October 2, 2017

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Re: H.R. 3089, the Corporate Transparency Act of 2017

Dear Chairman Hensarling and Ranking Member Waters:

The National Association of Criminal Defense Lawyers (NACDL) wishes to raise concerns regarding H.R. 3089, the Corporate Transparency Act of 2017. Specifically, this bill imposes a criminal penalty of up to three years of imprisonment for conduct that is, in essence, a paperwork violation—even for a first-time offender. Given the bill's broad reach, vague definitions, and authorization of further regulatory input, NACDL is concerned that law-abiding citizens could be convicted under these offenses even where there is inadequate intent to violate the law.

The Corporate Transparency Act of 2017 requires either that states amend their own incorporation laws, or for non-compliant states, tasks the Financial Crimes Enforcement Network (FinCEN) to maintain information concerning anyone deemed a "beneficial owner" of any corporation or LLC. To achieve this goal, the act requires anyone forming such a corporation to provide a list of every possible "beneficial owner" of the business, along with various other information (such as a current addresses of those owners), to either the state of formation or FinCEN. In addition to the initial filing, these filings must be updated within 60 days of any change in the beneficial ownership information, and these filings must also be updated annually. (Importantly, these mandated updates seem to be triggered by their mere occurrence, rather than a person's notice of their occurrence—something that *should* serve as an important distinction in assessing the criminality of someone's failure to meet these legal obligations.) The bill would create four new federal criminal offenses, each of which is 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 also be imposed by a state. The bill also seeks to amend the United States Code to include anyone who forms a corporation or LLC, including lawyers who owe ethical duties to their clients, to a variety of many additional record-keeping

and reporting regulations under numerous additional existing federal criminal laws. NACDL is concerned about the creation of new criminalization under these circumstances for a number of reasons.

As an initial matter, NACDL is deeply concerned that the Corporate Transparency Act would require members of the legal profession to establish anti-money laundering and other compliance programs inside their own business entities. Such programs would require lawyers to "report on" their own clients and will very likely lead to conflicts between a lawyer's legal obligations under this law and a lawyer's existing legal and ethical obligations to his or her client. The attorney-client privilege is one of the oldest, and most sacrosanct, privileges in our legal canon. The unassailable existence of the privilege is fundamental to fairness and balance in our justice system and, separately, is essential to successful corporate compliance regimes. Without reliable privilege protections, business owners and employees will be discouraged from asking difficult questions or seeking guidance regarding the most sensitive situations. The bill's 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 and, in fact, would be promoting the unauthorized practice of law in certain jurisdictions. In addition, lawyers should not be forced to choose between outsourcing work that they are particularly suited to handle and establishing in-house reporting programs that violate their ethical duties. NACDL rejects this Hobson's choice and strongly encourages the absolute exclusion of members of the legal profession from this bill's mandates.

Second, this bill criminalizes the failure to provide complete or merely current beneficial ownership information as well as the provision of incorrect beneficial ownership information, but the bill's definition of who constitutes a "beneficial owner" is both overly broad and unknowingly vague. As a result, someone could be prosecuted for simply failing to understand what the law actually requires. Under the current definition, any person who has either direct or indirect "substantial control over," "interest in," or who directly or indirectly receives an economic benefit from the corporate entity, is a beneficial owner. But how is one to know what constitutes an "indirect economic benefit," for example? Unlike other similar corporate law definitions, the bill's definition of "beneficial owner" does not require that an individual's control or entitlement to funds enable him or her to *actually* control, manage, or direct the corporation. 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. Despite previous communications raising concerns over the overbreadth and vagueness of the bill's single most important term, which would serve as the basis of multiple new federal criminal laws, this newest iteration still fails to satisfy these requirements.

