



# **Economic Costs to Small Businesses Due to the Corporate Transparency Act**

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## **Executive Summary**

To secure more extensive information on the beneficial ownership of legal entities registered in the United States, federal legislators recently introduced H.R. 2513, the Corporate Transparency Act of 2019. The proposed law would require small corporations and limited liability companies to annually complete and submit beneficial ownership information paperwork to the Treasury Department's Financial Crimes Enforcement Network. Supporters of the bill hope that more extensive beneficial ownership information will increase the ability of financial institutions, law enforcement, and the intelligence community to identify the assets and accounts of terrorist organizations, corrupt actors, money launderers, drug kingpins, proliferators of illegal weapons, and other national security threats.

While well-intentioned, the Corporate Transparency Act would create material risks and burdens for small businesses. An obvious concern is the increased risk that personally identifiable information of business owners may be abused or hacked by actors with malicious intent. Another consequence of a new information reporting requirement mandated by the federal government is additional paperwork burdens imposed on covered entities. Assuming the bill becomes law in 2020, we estimate that covered small businesses would be required to complete an average of approximately 13.2 million additional paperwork hours per year from 2022 to 2031, equivalent to an annual average of \$573 million in monetized regulatory costs. Over this ten-year period, covered small businesses would face a cumulative 131.7 million new paperwork hours or, equivalently, a cumulative \$5.7 billion in new regulatory costs due to the proposed law.

## **Introduction**

H.R. 2513, the Corporate Transparency Act of 2019, was recently introduced in the House of Representatives with the intent of preventing individuals with malintent from exploiting certain business structures allowed in the United States for criminal gain or engaging in terrorism, money laundering, or other misconduct. The bill would require persons who form corporations or limited liability companies (LLCs) in the United States to disclose and update the beneficial owners of those businesses on a regular basis. Lawmakers supporting the bill believe such mandatory disclosures and updates would assist law enforcement investigative efforts of corporations and LLCs suspected of committing crimes, efforts which are supposedly hampered by a lack of available beneficial ownership information.<sup>1</sup>

Currently, financial institutions are required by law to identify the beneficial owners of legal entity customers and to maintain and update this information as part of their customer due diligence requirements. The Customer Due Diligence (CDD) Requirement for Financial Institutions Rule of 2016 requires banks, brokers and dealers in securities, mutual funds, and futures commission merchants and introducing brokers in commodities to identify and verify the identity of beneficial owners of legal entity customers, subject to certain exclusions and exemptions.<sup>2</sup> The rule requires financial institutions to furnish this beneficial ownership information to the Financial Crimes Enforcement Network of the Treasury Department (FinCEN), upon receipt of a subpoena. By strengthening financial institutions' know-your-customer and anti-money laundering (KYC and AML) practices through this rule, the federal government hoped that improved customer identification, development of customer risk profiles, and ongoing monitoring for reporting suspicious transactions would increase the ability of financial institutions, law enforcement, and the intelligence community to identify the assets and accounts of terrorist organizations, corrupt actors, money launderers, drug kingpins, proliferators of illegal weapons, and other national security threats.<sup>3</sup>

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<sup>1</sup> There are currently three similar pieces of legislation in the Senate: S. 1978, the Corporate Transparency Act; S. 1889, the TITLE Act; and the ILLICIT CASH Act (bill number forthcoming).

<sup>2</sup> Although the CDD rule was finalized in 2016, it did not become applicable until May 11, 2018.

<sup>3</sup> See 31 C.F.R. Parts 1010, 1020, 1023, 1024, and 1026.

However, rather than focusing on improving the efficacy of existing regulations on financial institutions with existing compliance staff and allocated resources, some lawmakers want to shift this regulatory burden to businesses that lack the resources and ability to comply with regulatory information requests that financial institutions have. By introducing the Corporate Transparency Act earlier this year, lawmakers hope to require each applicant(s) to form a corporation or LLC under the laws of any of the 50 States or an Indian Tribe to file a report with FinCEN containing a list of the beneficial owners of the corporation or LLC that identifies each beneficial owner by full legal name, date of birth, current residential or business street address, and a unique identifying number from a non-expired passport issued by the United States, a non-expired personal identification card, or a non-expired driver's license issued by a State. An applicant would also have to provide identical own personal identifiable information (PII) even if they themselves are not a beneficial owner of the business entity.

Ambiguities associated with the definition of a beneficial owner according to the bill language present challenges to businesses that must comply with the mandate and to estimating the costs associated with this new reporting requirement. According to the legislation, a "beneficial owner" is defined as a "natural person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise—exercises substantial control over a corporation or limited liability company; owns 25 percent or more of the equity interests of a corporation or limited liability company; or receives substantial economic benefits from the assets of a corporation or limited liability company."<sup>4,5</sup> This expansive definition lends itself to flexible yet reasonable interpretations of who is and is not a beneficial owner of a business, creating uncertainty and, potentially, material added complexity in the filing process of well-meaning firms intending to comply fully with the proposed law.<sup>6</sup>

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<sup>4</sup> The legal definition of a "natural person" is an individual human being, distinguished from a "legal person," which may be a private or public organization created by operation of law.

<sup>5</sup> According to the bill, "substantial economic benefits" from the assets of a corporation or LLC accrue to a person if the person has an entitlement to more than a specified percentage of the funds or assets of the corporation or LLC as determined by the Secretary of the Treasury.

