



## IRS Does Not Collect Beneficial Ownership Information and Additional Concerns with an IRS Approach

To: Interested Parties  
From: The FACT Coalition  
Date: May 7, 2018

**RE: The IRS Does Not Collect Beneficial Ownership Information and Additional Concerns with an IRS Approach**

---

### Background

Global concern over the threats created by anonymous companies have been growing rapidly since the 2016 release of the Panama Papers.<sup>1</sup> The vast array of problems touches multiple sectors of our economy (e.g. counterfeit goods and services and fraudulent contracting), threatens national security (terror finance and sanctions evasion) and reaches into our communities (fueling the opioid epidemic and lack of affordable housing).

In response, the European Union has moved toward transparency. The United Kingdom has public beneficial ownership directories up and running. Even some of the most notorious secrecy jurisdictions — the Cayman Islands, Bermuda, and the British Virgin Islands — are facing new requirements to disclose beneficial ownership information.

The U.S. Congress is seriously considering legislation to end the abuse of anonymous companies.<sup>2</sup> Legislation in the House would direct the Financial Crimes Enforcement Network (FinCEN) to collect the information.<sup>3</sup> A Senate companion bill would do the same.<sup>4</sup> A second bill in the Senate would have the states collect the information.<sup>5</sup> Both approaches have benefits and offer workable solutions.

An additional approach has been raised — to use existing forms at the Internal Revenue Service (IRS) and hold the information at the tax authority. Unlike the bills, this approach has three fundamental

---

<sup>1</sup> See International Consortium of Investigative Journalists, *The Panama Papers: Exposing the Rogue Offshore Finance Industry*, April 2016, available at <https://www.icij.org/investigations/panama-papers/>.

<sup>2</sup> See House Committee on Financial Services, Joint Hearing entitled “Legislative Proposals to Counter Terrorism and Illicit Finance”, Nov. 29, 2017, available at <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=402691>.

<sup>3</sup> See H.R.3089, the Corporate Transparency Act of 2017, available at <https://www.congress.gov/bill/115th-congress/house-bill/3089>.

<sup>4</sup> See S.1717, the Corporate Transparency Act of 2017, available at <https://www.congress.gov/bill/115th-congress/senate-bill/1717>.

<sup>5</sup> See S.1454, the TITLE Act, available at <https://www.congress.gov/bill/115th-congress/senate-bill/1454>.

flaws that would undermine an effective response to the problems created by anonymous shell companies. The flaws are:

1. IRS forms do not require beneficial ownership information to be provided;
2. Even if the definition was properly amended, not all companies file with the IRS; and
3. Access to taxpayer information is restricted, creating barriers to those who would use the information.

## 1. IRS Forms Do Not Require Beneficial Ownership Information to Be Provided

It has been argued that the United States already collects beneficial ownership information for American companies through a variety of tax forms. They argue that new legislation requiring American companies to disclose their beneficial ownership information is therefore unnecessary because the IRS could simply be required to create a beneficial ownership database from the information provided in the identified forms.

Unfortunately, the tax forms identified allow for stand-ins for beneficial ownership to be listed. Requirements for identification of shareholders and partners could be actual real, natural persons, but they could also be other American or foreign companies, trusts, estates, etc., and not what is understood to be ultimate beneficial ownership.

There are six different IRS forms that have been suggested as sufficient to collect “the ownership of every business in America and each business’ responsible party” with the exception of non-dividend paying C corporations.<sup>6</sup> While they may collect ownership information, they do not necessarily collect beneficial ownership information, and they do not collect responsible party information for every American company. The six forms identified are:

- SS-4 (application for an Employer Identification Number (EIN))
- 1065 (Schedule K-1: Partner’s Share of Income, Deductions, Credits, Etc.)
- 1120S (Schedule K-1: Shareholder’s Share of Income, Deductions, Credits, etc.)
- 1041 (Schedule K-1: Beneficiary’s share of Income, Deductions, Credits, etc.)
- 1099 DIV (Dividends and Distributions); and
- 8822-B (Change of Address for Responsible Party: Business)

In considering the sufficiency of these forms, there are two key things to remember. First, a beneficial owner cannot be a legal entity — we are looking for the human being(s) at the end of what may be a chain of corporate/legal entity ownership. Second, American companies can and do have foreign legal entity ownership.

---

<sup>6</sup> Burton, David. *Backgrounder: Beneficial Ownership Reporting Regime Targets Small Businesses and Religious Congregations*. The Heritage Foundation, March 2018, available at [https://www.heritage.org/sites/default/files/2018-03/BG3289\\_0.pdf](https://www.heritage.org/sites/default/files/2018-03/BG3289_0.pdf).

The Schedule K-1s and the 1099 DIV are forms that tell the IRS who the shareholders, partners, and beneficiaries are of partnerships' and some corporations' wealth. Essentially, they identify to which owners a corporation or partnership distributed its profits. While, in some cases, that owner will be a human being — representing the end of an ownership chain and therefore a beneficial owner — that owner might just as easily be another corporation, partnership, trust, or estate. That is certainly not a beneficial owner.

