September 1, 2016

Re: S. 2489, the Incorporation Transparency and Law Enforcement Assistance Act

Dear Senate Judiciary Committee Members:

The National Association of Criminal Defense Lawyers (NACDL) wishes to raise concerns regarding S. 2489, the “Incorporation Transparency and Law Enforcement Assistance Act” (“ITLEAA”) and its companion, H.R. 4450. Specifically, this bill imposes a criminal penalty of up to three years of imprisonment for conduct that is, in essence, a paperwork violation. NACDL is concerned that law-abiding citizens could be convicted under this offense even where there is inadequate intent to commit a crime, given its vague definitions and authorization of further regulatory input.

In sum, ITLEAA mandates that states amend their incorporation laws to require those forming new corporations and LLCs to provide a list of the “beneficial owners” of the business to the state of formation. In addition to the initial filing, businesses must update their filing within 60 days of any change in the beneficial ownership information (or within 10 days if a formation agent is involved), and update the filing annually. (Importantly, these mandated disclosures seem to be triggered by occurrence, rather than a person’s notice of their occurrence.) This bill also seeks to amend the United States Code to include individuals who form new corporations and LLCs within the definition of “financial institutions,” thereby subjecting these individuals (including lawyers) to a variety of many additional recordkeeping and reporting regulations under existing federal laws that themselves carry criminal penalties.

NACDL is concerned with several provisions of ITLEAA, as detailed below. Specifically, the bill creates the following four new federal criminal offenses: (A) knowingly providing false beneficial ownership information, including a false identifying photograph; (B) willfully failing to provide complete or updated beneficial ownership information; (C) knowingly disclosing the existence of a subpoena, summons, or other request for beneficial ownership information (with limited exceptions); and (D) in the case of a formation agent, knowingly failing to obtain or maintain credible, legible, and updated beneficial ownership information. Each of these offenses would be punishable by a civil fine of up to $1,000,000, criminal fines, and imprisonment of up to three years. Such penalties would be in addition to any civil or criminal penalty that may be imposed by a state.

NACDL is concerned about the inclusion of criminal offenses in this bill for a number of reasons. First, this bill criminalizes the failure to provide complete or current beneficial ownership information or the provision of incorrect beneficial ownership information, but the bill’s definition of who constitutes a “beneficial owner” is vague and overbroad. Therefore, unfortunately, someone could be prosecuted for simply failing to understand what the law actually requires. Under the current definition, a person must have “direct or indirect substantial” control over, interest in, or receive an economic benefit from the corporate entity, in order to be a beneficial owner. What constitutes “indirect” control? What qualifies as “substantial” control? Unlike other similar corporate law definitions, this definition does not require that an individual’s control or entitlement to funds enable him or her to actually control, manage, or direct the corporation. In addition, while the definition includes a list of
exceptions, it also sets forth a broadly drafted exclusionary provision, lacking definition, standards, or a mens rea requirement, that seriously undermines the application of the exceptions.[i] Fundamental notions of fairness, as well as basic constitutional principles, require that individuals understand what is required of them under the law before they can be imprisoned for noncompliance. ITLEAA fails to satisfy these requirements.

Second, as discussed at length in our Without Intent report, published jointly with the Heritage Foundation, meaningful mens rea requirements are critical to protecting against unjust prosecutions, convictions, and punishments.[ii] With rare exception, the government should not be allowed to wield its power against an individual without having to prove that he or she acted with a wrongful intent. Absent a meaningful mens rea requirement, an individual’s other legal and constitutional rights cannot protect him or her from unjust punishment for making honest mistakes or engaging in conduct that he or she had every reason to believe was legal. This is particularly true in the case of certain paperwork or disclosure violations like those set forth in this bill. Three of the offenses in this bill only require general intent, i.e. “knowing” conduct, which federal courts regularly interpret to mean conduct merely done consciously.[iii] An individual need not have known that he or she was violating the law or acting in a wrongful manner in order to be convicted. In the case of certain crimes, general intent may be sufficient because the conduct is itself wrongful. However, when applied to conduct that is not inherently wrongful, such as committing certain “paperwork” violations, the “knowingly” mens rea requirement allows for punishment without an appropriate level of wrongful intent or culpability. Despite every intention to follow the law, even a cautious person could be found guilty under such laws. Importantly, these types of criminal provisions do not truly deter criminal activity because they do not require the defendant to have any notice of the law or the wrongful nature of his or her conduct.