<sup>6</sup> A brief example illustrates the complications that derive from the current ambiguous bill language. Consider a startup with three founders that is registered as a C corporation. Each of the founders has a 25 percent stake in the business. The remaining 25 percent of equity belongs to a venture capital firm that acquired its shares in exchange for seed funding. While no one person in the venture capital firm owns the entire 25 percent stake, the firm as a whole does, and profits from successful investments made by the firm

Existing corporations or LLCs would also be required to submit such information beginning two years after any final regulations pertaining to carrying out the law are issued. The proposed law would apply to any entity eligible for registration or registered to do business as a corporation or LLC in the 50 States or an Indian Tribe regardless of whether it is a U.S. or non-U.S. entity. Corporations and LLCs would be required to submit this information to FinCEN on an annual basis regardless of whether any changes in beneficial ownership of the business occurred during the previous year.

Should the Corporate Transparency Act become law, pending a decision by the Treasury Department, updates to the list of a business's beneficial owners or the PII of beneficial owners may need to be supplied to the federal government in intervals more frequent than once per year.<sup>7</sup> The PII of beneficial owners would need to be furnished whether or not those owners are U.S. citizens. There are added regulatory complexities associated with the provision of such information on behalf of beneficial owners who are not U.S. citizens.

Certain entities would be technically exempt from complying with the information requirements under the proposed law based on the type of commerce or activities in which they engage. These entities include businesses that issue securities; businesses constituted, sponsored, or chartered by a State or Indian Tribe, a political subdivision of a State or Indian Tribe, under an interstate compact between two or more States, by a department or agency of the United States, or under the laws of the United States; depository institutions; credit unions; bank holding companies; brokers or dealers; exchanges or clearing agencies; investment companies; insurance companies; futures commissions merchants, introducing brokers, commodity pool operators, or commodity trading advisors; public accounting firms; public utilities providing telecommunications services, electrical power, natural gas, or water and sewer services; and churches,

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are shared among all equity partners at the firm, of which there are many. Under this scenario, whose PII would need to be reported to FinCEN under the proposed law? Obviously, the PII of the three founders would need to be reported since each owns 25 percent of the business. But in the case of the venture capital firm, would the PII of every single one of these partners need to be reported? Or would only the PII of the partner(s) in charge of this particular investment need to be reported?

<sup>7</sup> For example, the Secretary of the Treasury may determine it necessary and subsequently require that updated beneficial ownership information of covered business entities be provided to FinCEN within 60 days of any change in information, as an earlier version of the legislation required. Such updates could be mandated as supplementary reports to the "official" annual reports that entities would be required to file.

charities, and nonprofits. Corporations or LLCs formed and owned by exempt entities based on type of commerce or activities described above would also be exempt.

Additional businesses would be exempt under the proposed law based on other criteria. Specifically, any business that (1) employs more than 20 employees on a full-time basis, (2) files income tax returns with more than \$5 million in reported gross receipts or sales, *and* (3) has an operating presence at a physical office in the U.S. would be excluded.<sup>8</sup> These stipulations in effect render larger businesses exempt from the proposed law. Sole proprietors, whether employers or nonemployers, are also exempt from information filing considerations due to sole proprietors not having to register as business entities in order to engage in commerce using that business structure.<sup>9</sup> The net effect of these exemptions essentially absolves financial institutions of KYC and AML information reporting requirements as outlined in the CDD rule, excludes big businesses from new information requirements under the proposed law, and places the burden of beneficial ownership information reporting requirements to FinCEN squarely on small businesses.

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<sup>8</sup> The overwhelming majority of S corporations, and possibly other pass-through businesses, would not be exempt. Approximately 90 percent of S corporations have fewer than 20 employees. The average total receipts reported to the IRS per S corporation in 2013 was \$1.6 million. Total receipts tend to increase with the number of shareholders. The average total receipts for S corporations with three shareholders in 2013 was \$3.7 million. S corporations with one or two shareholders reported lower averages. S corporations with three or fewer shareholders make up 95 percent of all S corporations. See IRS Statistics of Income Division Table 6 for S corporations for tax year 2013.

Meanwhile, up to 237,974 employer firms in the financial industry, which report average gross receipts per firm of \$15,286 and gross receipts per employee of \$600, could be made exempt from their existing reporting requirements under the CDD rule. These figures compare to gross receipts per firm of \$784 and gross receipts per employee of \$195 for employer firms with fewer than 20 employees excluding financial firms, utilities, and “religious, grantmaking, civic, professional, and similar organizations” (NAICS code 813). All else equal, a larger amount of gross receipts allows businesses to cover costs associated with paperwork burdens like the proposed beneficial ownership information requirement in the Corporate Transparency Act and mitigates the impact such burdens have on net income. See the Census Bureau’s Statistics of U.S. Businesses datasets for 2012 and 2016.

<sup>9</sup> Although technically considered a business structure category, sole proprietors are nothing more than individuals acting as business owners in their personal capacities without the formal structure, protections, benefits, and obligations of other business entity types that are required to formally register with federal and state governments. Sole proprietors report their business income to the IRS by attaching form Schedule C to their individual Form 1040 when filing personal income taxes.