One might argue that if those legal entity owners are also distributing profits upward, eventually the payouts will get to a real person. That is not necessarily true. The company may not make a distribution that year. The filer may be a trust or an estate, where those profits are simply absorbed. The distribution may be to a foreign entity that does not need to file in the U.S. In each scenario, we move further and further away from identifying our beneficial owners.

One might argue that none of the above matters because all American companies file an SS-4 form and provide information about a “responsible party” which is a beneficial owner by another name. That is also not necessarily the case.

The SS-4 form collects information on *one* “responsible party”. The IRS has amended the definition of “responsible party” a number of times over the past nine years to bring it ever closer to the concept of a beneficial owner. When FACT began working on this issue in 2009, a “responsible party” could be (and often was) another company. In meetings with IRS officials, we were told that the responsible party was intended to simply be a contact in case the IRS had a question.

The IRS most recently amended the definition of “responsible party” on the SS-4 Form in December of 2017. A responsible party is now “the person who ultimately owns or controls the entity or who exercises ultimate effective control over the entity. The person identified as the responsible party should have a level of control over, or entitlement to, the funds or assets in the entity that, as a practical matter, enables the person, directly or indirectly, to control, manage, or direct the entity and the disposition of its funds and assets. Unless the applicant is a government entity, the responsible party must be an individual (i.e., a natural person), not an entity.”

This brings the definition of responsible party closer to the concept of beneficial ownership but still suffers one significant flaw. Someone reading that definition would be quite likely to list the President, CEO or CFO of the company because they have a level of control over the funds or assets of the entity that enables them to manage it. But being a manager of a company does not make you a beneficial owner — it makes you an employee with a high degree of responsibility.

In 2018 testimony regarding similar shortcomings of the Customer Due Diligence Rule for Financial Institutions<sup>7</sup> before the House Financial Services Committee’s Financial Institutions and Consumer Credit Subcommittee, FACT’s executive director stated:

---

<sup>7</sup> 81 FR 29398.

*In 2004, an attorney named Michael Berger formed a California corporation called Beautiful Vision Inc. for his client, Teodoro Nguema Obiang Mangue, the 40 year-old son of the President of Equatorial Guinea. The incorporation papers named Mr. Berger as the company president; they did not mention Mr. Obiang. No evidence was located proving who actually owned the company shares, but evidence did establish that Mr. Obiang had asked Mr. Berger to form the corporation, supplied millions of dollars to accounts opened in the name of the corporation, and through Mr. Berger, exercised ultimate control over the company's actions and assets...*

*Because Mr. Berger had named himself as the company president and owner, the new U.S. CDD rule would have allowed Bank of America to rely on the information he provided, with no obligation to look deeper. The bank could have named Mr. Berger and stopped there, even though Mr. Berger did not have any ownership interest in the company, did not exercise ultimate control over the company's actions, and was instead acting on behalf of Mr. Obiang.<sup>8</sup>*

The fact that the SS-4 Form would have allowed Mr. Berger's position as company president to name him as the sole beneficial owner of the company demonstrates the severe shortcomings of the SS-4 Form as a source for beneficial ownership information.

## 2. Even if the Definition Was Properly Amended, Not All Companies File with the IRS

Even if the SS-4 Form *did* collect beneficial ownership information (which it does not as a rule), it would still be an inadequate solution. A company only files an SS-4 Form if they need an employee identification number (EIN). A company only needs an EIN if they will be paying taxes in the U.S., which they will only do if they have operations in the U.S. or open a bank account in the U.S. After many congressional hearings on the subject of money laundering and terror finance, Congress is aware that many companies are created in the U.S. and then used to operate abroad or simply used as one layer of ownership in a series of nested companies intended to cement the beneficial owner's anonymity by exploiting this massive loophole in the U.S. system. This is one of the main problems that we are trying to combat, and the SS-4 Form does nothing to address this problem.

The U.S. has collected the same information via these and similar forms for years, which is known to international assessors of our anti-money laundering and anti-terror finance regime (of which availability of beneficial ownership information is a cornerstone), and yet the U.S. has been found non-compliant with our international commitments to collect beneficial ownership information in the two most recent reviews.<sup>9</sup>

---

<sup>8</sup> *Implementation of FinCEN's Customer Due Diligence Rule – Financial Institution Perspective*, U.S. House Committee on Financial Services, 115<sup>th</sup> Cong., 2<sup>nd</sup> sess. (April 27, 2018) (statement of Gary Kalman, Executive Director, The FACT Coalition), available at <https://financialservices.house.gov/UploadedFiles/HHRG-115-BA15-WState-GKalman-20180427.pdf>.

<sup>9</sup> See Financial Action Task Force, *Mutual Evaluation Report: Anti-Money Laundering and Counter-Terrorist Financing Measures in the United States – 2016*, December 1, 2016, available at <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf>.