The concerns that arise over vague definitions for key statutory terms are compounded by both the breadth of these provisions and a lack of meaningful criminal intent. For example, the

disclosure offense at (c)(1)(A)(iii), which makes 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 people who would be on notice of the prohibition of such a disclosure. There is nothing inherent in this type of situation that would naturally alert anyone that any request for information should not be disclosed. To criminalize the disclosure of a request for such commonplace information (like the name and address of a business's owner) could thus turn law-abiding individuals into felons. Similarly, the formation agent offense at (c)(1)(B), which makes it a crime to fail to "obtain or maintain credible, legible, and updated beneficial ownership information," actually criminalizes people for something that is potentially not even in their control. A formation agent can certainly *attempt* to obtain updated information, such as a current address of a former client, but has no ability to compel an unresponsive third party to respond at all. The provision would make it a federal felony if the formation agent's records were simply out of date and irrespective of any intent to evade the reporting requirements.

In addition, meaningful criminal intent requirements are critical to protecting against unjust prosecutions, convictions, and punishments. With rare exception, the government should not be allowed to imprison individuals without having to prove that he or she acted with a wrongful intent. Absent a meaningful criminal intent 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, including the two mentioned above, only require general intent, i.e. "knowing" conduct. While it is reasonable for someone to presume that the term "knowing" means what commonsense dictates it would mean, unfortunately, federal courts regularly interpret "knowing" to mean conduct that is merely done consciously. Specifically, under the current version of the bill, a person would not necessarily need to have known that he or she was violating the law or acting in a wrongful manner when they disclosed the existence of a subpoena in order to be convicted of a crime; they would merely need to have consciously disclosed the subpoena. Nor would a formation agent need to purposefully or willfully fail to obtain updated information from third parties. In the case of certain crimes, general intent terms like "knowing" may be sufficient because the conduct of the offense is innately wrongful. However, when applied to conduct that is not inherently criminal, such as committing certain paperwork violations like those in this bill, the "knowing" standard 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 also do not truly deter criminal activity because they do not require the individual to have had any notice of their legal obligation or the wrongful nature of his or her conduct.

Moreover, NACDL objects to the inclusion of criminal penalties in the act 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."[1] 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. Given the human and fiscal cost of decades of such overcriminalization, NACDL urges Congress to legislate more carefully when criminalizing additional conduct.

NACDL is further concerned by the act's rejection of state control over local businesses. The act suggests that states should adopt the reporting requirements. However, if the states, as a matter of local policy and interest, do not enact these requirements, the act still requires individuals in those states to register with FinCEN. If a state justifiably rejected the reporting requirements, individuals in full compliance with state law would still face the threat of federal punishment.

NACDL is also troubled by the potential for further regulatory criminalization present in the act. Specifically, it authorizes unelected government employees to set forth regulations furthering the bill's mandates. While this rulemaking could hypothetically assist in bringing more concrete definitions and terms to the bill's criminal offenses, that responsibility should fall on the shoulders of Congress, not unelected government employees. Regulatory criminalization raises serious constitutional and separation of powers concerns, and unduly complicates the criminal code. With an already unknowable number of existing federal criminal regulations that individuals and business entities are meant to comply with, NACDL urges Congress to not invite the enactment of additional regulations with criminal consequences by bureaucratic fiat.

Finally, NACDL wishes to bring attention to the fact that the bill provides a lengthy list of large sophisticated exempt business entities, thus leaving the disclosure obligations to fall predominantly on small businesses, who are the least likely to have sophistical in-house lawyers or the resources to engage outside attorneys for the purpose of properly understanding and 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. Surprisingly, this legislation would apply retroactively and apply to all existing legal entities (not just those formed after enactment). With

[1] Herbert Wechsler, *The Challenge of a Model Penal Code*, 65 Harv. L. Rev. 1097, 1098 (1952).

no notice, small businesses that have been in operation for decades will suddenly be subject to brand new obligations that can be penalized with jail time.

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 support such flawed criminal law-making.

Respectfully,

The National Association of Criminal Defense Lawyers (NACDL)

cc: Members of the House Financial Services Committee