## **Privacy and Cybersecurity**

Although well-intentioned, the Corporate Transparency Act would generate multiple negative consequences among small business owners whom it would obligate to comply with the proposed law. Foremost among these may be privacy issues surrounding the highly personal and sensitive data collected by the federal government, stored in a database maintained by FinCEN, and made accessible, under certain circumstances, to law enforcement agencies, federal agencies, and financial institutions. Despite awareness at the highest levels of government of the need for better cybersecurity and mechanisms to prevent hacks and deter malign cyber actors,<sup>10</sup> frequent cyber intrusions remain a reality.<sup>11</sup> Cyber intruders may be motivated to hack a database for a host of reasons with different consequences for the victims depending on the database and underlying motivation, but even repercussions as basic as simple identity theft are costly. The Justice Department estimates that 17.7 million individuals experienced one or more incidents of identity theft with known financial losses in 2016. The total loss across all identity theft incidents is estimated at \$17.5 billion, which equates to an average loss of \$989 per victim.<sup>12</sup>

Allowing broad access by external actors to a database containing the PII of millions of business owners as outlined in the proposed law increases the potential for improper disclosure or misuse of private information.<sup>13</sup> FinCEN's database has already proved itself vulnerable to abuse and disclosure of confidential information by government officials with insider access.<sup>14</sup> Compounding these risks is the fact that such changes

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<sup>10</sup> See "National Cyber Strategy of the United States of America," September 2018. It is the first national cyber strategy to be released in 15 years.

<sup>11</sup> According to the U.S. Government Accountability Office, over 35,000 information security incidents were reported by federal executive branch civilian agencies to the Department of Homeland Security in fiscal year 2017. See U.S. Government Accountability Office, "Information Security: Agencies Need to Improve Implementation of Federal Approach to Securing Systems and Protecting against Intrusions," December 2018.

<sup>12</sup> According to the Bureau of Justice Statistics (BJS), incidents of identity theft have increased over time. BJS estimates that 17.6 million persons 16 years or older were victims of identity theft in 2014, while 16.6 million persons were victims in 2012. In 2010, an estimated 8.6 million households had at least one person aged 12 or older experience identity theft. In 2005, an estimated 6.4 million households were victimized. See Bureau of Justice Statistics, "Victims of Identity Theft" report series.

<sup>13</sup> Under current rules, financial institutions do not have access to the FinCEN database. The Corporate Transparency Act would allow financial institutions to access the database provided certain requirements are met.

<sup>14</sup> For example, see *United States v. John C. Fry*, <https://www.justice.gov/usao-ndca/press-release/file/1134051/download>;

would create an abundance of new threat vectors that can be exploited by cyber criminals. As declared in the recent U.S. National Cyber Strategy, cybersecurity is now a national priority. While the nation's cyber defenses might be improving, no system is 100 percent failsafe, and the numerous large-scale hacks of government agencies and major corporations in recent years provide good reason for lawmakers to pause and reconsider the proposed changes to the FinCEN database.

### **Paperwork and Recordkeeping**

A major cost to covered firms under the proposed law are new paperwork and recordkeeping requirements that arise from business owners' efforts to comply with the mandate. With no suggested beneficial ownership information paperwork out in draft form yet, there are obviously no official government estimates as to how long it would take to complete the paperwork requirements and file the requested information. However, certain comments submitted by interested observers to the existing CDD rule provide some guidance as to the possible cost of this potential new paperwork requirement. Specifically, estimates of the paperwork burdens associated with filing IRS Form SS-4 may serve as a good proxy for the paperwork burdens associated with any new information requirement imposed on covered businesses by the Corporate Transparency Act.

During the rulemaking process for the CDD rule, multiple comments were submitted during the open comments period in 2014 suggesting that the appropriate government authority to collect beneficial ownership information of business financial accounts lies with the IRS and not FinCEN.<sup>15</sup> The proposed mechanism by which the IRS would obtain this information is Form SS-4, which must be filed by businesses when seeking an Employer Identification Number (EIN). Commenters suggested that new EIN applicants could submit initial beneficial ownership information when filing Form SS-4 and could update beneficial ownership annually when filing income taxes.

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*United States v. Natalie Mayflower Sours Edwards*, <https://www.justice.gov/usao-sdny/press-release/file/1101511/download>.

<sup>15</sup> For example, see the following comments:

<https://www.regulations.gov/document?D=FINCEN-2014-0001-0131>;  
<https://www.regulations.gov/document?D=FINCEN-2014-0001-0076>;  
<https://www.regulations.gov/document?D=FINCEN-2014-0001-0013>;  
<https://www.regulations.gov/document?D=FINCEN-2014-0001-0015>.

According to the IRS's own estimates calculated to comply with the Paperwork Reduction Act of 1980, the time needed to complete and file Form SS-4 exceeds ten hours. Most of the required time is due to recordkeeping, estimated to take 8 hours 36 minutes. An additional 42 minutes is required for "learning about the law or the form." Finally, 52 minutes is required for "preparing, copying, assembling, and sending the form to the IRS."<sup>16</sup> Assuming additional fields of required beneficial ownership information are added to this form as per the proposed law, the estimated amount of time for a business applying for an EIN would increase. The question is how much.

While ten-plus hours might seem a reasonable paperwork burden estimate for a business owner seeking to obtain an EIN and filing Form SS-4 for the first time, this estimate may be excessive for the average covered business to update beneficial ownership information as proposed in the Corporate Transparency Act. This judgment is based on the noticeable difference between what information is asked for on Form SS-4 when applying for an EIN and the more abbreviated set of information requested by the Corporate Transparency Act when updating beneficial ownership information.<sup>17</sup>

Existing estimates of the time required to file statements of changes in beneficial ownership by insiders of public companies with the Security and Exchange Commission (SEC) provide some guidance as to what the incremental time burden might be for small business owners called to comply with the new information requirements contained in the Corporate Transparency Act. According to the Office of Management and Budget (OMB), the estimated average paperwork burden hours associated with filing SEC Form 4, the commission's required statement of changes in beneficial ownership, is 0.5 hours per response.<sup>18</sup> While SEC Form 4 asks for considerably more complex and detailed information than the beneficial ownership information asked for in the Corporate Transparency Act, company insiders required to supply the SEC with Form 4 are also

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<sup>16</sup> See "Instructions for Form SS-4," Internal Revenue Service, Department of the Treasury, p. 6.

