

## New Transparency Rules Will Require Beneficial Ownership Reporting for Business Entities

Many privately held corporations, limited liability companies and other business entities that are formed or registered to do business in any state of the United States will soon be required to disclose their beneficial ownership to the U.S. government.

The new disclosure requirements, which are scheduled to become effective sometime within the next year, are contained in the Corporate Transparency Act (CTA), which was enacted into law on Jan. 1, 2021, as part of the National Defense Authorization Act. Any business entity subject to the CTA (called a “reporting company” in the legislation) will be required to report to the U.S. Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) who its beneficial owners are, and will have a continuing obligation to file updates reporting any changes in such beneficial ownership. The purpose of the new reporting requirements is to provide governmental agencies with additional information that may be used to identify and combat illegal activities, including money laundering, terrorism financing, serious tax fraud and other financial crimes. However, the new reporting requirements are broad and will subject millions of businesses to beneficial ownership reporting obligations.

### Key Takeaways:

- The new beneficial ownership reporting requirements are not effective yet (i.e., no reporting is required yet). The reporting requirements will not take effect until FinCEN issues final regulations (which it must do by Jan. 1, 2022).



- The beneficial ownership information reported to FinCEN will not be part of any publicly accessible database.
- Following the issuance of final regulations, existing entities will have two years to submit beneficial ownership reports to FinCEN. Entities formed (or qualified to do business) after the issuance of final regulations must submit beneficial ownership reports to FinCEN at the time of formation (or registration). All entities will have an obligation to update their reports if there are changes in beneficial ownership.
- At this time, trusts and partnerships appear to not be included as reporting companies. However, (1) a report is to be submitted to Congress within two years of the issuance of regulations under the CTA regarding such entities and the wisdom of requiring beneficial ownership information of such entities, and (2) it is possible that the final regulations will contain provisions that will result in some information being required (for example, it is possible that a trust that is a beneficial owner of a reporting company will have to be identified), but at this point, we do not know what the regulations will say.

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- No specific guidance currently exists on how to identify the beneficial owners of reporting companies that are owned through trusts, estates and other complex structures commonly used by private clients. Presumably, the forthcoming regulations will provide more guidance on the issue.
- Failure to comply with the reporting requirements and the unauthorized disclosure or use of the information carry fines and the possibility of imprisonment.

### Which entities are subject to the reporting requirements?

The CTA imposes beneficial ownership reporting requirements on reporting companies, which include privately held corporations, LLCs, and other similar entities formed under state law or the law of an Indian tribe. Non-U.S. entities that are registered to do business in any state of the United States or with any Indian tribe also fall within the definition of reporting companies.

The CTA does provide for several exemptions from the definition of reporting company, including:

- Entities that are already highly regulated or subject to governmental supervision (such as companies that are SEC registered under the Securities and Exchange Act of 1934, charitable trusts, 501(c) nonprofit organizations, investment companies, pooled investment vehicles, insurance companies, banks, credit unions, registered money transmitting businesses, exchanges or clearing agencies, public accounting firms, and public utility companies)
- Entities that employ more than 20 people, filed an income tax return in the U.S. for the previous year reporting gross receipts in excess of \$5 million and have a physical presence in the United States
- Dormant entities
- Certain entities that are owned or controlled by an exempt entity

### What information must be reported?

A reporting entity must disclose the following information about each beneficial owner and each applicant:

1. Full legal name
2. Date of birth
3. Current residential or business address

4. Identification number from an acceptable identification document (such as an unexpired passport issued by the U.S. or a foreign country, a U.S. driver's license, or another U.S. identification document)

Individuals can instead request and use a FinCEN identifier number, which can be obtained by providing FinCEN with the above information.

The reporting entity is obligated to file an updated report if there are any changes to the information listed above (including changes caused by a change in beneficial ownership) within one year of the change.

### Who is a beneficial owner or an applicant?

The CTA defines the term "beneficial owner" broadly to include any individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, meets either of the below tests:

1. Exercises substantial control over the entity
2. Owns or controls not less than 25% of the ownership interests of the entity

Certain categories of individuals are excluded from the definition of beneficial owners—including minors (provided that information for a parent is provided), nominees, intermediaries, custodians, agents acting on behalf of another individual, individuals acting solely as employees, individuals whose only interest is through a right of inheritance, and creditors.

The term "applicant" is defined broadly to include any individual who files an application to form an entity or registers an entity to do business anywhere in the U.S.