### 3. Access to Taxpayer Information Is Restricted, Creating Barriers to Those Who Would Use the Information

Even if the IRS collected the requisite information through these forms, the strict confidentiality on which the IRS holds information from these tax forms, and therefore the inability of relevant law enforcement and financial institutions that we charge with assisting efforts to combat money laundering to access it in a timely or cost-efficient manner, would render this approach wholly insufficient.

The personal identification information provided by taxpayers on IRS forms (that some are claiming is effectively beneficial ownership information) is categorized by IRS regulations as “taxpayer return information.” Taxpayer return information is treated with a very high level of confidentiality afforded by the IRS.

While available to federal agencies for purposes of tax enforcement<sup>10</sup>, these forms can only be accessed by federal law enforcement in relation to investigations of other crimes “upon the grant of an ex parte order by a Federal district court judge or magistrate judge.” The application for that ex parte order has to be authorized by the Attorney General, any Deputy, Associate, or Assistant Attorney General, a U.S. Attorney, or certain special prosecutors and attorneys in charge of specifically authorized organized crime strike forces.<sup>11</sup> Such information may NOT be disclosed to State and local law enforcement agencies unless they are working on a team with a Federal agency on an investigation pertaining to a missing or exploited child.<sup>12</sup>

Access to information on these IRS forms for any non-tax related investigation is extremely onerous for federal law enforcement and almost nonexistent for state and local law enforcement.

Jennifer Shasky Calvery, then Senior Counsel to the Deputy Attorney General at the U.S. Department of Justice and later Director of FinCEN, testified before the Senate Committee on Homeland Security and Governmental Affairs in November 2009 about the effects of lack of access to beneficial ownership information on law enforcement investigations. She stated:

*The audience — including investigators from nine federal law enforcement agencies and prosecutors from a variety of districts and offices — was attending a financial investigation seminar designed to teach them how to investigate the financial aspects of international criminal organizations. The instructor, who was lecturing on U.S. shell companies, asked the members of the audience to raise their hand if they had ever reached a dead end in one of their investigations because of a U.S. shell company. Nearly every person in the room raised his or her hand. Departmental instructors report that such a response is common in money laundering courses delivered both domestically and abroad.*<sup>13</sup>

<sup>10</sup> 26 U.S.C. §6103(f).

<sup>11</sup> 26 U.S.C. §6103(i)(1).

<sup>12</sup> 26 U.S.C. §6103(i)(2)(C).

<sup>13</sup> “*Business Formation and Financial Crime: Finding a Legislative Solution*, U.S. Senate Committee on the Homeland Security and Governmental Affairs, 111<sup>th</sup> Cong., 1<sup>st</sup> sess. (November 5 2009) (statement of Jennifer Shasky, Senior Counsel to the

Collecting beneficial ownership information via IRS forms is clearly not a tenable option given that the information is needed in state and federal criminal investigations on a regular basis.

## Conclusion

In the past several years, various agencies and Congress have taken partial steps toward a comprehensive solution to the beneficial ownership problem. Treasury's Customer Due Diligence Rule codifies practices that banks have developed to identify beneficial ownership. In 2017, Congress adopted a provision in the National Defense Authorization Act for FY2018 to require the Department of Defense to know the beneficial owners of high security office space leased by the military.<sup>14</sup> FinCEN has created and renewed Geographic Targeting Orders in seven metropolitan areas to collect beneficial ownership information for high-end, cash-financed real estate transactions.<sup>15</sup>

These are all important steps, but if we are serious about protecting the integrity of our financial system and cracking down on the harms caused by illicit entities with hidden owners, Congress should create one consistent, national standard that levels the playing field for all states and corporate entities, and collection of that information should not involve the IRS.

Congress has before it several bipartisan bills that have broad support from law enforcement, the business community, national security experts, faith leaders, human rights advocates and more. Members should move quickly to protect our financial system and pass legislation that effectively and comprehensively addresses the threats of anonymous companies.

---

Deputy Attorney General, U.S. Department of Justice), available at <https://www.justice.gov/sites/default/files/testimonies/witnesses/attachments/11/05/09/11-05-09-shasky-business-formation-financial-crime.pdf>.

<sup>14</sup> See H.R.2810, the National Defense Authorization Act for Fiscal Year 2018 (Section 2876), 115<sup>th</sup> Cong., 1<sup>st</sup> sess. (2017), available at <https://www.congress.gov/bill/115th-congress/house-bill/2810/text#toc-HB71776B05A39465CBEF495585842F0A8>.

<sup>15</sup> Financial Crimes Enforcement Network (FinCEN), *FinCEN Targets Shell Companies Purchasing Luxury Properties in Seven Major Metropolitan Areas*, August 22, 2017, available at <https://www.fincen.gov/news/news-releases/fincen-targets-shell-companies-purchasing-luxury-properties-seven-major>.

## FACTCOALITION