<sup>17</sup> Form SS-4 asks for some similar information, such as the name of the business's responsible party and street address, that is also requested by the Corporate Transparency Act when updates to beneficial ownership information would be required. However, Form SS-4 also asks for certain information that would typically require a business owner to sort through their records or make an estimation to complete the form, e.g., the date the business was started or acquired, the highest number of employees expected in the next 12 months, the first date wages or annuities were paid.

<sup>18</sup> See SEC Form 4, "Statement of Changes in Beneficial Ownership," OMB Number 3235-0287.



likely to have at their disposal savvy and trained professionals who can efficiently file the paperwork on their behalf.

In contrast, at a business with 20 or fewer employees, it will frequently be the owner themselves who fills out and files the paperwork.<sup>19</sup> Since small business owners' time is consumed with operating their businesses and not focusing on record keeping, staying on top of filing deadlines, and fulfilling government information requests, the efficiency with which they complete paperwork related to changes in beneficial ownership ought to lag the efficiency of larger firms with trained specialists who may have such activities as part of their official job duties. So while the beneficial ownership information requested by the Corporate Transparency Act is simpler than what is asked for in SEC Form 4, any savings in time from the relative simplicity of the information request is offset by the relatively inefficient manner in which small businesses would file the paperwork (compared to large public enterprises).

For this analysis, we assume that these two considerations perfectly offset from a baseline hourly paperwork burden as estimated for SEC Form 4 the OMB, and we adopt 0.5 hours as the estimated average amount of time it will take to respond to a single beneficial ownership information request as mandated by the Corporate Transparency Act.<sup>20</sup> This assumption assumes that the beneficial owners of covered businesses are readily identifiable (as opposed to the ambiguous cases described in footnote 4 and similar scenarios). We also assume that the corporate governance structure of small corporations and LLCs is relatively simple compared to their larger peers, with executive leadership consisting of no more than three key officers (president, secretary, and

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<sup>19</sup> According to a nationally representative survey on small businesses, 34 percent of business owners or managers at firms with one to nine employees indicated that they personally did their business's paperwork and record-keeping for government information requests. Nineteen percent of owners or managers at firms with ten to 19 employees indicated they did the same. See Dennis, Jr., William J., series ed., "Paperwork and Record-keeping," NFIB National Small Business Poll 3 (5) 2003.

<sup>20</sup> Supporting this hourly paperwork burden assumption is an estimate from the Regulatory Flexibility Analysis for the CDD rule which states: "We consider a range of 20 to 40 minutes of additional time on average to open an account under the CDD rule, based on a series of telephone calls with covered institutions, and on public comments received in response to both the NPRM and the preliminary version of the RIA published in December 2015." The final regulation (OMB Control Number 1506-0070) provides an identical estimate: "Customer identification, verification, and review and recordkeeping of the beneficial ownership information: A range of 20 to 40 minutes per legal entity customer."

treasurer) and boards consisting of an average of 2.0 directors.<sup>21</sup> The key officer positions are assumed to be filled by different individuals, and board members are assumed to be non-executive, external members, totaling to 5.0 beneficial owners per covered business. For simplicity, we assume that all persons who may exercise substantial control over a business, own 25 percent or more of the equity interests of a business, or receive substantial economic benefits from the assets of a business are limited to individuals who are also key officers or board members. Based on the above assumptions, the estimated annual hourly paperwork burden for filing beneficial

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<sup>21</sup> The beneficial ownership structure of corporations and LLCs can theoretically become quite complex even if all beneficial owners are individuals “inside” the organization. For example, corporations are generally required to have at least three officers: a president, a treasurer or chief financial officer, and a secretary. Corporations may have additional officers that also play a leadership role in the organization. Both C corporations and S corporations are required to have a board of directors. Exact rules and regulations for the size of boards may vary according to differences in state laws and corporate bylaws which stipulate different required minimum and maximum numbers of directors. For corporations, the paperwork burden associated with the Corporate Transparency Act will vary depending on the number of executives with leadership roles and the size of boards.

Illustrating the variance in the required minimum number of directors a corporation must have contingent upon state law are the Delaware Code, which stipulates that a the board of a corporation registered in Delaware must have at least one director, and the corporate governance laws of California, which require corporations registered in California to have not less than three directors unless there are only one or two shareholders of record, in which case the number of directors may be less than three but not less than the number of shareholders. According to 2003 data from the Corporate Library which captured corporate governance dynamics at 1,700 of the largest U.S. public companies, the average board size was 9.2 members with the smallest board having three members and the largest board having 31 members. A more recent analysis of 400 companies in 2014 by GMI found the average size of boards was 11.2 members. Spencer Stuart found the average board size of S&P 500 companies in 2017 to be 10.8 members.

