-ownership-reporting-regime-targets-small-businesses>

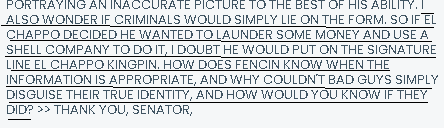
The vast majority of the information that the proposed beneficial ownership reporting regime would obtain is *already* provided to the Internal Revenue Service. Simply creating a database based on information provided to the IRS and allowing the IRS to share this information with the Treasury Department’s Financial Crimes Enforcement Network (FinCEN) would better meet the needs of law enforcement by providing more comprehensive information and better enforcement than would the proposed beneficial ownership reporting regimes.

SOLVENCY

1. Bad guys lie on forms

New forms to fill out don’t mean much, since bad guys will lie on those too

Sen. Pat Toomey 2019 (R-Pennsylvania) 21 May 2019 hearing before the Senate Finance Committee Illicit Financing and Anonymous Shell Companies <https://www.c-span.org/video/?460929-1/senate-banking-committee-holds-hearing-illicit-financing-anonymous-shell-companies&start=2402> (Note: “FENCIN” in this transcript is a misspelling of “FINCEN,” the Treasury Department Financial Crimes Enforcement Network)



May be shocking but: Criminals won’t follow the rules

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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 $40 million in funding contemplated in the legislation is vastly too low to support non-trivial audit rates on roughly 12 million entities.

A/T “Our enforcement will catch them” – Actually it won’t. IRS audits and funding for investigation are far too feeble

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In fiscal year 2016, the Internal Revenue Service audited 21,136 C-corporation tax returns and 30,514 partnership or S-corporation tax returns. The IRS audit rate for C corporations was 1.1 percent and for pass-through entities less than 0.4 percent. The IRS has an enforcement budget of approximately $4.7 billion, although only a portion of this relates to business tax returns. The contemplated $40 million budget is less than one percent of the IRS enforcement budget, and the bulk of the $40 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.

2. Compliance impossible

So many twists and turns in the rules that some scenarios would make compliance literally impossible

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Thus, for example, a non-exempt firm that had an investment from a venture capital fund would presumably have to obtain information and report on the beneficial ownership of the venture capital fund and report any changes to the venture capital fund’s ownership. How the entrepreneurial firm would be able to secure regular updates from its venture capital fund investor so as to make new filings with FinCEN within the required 60 days regarding change of ownership in the venture capital firm is left unexplained—even though failure to do so would be a felony. The entrepreneur would have no legal means of compelling compliance by the venture capital fund. It is particularly unclear how this would be accomplished if the investing corporation (the venture capital firm, for example) is exempt and not required to report its beneficial ownership. In fact, exempt firms may not even *know* their beneficial ownership (as defined in the legislation).

3. Evasion Easy – even under the new reporting rules

Bad guys can evade easily by using a “two-tier” corporate structure

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Successful money launderers are typically sophisticated. They can lawfully avoid the requirements of the proposed reporting regime quite easily. It does not apply to partnerships (general partnerships, limited partnerships, limited liability partnerships) and business trusts. Therefore, to avoid the application of these rules, they 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 and 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, then the requirements could be lawfully avoided by simply having a two-tier corporate structure.

4. Already tried & Failed

Other countries have already tried the AFF plan and it didn’t work

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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. But 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. Since the tax information is already available to the IRS (to the extent firms are compliant with the U.S. tax-reporting requirements), the only gain to be had for the U.S. from the proposed regime is with respect to non-tax law enforcement.

DISADVANTAGES

1. Burden exceeds benefit (government cost + private sector costs)

Government enforcement costs of money laundering enforcement exceed benefits

**[In context this article is talking about the “beneficial owners” rule proposed in the AFF plan compared with money laundering rules in general]**

Richard Rahn 2019 (*chairman of the Institute for Global Economic Growth and Improbable Success Production*) 11 Nov 2019 “Abuse of government control over banks can happen in U.S.” <https://www.washingtontimes.com/news/2019/nov/11/abuse-of-government-control-over-banks-can-happen-/>

All of this is being done in the name of trying to reduce “money laundering.” The existing anti-money laundering rules and regulations are estimated to cost $4.8 billion to $8 billion per year. Yet, all of these costs and efforts result in fewer than 700 convictions per year (many of which are just add-ons). Sophisticated people can find many legal and illegal ways to launder money, so the law catches mostly the naive, at a cost of $7 million per conviction — which is a huge waste of resources.

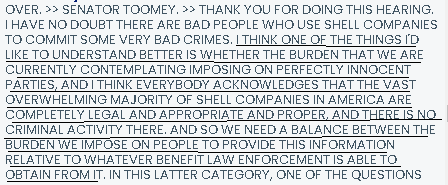
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These figures also give a sense of the scale of the compliance industry that would develop and the costs that would be incurred. Assuming, probably heroically, that a small business owner can, on average, read and become familiar with these rules and file the relevant form in one hour, then the number of compliance hours would be 12 million hours. Monetized at $50/hour (which is a very low, fully burdened rate for management), the compliance costs would be $600 million. If, more realistically, you assume a greater compliance time or a higher hourly rate or that one engages outside counsel or compliance experts (which is likely for many, given the ambiguities discussed above), then the likely cost would be well over $1 billion annually and quite likely many billions of dollars.

