

**STATEMENT OF SENATOR CARL LEVIN (D-MICH)  
ON INTRODUCING THE  
INCORPORATION TRANSPARENCY  
AND LAW ENFORCEMENT ASSISTANCE ACT**

May 1, 2008

Mr. President, I am introducing today, with my colleagues Senator Coleman and Senator Obama, the Incorporation Transparency and Law Enforcement Assistance Act. This bill tackles a longstanding homeland security problem involving inadequate state incorporation practices that leave this country unnecessarily vulnerable to terrorists, criminals, and other wrongdoers, hinder law enforcement, and damage the international stature of the United States.

The problem is straightforward. Each year, the States allow persons to form nearly 2 million corporations and limited liability companies in this country without knowing – or even asking -- who the beneficial owners are behind those corporations. Right now, a person forming a U.S. corporation or limited liability company (LLC) provides less information to the State than is required to open a bank account or obtain a driver's license. Instead, States routinely permit persons to form corporations and LLCs under State laws without disclosing the names of any of the people who will control or benefit from them.

It is a fact that criminals are exploiting this weakness in our State incorporation practices. They are forming new U.S. corporations and LLCs, and using these entities to commit crimes ranging from terrorism to drug trafficking, money laundering, tax evasion, financial fraud, and corruption. Law enforcement authorities investigating these crimes have complained loudly for years about the lack of beneficial ownership information.

Last year, for example, the U.S. Department of the Treasury sent a letter to the States stating: “the lack of transparency with respect to the individuals who control privately held for-profit legal entities created in the United States continues to represent a substantial vulnerability in the U.S. anti-money laundering/counter terrorist financing (AML/CFT) regime. ... [T]he use of U.S. companies to mask the identity of criminals presents an ongoing and substantial problem ... for U.S. and global law enforcement authorities.”

Last month, Secretary Michael Chertoff, head of the U.S. Department of Homeland Security, wrote the following: “In countless investigations, where the criminal targets utilize shell corporations, the lack of law enforcement's ability to gain access to true beneficial ownership information slows, confuses or impedes the efforts by investigators to follow criminal proceeds. This is the case in financial fraud, terrorist financing and money laundering investigations. ... It is imperative that States maintain beneficial ownership information while the company is active and to have a set time frame for preserving those records. ... Shell companies can be sold and resold to several beneficial owners in the course of a year or less. ... By maintaining records not only of

the initial beneficial ownership but of the subsequent beneficial owners, States will provide law enforcement the tools necessary to clearly identify the individuals who utilized the company at any given period of time.”

These types of complaints by U.S. law enforcement, their pleas for assistance, and their warnings about the dangers of anonymous U.S. corporations operating here and abroad are catalogued in a stack of reports and hearing testimony from the Department of Justice, the Department of Homeland Security, the Financial Crimes Enforcement Network of the Department of the Treasury, the Internal Revenue Service, and others.

To add insult to injury, our law enforcement officials have too often had to stand silent when asked by their counterparts in other countries for information about who owns a U.S. corporation committing crimes in their jurisdictions. The reality is that the United States is as bad as any offshore jurisdiction when it comes to responding to those requests – we can’t answer them because we don’t have the information.

In 2006, the leading international anti-money laundering body in the world, the Financial Action Task Force on Money Laundering – known as FATF – issued a report criticizing the United States for its failure to comply with a FATF standard requiring countries to obtain beneficial ownership information for the corporations formed under their laws. This standard is one of 40 FATF standards that this country has publicly committed itself to implementing as part of its efforts to promote strong anti-money laundering laws around the world.

FATF gave the United States two years, until July 2008, to make progress toward coming into compliance with the FATF standard on beneficial ownership information. That deadline is right around the corner, but we have yet to make any real progress. That is another reason why we are introducing this bill today. Enacting the bill would bring the United States into compliance with the FATF standard by requiring the States to obtain beneficial ownership information for the corporations formed under their laws. It would ensure that the United States met its international commitment to comply with FATF anti-money laundering standards.