Less information is known about the corporate governance structure of private enterprises than public companies, but a pattern that probably holds true for both private and public companies is that the size of boards is likely directly proportionate to firm size. Since the Corporate Transparency Act information requirement targets small businesses, it is likely that most boards of covered entities are small. To be conservative in our cost estimates, we assume that the number of board members for the smallest S corporations (those with three or fewer shareholders) equals the number of shareholders for each entity. This subset constitutes approximately 95.2 percent of all S corporations filing returns with the IRS and averages 1.38 board members per entity. For larger S corporations as well as all C corporations that are covered entities under the proposed law, we assume an average of three directors per board. Such an assumption is in keeping with state laws like those of California. This assumption also allows for the good practice of having multiple views and voices when issues need to be taken up by the board. As well, a board with three members allows for no deadlocked votes assuming all directors vote and there are no abstentions. Under these assumptions, we estimate there are approximately 1.99 board members per covered corporation under the Corporate Transparency Act.

Sources: Corporate Library; Delaware Code; DLA Piper; Harbor Compliance; Spencer Stuart; Stimmel, Stimmel & Smith; *Wall Street Journal*.

ownership information with FinCEN pursuant to the Corporate Transparency Act is approximately 2.5 paperwork hours per business entity.<sup>22</sup>

There are opportunity costs associated with government paperwork requirements. For individuals and households, such costs can take the form of reduced leisure and quality family time, decreasing their standard of living. For businesses, the opportunity cost is pecuniary: time spent filling out government information requests is time that could be spent acquiring more customers, reviewing existing and launching new marketing efforts, interviewing and hiring additional employees, or finalizing decisions on the next capital expenditure, all of which can lead to higher profits.

The monetized cost of businesses complying with paperwork requirements can also include explicit costs which vary depending on the type of information requested, given that different information requests entail varying levels of reliance on outside experts to fulfill the requests. For example, completing tax paperwork may require paying for the assistance of an accountant or tax preparer. The same may be said for completing information requests related to financial records. Business owners have reported a premium to the per hour costs associated with completing these two categories of information requests relative to the per hour cost associated with fulfilling government information requests. Small business owners have estimated that the average per hour cost of paperwork and record-keeping for tax-related paperwork is \$74.24 per hour. For financial paperwork, the estimated average per hour cost is \$62.16 per hour. And for government information requests, it is \$43.50 per hour.<sup>23</sup>

To estimate the total annual monetized cost of the new paperwork burden imposed on small businesses by the Corporate Transparency Act, we multiply the estimated hourly per firm cost it takes to fulfill the beneficial ownership information requirement by the number of covered firms and, subsequently, multiply this product by the reported dollar value of an hour spent fulfilling government information requests. The number of covered firms will be a subset of the universe of C corporations, S corporations, and LLCs in the U.S. According to the Census Bureau, there were 3,947,681 incorporated employer firms

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<sup>22</sup>  $(0.5 \text{ hours} / \text{SS-4 form}) \times (\text{Avg. \# SS-4 forms} / \text{Covered corporation or LLC}) = (0.5 \text{ hours per form}) \times (4.989 \text{ forms per business}) = 2.495 \text{ paperwork hours per business.}$

<sup>23</sup> Dennis, Jr.

in the U.S. Of this group of firms, 974,234 were C corporations and 2,973,447 were S corporations.<sup>24</sup> Since the paperwork burden only applies to firms with 20 or fewer employees, we look only at this subset of firms. The Census Bureau estimates the number of C corporations with fewer than 20 employees at 826,267, while the corresponding number of S corporations is estimated at 2,669,996. In total, there were 3,496,263 U.S. employer corporations with fewer than 20 employees in 2016.<sup>25</sup>

Nonemployer corporations are also considered covered entities under the Corporate Transparency Act. According to the U.S. Small Business Administration (SBA), in 2013 there were approximately 28.8 million small businesses in the country, approximately 23 million of which were nonemployer firms.<sup>26</sup> Some 4.7 percent of these nonemployer firms were organized as S-corporations. Approximately 1.6 percent were classified as C corporations. In total, some 1,449,000 nonemployer firms were organized as corporations. Combining employer and nonemployer firms, 4,945,263 corporations would be required to supply beneficial ownership information to FinCEN on an annual basis.

We exclude LLCs from our calculation of the total annual monetized cost imposed on covered entities due to data constraints. Specifically, the unavailability of data on the number of LLCs with an operating presence in the U.S. differentiated by size of firm, with firm size measured by the number of employees working at a firm, prevents us from estimating a paperwork burden for covered LLCs. The exclusion of LLCs from the analysis may contribute to an underestimation of the total paperwork burden faced by covered business entities.<sup>27</sup>

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<sup>24</sup> Statistics of U.S. Businesses Annual Dataset, U.S. Census Bureau, 2016.

<sup>25</sup> While the Corporate Transparency Act applies to businesses with 20 or fewer employees, data from the Census Bureau's Statistics of U.S. Businesses (SUSB) dataset segments business data into different size-of-firm categories (as measured by number of employees) using different employee threshold figures. Relevant to the current discussion is that the SUSB dataset publishes data for firms with fewer than 20 employees, but not for firms with 20 or fewer employees (as the proposed law requires). This nuance explains the different phrasing in consecutive sentences in the exposition. Readers will also observe that due to this characteristic of the data, we are also examining the subset of firms with fewer than 20 employees, not the subset of firms with 20 or fewer employees, and are therefore omitting from our cost estimate firms with exactly 20 employees.

<sup>26</sup> "Frequently Asked Questions," U.S. Small Business Administration Office of Advocacy, June 2016.

<sup>27</sup> In most if not all states, an LLC may have an unlimited number of members. LLC members are shareholders in the company that have voting power and receive profits from the firm based on their ownership stakes. Although not required, an LLC may also elect to have a board of directors.