Burden on the many law-abiding corporate owners exceeds the potential anti-crime benefit

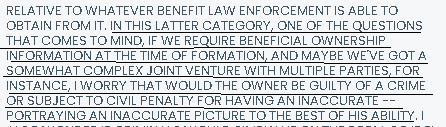
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2. Punishing the innocent

Corporate structures are so complex that innocent corporate directors could easily be prosecuted for honest mistakes

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Complicated disclosure requirements would get innocent people prosecuted for honest mistakes

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It would require a corporation or limited liability company to file a report with the Treasury containing a list of its beneficial owners. However, partnerships, trusts, and other legal entities would be exempt, (as if any of this made any sense). A couple of million other businesses and non-profits, including churches, will need to seek exemption from the regime. Failure to report fully and accurately can result in substantial fines and even prison time. Most very small business, charity and church officials are likely unaware of all of the new requirements, let alone understanding them, given the vagueness of much of the language. Are we really going to send the “church lady” who also keeps the books to jail because she failed to file an incomprehensible form to the government, with no cost-benefit justification?

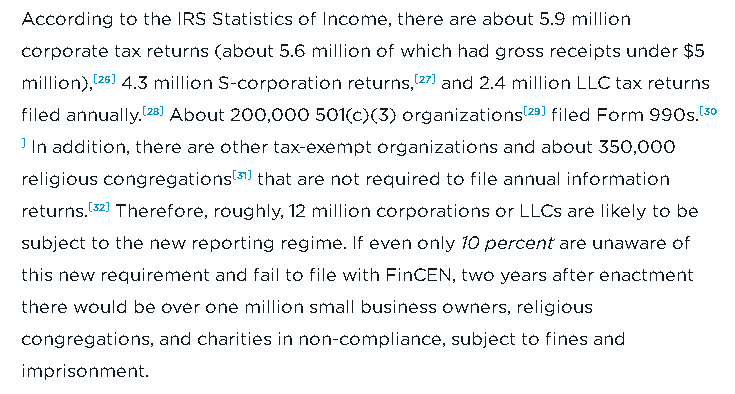
Quantification: Plan would create 1 million new inadvertent felons

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The proposed beneficial ownership reporting requirements being debated by Congress would create a major administrative burden on small business and religious congregations—creating a new class of up to one million inadvertent felons. Furthermore, the vast majority of the information that the proposed reporting regime would obtain is already provided to the Internal Revenue Service.

Thousands of church pastors become felons

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3. Human rights abuses

AFF plan would create the same kind of government abuse of power as happens in Russia. And yes, it can and would happen here in the U.S.

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Opposition leaders who are fighting the corruption of the Putin regime have found their bank accounts drained in recent months. The Russian government uses the excuse that the monies are corrupt, when, in fact, the corruption fighters are being deprived of their property by the corrupt government as a warning not to oppose the Putin-controlled state.  Many believe that the abuse of government control over banks could not happen in the United States. But, in fact, it already happened under the Obama administration when the administration sent word to the banks that opening and maintaining accounts for “socially undesirable” businesses like gun dealers would be looked upon with disfavor. This, despite the fact that such businesses are totally legal, and “socially undesirable” has no basis in law and is totally in the eye of the government bureaucrats. Because banks are so highly regulated, bank executives, for good reason, are justifiably afraid of irritating the regulators, who can subject them to extreme and costly audits, etc. It is ironic that many in the press and political left accuse President Trump of fascism, while it was the Obama administration that used the IRS, bank regulators and the FBI to abuse and spy upon political opponents.  Congress may soon greatly increase the power of the government over not only banks, but all businesses, particularly, small businesses, with greatly expanded “beneficial ownership” reporting requirements.

4. Small businesses destroyed

Reporting requirements are so complicated that small businesses would incur costs big enough to destroy them

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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 brief description in the section above, determining who is and is not a “beneficial owner” under the proposal is complex, highly ambiguous, and would often require hiring counsel or a compliance expert. In fact, it would probably take a decade or more of prosecutions and litigation before the meanings of “beneficial owner,” “substantial control as a practical matter,” “substantial economic benefit,” “an entitlement to the funds or assets,” and “directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise” are reasonably well established. Defending these cases would be expensive and would in many cases economically destroy the small business and business owner who must defend themselves against the federal government.

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Even “exempt” entities, however, must 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 anti-money-laundering laws and regulations any more than does the local baker, restauranteur, or Main Street store owner.

A/T “Small businesses exempt” – Actually they’re not. They still have to file complicated forms to prove they’re “exempt”

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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, the reporting burden may be quite high. An entire army of compliance experts and lawyers would develop to explain these rules and how to file with FinCEN.