The bill being introduced today is the product of years of work by the U.S. Senate Permanent Subcommittee on Investigations, on which I, Senator Coleman, and Senator Obama serve together. As long ago as 2000, the Government Accountability Office (GAO), at my request, conducted an investigation and released a report entitled, *Suspicious Banking Activities: Possible Money Laundering by U.S. Corporations Formed for Russian Entities*. This report revealed that one person was able to set up more than 2,000 Delaware shell corporations and, without disclosing the identity of the beneficial owners, open U.S. bank accounts for those corporations, which then collectively moved about \$1.4 billion through the accounts. It is one of the earliest government reports to give some sense of the law enforcement problems caused by U.S. corporations with unknown owners. It sounded the alarm sounded 8 years ago, but to little effect.

In April 2006, in response to a Levin-Coleman request, GAO released a report entitled, *Company Formations: Minimal Ownership Information Is Collected and Available*, which reviewed the corporate formation laws in all 50 States. GAO disclosed that the vast majority of the States don't collect any information at all on the beneficial owners of the corporations and LLCs formed under their laws. The report also found that many States have established automated procedures that allow a person to form a new corporation or LLC within the State within 24 hours of filing an online application without any prior review of that application by a State official. In exchange for a substantial fee, two States will even form a corporation or LLC within one hour of a request. After examining these State incorporation practices, the GAO report described the problems that the lack of beneficial ownership information has caused for a range of law enforcement investigations.

In November 2006, our Subcommittee held a hearing further exploring this issue. At that hearing, representatives of the U.S. Department of Justice (DOJ), the Internal Revenue Service (IRS), and the Department of Treasury's Financial Crimes Enforcement Network (FinCEN) testified that the failure of States to collect adequate information on the beneficial owners of the legal entities they form has impeded federal efforts to investigate and prosecute criminal acts such as terrorism, money laundering, securities fraud, and tax evasion. At the hearing, DOJ testified: "We had allegations of corrupt foreign officials using these [U.S.] shell accounts to launder money, but were unable - due to lack of identifying information in the corporate records - to fully investigate this area." The IRS testified: "Within our own borders, the laws of some states regarding the formation of legal entities have significant transparency gaps which may even rival the secrecy afforded in the most attractive tax havens." FinCEN identified 768 incidents of suspicious international wire transfer activity involving U.S. shell companies.

In addition, last year, when listing the "Dirty Dozen" tax scams for 2007, the IRS highlighted shell companies with unknown owners as number four on the list, as follows:

**"4. Disguised Corporate Ownership:** Domestic shell corporations and other entities are being formed and operated in certain states for the purpose of disguising the ownership of the business or financial activity. Once formed, these anonymous entities can be, and are being, used to facilitate underreporting of income, non-filing of tax returns, listed transactions, money laundering, financial crimes and possibly terrorist financing. The IRS is working with state authorities to identify these entities and to bring their owners into compliance."

That's not all. Dozens of Internet websites advertising corporate formation services highlight the fact that some of our States allow corporations to be formed under their laws without asking for the identity of the beneficial owners. These websites explicitly point to anonymous ownership as a reason to incorporate within the United States, and often list certain States alongside notorious offshore jurisdictions as preferred locations for the formation of new corporations, essentially providing an open invitation for wrongdoers to form entities within the United States.

One website, for example, set up by an international incorporation firm, advocates setting up companies in Delaware by saying: “DELAWARE - An Offshore Tax Haven for Non US Residents.” It cites as one of Delaware’s advantages that: “Owners’ names are not disclosed to the state.” Another website, from a U.K. firm called “formacompany-offshore.com,” lists the advantages to incorporating in Nevada. Those advantages include: “No I.R.S. Information Sharing Agreement” and “Stockholders are not on Public Record allowing complete anonymity.”

Despite this type of advertising, years of law enforcement complaints, and mounting evidence of abuse, many of our States are reluctant to admit there is a problem with establishing U.S. corporations and LLCs with unknown owners. Too many of our States are eager to explain how quick and easy it is to set up corporations within their borders, without acknowledging that those same quick and easy procedures enable wrongdoers to utilize U.S. corporations in a variety of crimes and tax dodges both here and abroad.