Lacking more recent data, for this cost analysis we adopt the 2016 Census figures for employer firms and the 2013 SBA figures for nonemployer firms as the baseline number of covered corporations that are already registered in the first year that existing covered businesses would need to provide beneficial ownership information to FinCEN under the Corporate Transparency Act.<sup>28</sup> According to the proposed law, existing corporations or LLCs would need begin supplying beneficial ownership information “[o]n and after the date that is 2 years after the final regulations are issued.” For this analysis, we assume that the bill becomes law in 2020 and that final regulations are also issued in 2020. Consequently, mandatory compliance with the information requirements by existing firms is assumed to begin in 2022. Using a ten-year forecast window, our cost analysis spans 2022 to 2031.

Given the above assumptions, the Corporate Transparency Act would cause small businesses to face a new annual paperwork burden totaling more than 12.2 million paperwork hours per year starting from the first year of compliance.<sup>29</sup> The monetized cost of this new paperwork burden for existing firms is approximately \$534 million in the first year.<sup>30</sup> This cost can be expected to grow over time given trend growth in the number of corporations in the United States. According to IRS data, an average of 95,763 new corporations filed tax returns each year between 1980 and 2013, a period that includes multiple business cycles (**Figure 1**). Omitting economic downturns and looking at what may be considered a recent extended period with a generally healthy economy—the period spanning 1995 to 2006—the average number of new corporate tax filers increases to 124,455 per year. To be conservative in our cost estimates and account for the possibility of future economic downturns during our ten-year forecast window, we adopt the longer-term average change of 95,763 net new corporations per year as the trend baseline number of new corporations created per year.

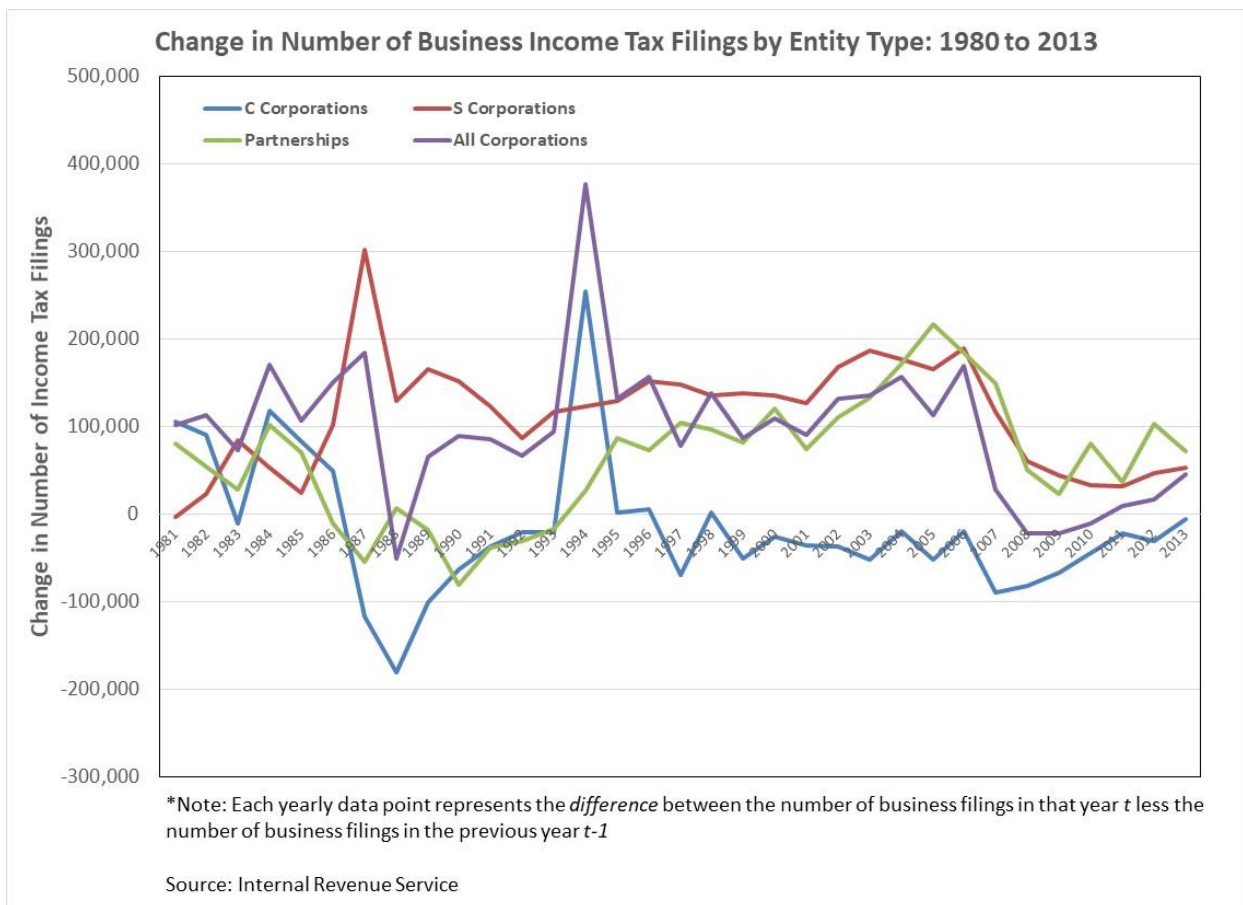
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<sup>28</sup> Given the prolonged and continuous economic expansion since 2013 to the present and the consistently positive net firm creation during that period, it is possible that these figures underestimate the current number of corporations currently registered in the United States. For details on net firm creation in the U.S., please refer to the Bureau of Labor Statistics’s Business Employment Dynamics dataset.