These problems are compounded by the breadth of application in the disclosure offense at (b)(1)(C) and the vague terminology in the formation agent offense at (b)(1)(D). The disclosure offense (making it a crime to disclose “the existence of a subpoena, summons, or other request for beneficial ownership information”) is extremely troubling because it is not limited in its application to individuals who would be on notice of the prohibition of such disclosure, nor does it require an individual to “know” such disclosure is prohibited before he or she can be prosecuted. Aside from the offense itself, there is nothing that would alert anyone that this type of information is of a nature that should not be disclosed. Criminalizing the disclosure of such commonplace information could thus turn law-abiding individuals into felons. Similarly, the formation agent offense (making it a crime to fail to “obtain or maintain credible, legible, and updated beneficial ownership information”) employs vague terms without any definition or standards. Absent clear, specific requirements, individuals can fall victim to vague laws.

Third, NACDL objects to the inclusion of criminal penalties in ITLEAA because there is no justification for turning a “paperwork” violation, particularly a first-time violation, into a criminal offense, let alone a felony federal criminal offense. Criminal prosecution and punishment constitute the greatest power that a government routinely uses against its own citizens. As Harvard Professor Herbert Wechsler famously put it, criminal law “governs the strongest force that we permit official agencies to bring to bear on individuals.”[iv] This law would result in a criminal conviction and, in some cases a term of imprisonment, for a
person’s failure to provide the proper paperwork. This could include a person who is sloppy or lazy, or who happens to make a mistake, even where there is no actual harm resulting from his or her conduct. None of these offenses require a specific intent to violate the law, a specific intent to assist others in violating the law, or require the showing of any harm to another individual or the United States. This is, quite simply, a punishment that does not fit the crime.

NACDL is also troubled by the potential for further regulatory criminalization present in ITLEAA. Specifically, it authorizes unelected government employees to set forth regulations “clarifying” the bill’s own definitions and specifying how to verify beneficial ownership or other identification information. While this rulemaking could hypothetically assist in bringing more concrete definitions and terms to the bill’s criminal offenses, that responsibility falls squarely on the shoulders of Congress, not unelected government employees. As discussed in the Without Intent report, regulatory criminalization raises serious constitutional and separation of powers concerns, and unduly complicates the criminal code. Here, the regulatory criminalization is particularly disturbing because the bill explicitly circumvents the regular rulemaking process, which includes periods of public comment, and allows government employees to enact regulations with criminal consequences by fiat.

Lastly, NACDL is also concerned that ITLEAA would require members of the legal profession to establish anti-money laundering programs inside their own business entities. Such a program would require lawyers to “report” on their own clients and may very likely lead to conflicts between a lawyer’s legal obligations under ITLEAA and a lawyer’s ethical obligations to his or her client. The exclusion of attorneys who pay to use a separate formation agent to form the corporation will still not likely remedy attorney-client privilege and conflict concerns. In addition, lawyers should not be forced to choose between outsourcing work, which they are particularly suited to handle, and establishing mandating in-house reporting programs. NACDL rejects this Hobson’s choice and strongly encourages the absolute exclusion of members of the legal profession from the definition of “financial institution.”

Finally, NACDL wishes to bring attention to the fact that the bill provides a lengthy list of exempt entities, thus leaving the disclosure obligations to fall predominantly on small businesses, who are the least likely to have in-house counsel or the resources to engage outside counsel for the purpose of properly meeting these new disclosure requirements. These small business owners will be forced to decide between the risk of criminal prosecution and the expense of counsel; though, for many, their financial circumstances will dictate that decision.

The injury inflicted by a single misguided, even if well-intentioned, act of overcriminalization is not limited to an individual defendant and his or her family, but rather it undermines our entire criminal justice system and public confidence therein. For all the reasons listed herein, NACDL urges you to not to support such flawed criminal law-making.

Respectfully,
Shana-Tara O’Toole

[i] Specifically, the bill states that the exceptions “shall not apply if used for the purpose of evading, circumventing, or abusing” the disclosure provisions of the bill.

[iii] The fourth criminal offense in this bill, at (b)(1)(B), includes the mens rea requirement “willfully.” While this offense could be improved with a materiality requirement, this mens rea requirement is a significant improvement over previous versions of the offense.