Since 2006, the Subcommittee has worked with the States to encourage them to recognize the homeland security problem they’ve created and to come up with their own solution. After the Subcommittee’s hearing on this issue, for example, the National Association of Secretaries of State (NASS) convened a 2007 task force to examine state incorporation practices. At the request of NASS and several States, I delayed introducing legislation while they worked on a proposal to require the collection of beneficial ownership information. My Subcommittee staff participated in multiple conferences, telephone calls, and meetings; suggested key principles; and provided comments to the Task Force.

In July 2007, the NASS task force issued a proposal. Rather than cure the problem, however, the proposal was full of deficiencies, leading the Treasury Department to state in a letter that the NASS proposal “falls short” and “does not fully address of the problem of legal entities masking the identity of criminals.”

Among other shortcomings, the NASS proposal does not require States to obtain the names of the natural individuals who would be the beneficial owners of a U.S. corporation or LLC. Instead, it would allow States to obtain a list of a company’s “owners of record” who can be, and often are, offshore corporations or trusts. The NASS proposal also doesn’t require the States themselves to maintain the beneficial ownership information, or to supply it to law enforcement upon receipt of a subpoena or summons. The proposal also fails to require the beneficial ownership information to be updated over time. These and other flaws in the proposal have been identified by the Treasury Department, the Department of Justice, myself, and others, but NASS has given no indication that the flaws will be corrected.

It is deeply disappointing that the States, despite the passage of more than one year, have been unable to devise an effective proposal. Part of the difficulty is that the States have a wide range of practices, differ on the extent to which they rely on incorporation fees as a major source of revenue, and differ on the extent to which they

attract non-U.S. persons as incorporators. In addition, the States are competing against each other to attract persons who want to set up U.S. corporations, and that competition creates pressure for each individual State to favor procedures that allow quick and easy incorporations. It's a classic case of competition causing a race to the bottom, making it difficult for any one State to do the right thing and request the names of the beneficial owners.

That is why we are introducing federal legislation today. Federal legislation is needed to level the playing field among the States, set minimum standards for obtaining beneficial ownership information, put an end to the practice of States forming millions of legal entities each year without knowing who is behind them, and bring the United States into compliance with its international commitments.

The bill's provisions would require the States to obtain a list of the beneficial owners of each corporation or LLC formed under their laws, to maintain this information for five years after the corporation is terminated, and to provide the information to law enforcement upon receipt of a subpoena or summons. If enacted, this bill would ensure, for the first time, that law enforcement seeking beneficial ownership information from a State about one of its corporations or LLCs would not be turned away empty-handed.

The bill would also require corporations and LLCs to update their beneficial ownership information in an annual filing with the State of incorporation. If a State did not require an annual filing, the information would have to be updated each time the beneficial ownership changed.

In the special case of U.S. corporations formed by non-U.S. persons, the bill would go farther. Following the lead of the Patriot Act which imposed additional due diligence requirements on certain financial accounts opened by non-U.S. persons, our bill would require additional due diligence for corporations beneficially owned by non-U.S. persons. This added due diligence would have to be performed -- not by the States -- but by the persons seeking to establish the corporations. These incorporators would have to file with the State a written certification from a corporate formation agent residing within the State attesting to the fact that the agent had verified the identity of the non-U.S. beneficial owners of the corporation by obtaining their names, addresses, and passport photographs. The formation agent would be required to retain this information for a specified period of time and produce it upon request.

The bill would not require the States to verify the ownership information provided to them by a formation agent, corporation, LLC, or other person filing an incorporation application. Instead, the bill would establish federal civil and criminal penalties for anyone who knowingly provided a State with false beneficial ownership information or intentionally failed to provide the State with the information requested.

The bill would also exempt certain corporations from the disclosure obligation. For example, it would exempt all publicly-traded corporations and the entities they form, since these corporations are already overseen by the Security and Exchange Commission

(SEC). It would also allow the States, with the written concurrence of the Homeland Security Secretary and the U.S. Attorney General, to identify certain corporations, either individually or as a class, that would not have to list their beneficial owners, if requiring such ownership information would not serve the public interest or assist law enforcement in their investigations. These exemptions are expected to be narrowly drafted and rarely granted, but are intended to provide the States and federal law enforcement added flexibility to fine-tune the disclosure obligation and focus it where it is most needed to stop crime, tax evasion, and other wrongdoing.