<sup>29</sup> (# of paperwork hours per business) x (# of covered small businesses required to file beneficial ownership information) = (2.484439 paperwork hours per covered business) x (4,945,263 covered businesses) = 12,286,206 paperwork hours per year.

<sup>30</sup> (# of paperwork hours per year) x (\$43.50 cost per paperwork hour) = (12,286,206 hours) x (\$43.50 per hour) = \$534,449,967 in paperwork costs per year.

The most recent IRS data point for year-over-year change in the number of corporations filing tax returns is 45,843 new corporations, considerably below the trend rate of 95,763 new corporations per year. Returning to trend growth requires an increase in the pace of business formation from the reported 2013 rate. Data from the several years immediately preceding 2013 provide guidance on how a return to baseline could be modeled. **Table 1** provides figures for the net change in corporation tax filings reported by the IRS for 2006 to 2013 as well as the year-over-year change in the net change in corporation tax filings, that is, the annual change in the growth rate of corporations filing tax returns ( $\Delta growth$ ). The data show the extent of firm destruction that occurred during the 2007/2008 financial crisis and Great Recession, characterized by a period when firms deaths exceeded firm births, as well as the gradual recovery from the recession and a return to net firm creation.



**Figure 1**

**Table 1: Number of Corporate Tax Returns and Year-over-Year Change in Growth of Corporate Tax Returns, 2006 to 2013**

Year	2006	2007	2008	2009	2010	2011	2012	2013
<b>Number of Corporate Returns (Millions)</b>	5.841	5.869	5.847	5.825	5.813	5.823	5.841	5.888
<b><math>\Delta</math>growth</b>	55,766	-141,654	-49,915	149	11,389	19,574	7,670	29,764

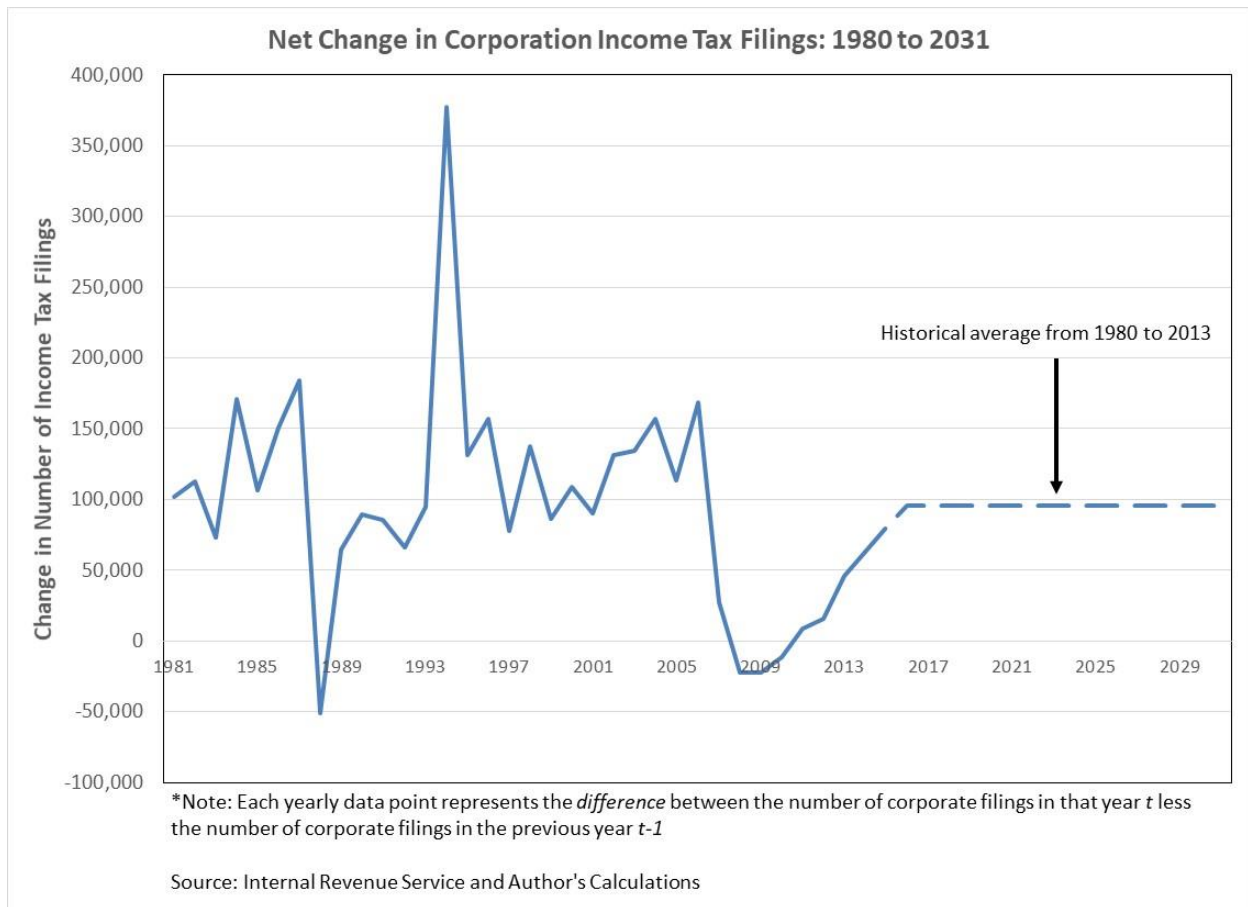
Source: Internal Revenue Service and Author's Calculations