### When will entities have to comply with the reporting requirements?

Although the CTA has generated a great deal of concern regarding the burden it might impose on legitimate entities, the reporting requirements are not effective until FinCEN issues final regulations. These regulations—which must be issued by Jan. 1, 2022—will set the effective date of the new reporting requirements. Entities that have been formed or registered before the effective date must file a report within two years of the effective date. Entities formed or registered after the effective date will be required to submit their reports at the time of formation

or registration. Finally, all reporting companies will be required to file an updated report if there have been any changes to the information they submitted (including changes caused by a change in beneficial ownership) within one year of any such change.

### Will the information be public?

No, the database will not be available to the public.

### How will the information be stored? Who will have access to the information?

Reported information will be stored in a secure private database maintained by FinCEN and will be available only in limited situations upon appropriate request by U.S. federal law enforcement agencies (including requests made by U.S. federal authorities on behalf of non-U.S. law enforcement), state and local law enforcement with court authorization for such information, financial institutions that have the consent of the business entity in question, and certain federal regulatory agencies. The Department of the Treasury has its own broad authorization to use the information, including for tax-related purposes.

In order to ensure the security of the information, the CTA imposes penalties for the unauthorized disclosure or use of the information. A person (including both government employees and third-party recipients) may be fined up to \$250,000 and/or imprisoned for up to five years for knowingly using or disclosing beneficial ownership information received by or through FinCEN in an unauthorized manner.

### What are the penalties for failing to comply with the reporting obligation?

Willful violations of the reporting requirements carry steep penalties. Any person who willfully fails to report complete or updated beneficial ownership information to FinCEN faces fines of up to \$10,000 and/or imprisonment for up to two years. The same penalties also apply to any person who willfully provides (or attempts to provide) false or fraudulent beneficial ownership information. In this context, willfully means the voluntary, intentional violation of a known legal duty.

From a practical perspective, any noncomplying entity will also likely find it difficult to open or maintain a bank account or other financial account, particularly in the U.S.

## Insights for private clients

### Are trusts and partnerships subject to the new reporting requirements?

Only an entity that is created (or registered to do business) by filing a document with a U.S. state or Indian tribe falls within the definition of reporting company. This would exempt most trusts used for estate planning purposes.

While corporations and LLCs are expressly included within the definition of a reporting company, whether a partnership that has filed with a U.S. state and/or registered to do business in any U.S. state is included is an open question.

A provision in the Anti-Money Laundering Act of 2020, which also was enacted as part of the same legislation on Jan. 1, 2021, requires a study to be conducted and presented to Congress within two years of the issuance of the regulations under the CTA to evaluate whether the lack of beneficial ownership information with respect to trusts, partnerships and other entities raises concerns with respect to investigations of money laundering and other illegal activities or results in criticism from other nations.

The final FinCEN regulations hopefully will provide additional clarification regarding whether, and to what extent, trusts and partnerships will be subject to the reporting requirements of the CTA.

### If a reporting company is owned by a trust, estate or other complex structure, who must be disclosed as the beneficial owner?

The definition of beneficial owner focuses on ownership and control over an entity, but does not provide guidance on how to identify individuals who own or control trusts, estates and other complex structures commonly used by private clients. Presumably, forthcoming regulations will provide more guidance on this issue.

For now, we are only left with questions, including:

- Who should be considered to own or control an estate or trust—settlers, trustees, beneficiaries, protectors?
- To what extent should a discretionary beneficiary be deemed to own or control a trust?
- In crafting the new regulations, will FinCEN look to the standard it set for filing Reports of Foreign Bank and Financial Accounts (FBARs) or the standard set by the Foreign Account Tax Compliance Act?

**Are non-U.S. entities with investments in the United States subject to the new reporting requirements?**

Non-U.S. entities that formally register to do business in the U.S. (i.e., by making a filing with a secretary of state of any U.S. state) fall within the definition of reporting company and are subject to the new reporting requirements, but those that have not formally registered are not. An individual may still be able to anonymously invest in the United States through an unregistered non-U.S. entity. But the extent to which this remains possible will depend on the ever-evolving landscape of customer due diligence requirements, the requirements of each U.S. state regarding when an entity is engaged in activity that requires it to file to do business in such state, and the reporting requirements of the jurisdiction where the non-U.S. entity was created.

The CTA is expressly meant to capture indirect ownership. For example, consider a non-U.S. individual (FI) who has formed a non-U.S. corporation (FC) that is not registered to do business in the U.S. FC has formed a U.S. corporation (USC). It appears that because FC is

not registered to do business in the U.S., FC will not be a reporting company for purposes of the CTA and will not be required to file a report with FinCEN disclosing its beneficial ownership. USC, however, will be a reporting company for purposes of the CTA and will be required to file a report with FinCEN disclosing its beneficial ownership, including information about FI.

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