Another area of flexibility in the bill involves privacy issues. The bill deliberately does not take a position on the issue of whether the States should make the beneficial ownership information they receive available to the public. Instead, the bill leaves it entirely up to the States to decide whether and under what circumstances to make beneficial ownership information available to the public. The bill explicitly permits the States to place restrictions on providing beneficial ownership information to persons other than government officials. The bill focuses instead only on ensuring that law enforcement and Congress, when equipped with a subpoena or summons, are given ready access to the beneficial ownership information collected by the States.

To ensure that the States have the funds needed to meet the new beneficial ownership information requirements, the bill makes it clear that States can use their DHS state grant funds for this purpose. Every State is guaranteed a minimum amount of DHS grant funds every year and may receive funds substantially above that minimum. Every State will be able to use all or a portion of these funds to modify their incorporation practices to meet the requirements in the Act. The bill also authorizes DHS to use appropriated funds to carry out its responsibilities under the Act. These provisions will ensure that the States have the funds needed for the modest compliance costs involved with amending their incorporation forms to request the names of beneficial owners.

It is common for bills establishing federal standards to seek to ensure State action by making some federal funding dependent upon a State's meeting the specified standards. This bill, however, states explicitly that nothing in the bill authorizes DHS to withhold funds from a State for failing to modify its incorporation practices to meet the beneficial ownership information requirements in the Act. Instead, the bill simply calls for a GAO report in 2012 to identify which States, if any, have failed to strengthen their incorporation practices as required by the Act. After getting this status report, a future Congress can decide what steps to take, including whether to reduce any DHS funding going to the noncompliant States.

Finally, the bill would require the U.S. Department of the Treasury to issue a rule requiring formation agents to establish anti-money laundering programs to ensure they are not forming U.S. corporations or LLCs for criminals or other wrongdoers. GAO would also be asked to conduct a study of existing State formation procedures for partnerships and trusts.

We have worked hard to craft a bill that would address, in a fair and reasonable way, the homeland security problem created by States allowing the formation of millions of U.S. corporations and LLCs with unknown owners. What the bill comes down to is a simple requirement that States change their incorporation applications to add a question requesting the names and addresses of the prospective beneficial owners. That is not too much to ask to protect this country and the international community from U.S. corporations engaged in wrongdoing and to help law enforcement track down the wrongdoers.

For those who say that, if the United States tightens its incorporation rules, new companies will be formed elsewhere, it is appropriate to ask exactly where they will go? Every country in the European Union is already required to get beneficial information for the corporations formed under their laws. Most offshore jurisdictions already request this information as well, including the Bahamas, Cayman Islands, Jersey, and the Island of Man. Our States should be asking for the same ownership information, but they don't, and there is no indication that they will any time in the near future, unless required to do so.

I wish federal legislation weren't necessary. I wish the States could solve this homeland security problem on their own, but ongoing competitive pressures make it unlikely that the States will reach agreement. We've waited more than a year already with no real progress to show for it, despite repeated pleas from law enforcement.

Federal legislation is necessary to reduce the vulnerability of the United States to wrongdoing by U.S. corporations with unknown owners, to protect interstate and international commerce from criminals misusing U.S. corporations, to strengthen the ability of law enforcement to investigate suspect U.S. corporations, to level the playing field among the States, and to bring the United States into compliance with its international anti-money laundering obligations.

There is also an issue of consistency. For years, I have been fighting offshore corporate secrecy laws and practices that enable wrongdoers to secretly control offshore corporations involved in money laundering, tax evasion, and other misconduct. I have pointed out on more than one occasion that corporations were not created to hide ownership, but to shield owners from personal liability for corporate acts. Unfortunately, today, the corporate form has too often been corrupted into serving those wishing to conceal their identities and commit crimes or dodge taxes without alerting authorities. It is past time to stop this misuse of the corporate form. But if we want to stop inappropriate corporate secrecy offshore, we need to stop it here at home as well.

For these reasons, I urge my colleagues to support this legislation and put an end to incorporation practices that promote corporate secrecy and render the United States and other countries vulnerable to abuse by U.S. corporations with unknown owners.

I ask unanimous consent that a summary of the bill and its text be included in the Congressional Record at this time.