While  $\Delta$ growth was strongly negative in 2007 and 2008, it turned positive in 2009 and has stayed positive since. The average increase in the growth rate of new corporate tax filings between 2010 and 2013 was 17,099 new corporations per year. We adopt this average  $\Delta$ growth figure for 2010 to 2013 as the assumed  $\Delta$ growth between 2013 and whichever year the year-over-year change in the number of corporate tax filings returns to trend. Under the above conditions, the return to trend growth is achieved in 2016. We assume that trend growth is maintained (with no deviations from it) in 2017 and beyond (**Table 2; Figure 2**).

**Table 2: Assumed Change in Growth Rate of Corporations Between 2010 and 2031**

Year	2010	2011	2012	2013	2014	2015	2016	2017 to 2031
<b><math>\Delta</math>growth</b>	-11,165	8,409	16,079	45,843	62,942	80,042	95,763	95,763

Source: Internal Revenue Service and Author's Calculations



**Figure 2**

An ever-increasing number of corporations has implications for the estimated number of covered entities under the Corporate Transparency Act. Not all newly registered corporations will meet the qualifying requirements to be considered a covered entity under the proposed law, but a vast majority likely will. According to SBA data from 2014, 95 percent of new firms begin with fewer than 20 employees.<sup>31</sup> This percentage decreases very little during the initial years of the firm's life. Nine-one percent of firms that have been in business for five years have fewer than 20 employees. Vast majorities of even older firms would be covered entities under the proposed law.<sup>32</sup> Recent research by economists at the BLS has also found that new firms are starting smaller than they

<sup>31</sup> See the Small Business Administration's Business Dynamics Statistics (BDS) dataset by firm age.

<sup>32</sup> According to the SBA's BDS dataset, 90.6 percent of firms between 6 and 10 years of age in 2014 had fewer than 20 employees. Corresponding percentages for firms between 11 to 15 years of age, 16 to 20 years of age, and 21 to 25 years of age were 88.7 percent, 87.9 percent, and 86.6 percent, respectively.



have in the past (as measured by number of employees) and are staying smaller.<sup>33</sup> For this analysis, we assume that 90.6 percent<sup>34</sup> of net new corporations created between 2022 and 2031 will be covered entities during the entire forecast period. **Table 3** gives the estimated number of covered entities for years 2022 to 2031 given the above assumptions, the associated annual paperwork hours imposed on these businesses, and the monetized costs of the paperwork burdens.

**Table 3: Estimated Number of Covered Entities, Additional Paperwork Hours, and Monetized Regulatory Costs Under Corporate Transparency Act, 2022 to 2031**

Year	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
<b>Est. # Covered Entities (Millions)</b>	4.945	5.032	5.119	5.206	5.292	5.379	5.466	5.553	5.639	5.726
<b>Est. Paperwork Hours (Millions)</b>	12.205	12.420	12.634	12.848	13.062	13.276	13.490	13.704	13.919	14.133
<b>Est. Monetized Regulatory Costs (Nominal Millions of Dollars)</b>	\$530.9	\$540.3	\$549.6	\$558.9	\$568.2	\$577.5	\$586.8	\$596.2	\$605.5	\$614.8

Over a ten-year period spanning 2022 to 2031, the estimated number of covered corporations due to firm dynamics increases from approximately 4.9 million corporations in 2022 to approximately 5.7 million corporations in 2031. Estimated annual paperwork hours for these businesses increases from 12.2 million hours in 2022 to 14.1 million hours in 2031. The monetized cost of these paperwork hours increases from approximately \$531 million in 2022 to approximately \$615 million in 2031. Over the entire ten-year forecast period, covered small corporations would have to deal with over 131 million additional paperwork hours due to the Corporate Transparency Act, equivalent to more than \$5.7 billion in monetized costs.

<sup>33</sup> See Choi, Eleanor J. and James R. Spletzer, “The declining average size of establishments: evidence and explanations,” Monthly Labor Review, Bureau of Labor Statistics, March 2012.

<sup>34</sup> The percentage of firms aged 6 to 10 years old that had fewer than 20 employees according to the SBA’s data.

## **Concluding Remarks**

In an age of increasing cybercrime, securing and safeguarding highly personal and sensitive digitized data is paramount. Even a basic malicious outcome of a data breach, like identity theft, can have material financial repercussions for a victim. Enhancing the ability of law enforcement and the national security apparatus to deal with threats to U.S. interests is obviously good, but the cybersecurity risks posed by the proposed changes to the FinCEN database warrant serious consideration given the current state of the nation's cyber readiness.

Paperwork burdens can also pose a major regulatory cost to small businesses who frequently lack specialized employees to deal with items like government information requests. Frequently, it is the owner themselves who completes the paperwork, diverting valuable time and focus away from operating their business. The Corporate Transparency Act would impose a new annual paperwork burden cost on small businesses estimated at approximately 13.2 million additional paperwork hours per year from 2022 to 2031. The monetized equivalent of this new paperwork burden is an annual average of \$573 million in new regulatory costs on small businesses. Over this ten-year period, covered small businesses would face a cumulative 131.7 million new paperwork hours or, equivalently, a cumulative \$5.7 billion in new regulatory costs due to the proposed law.