

Removing Anonymity: New U.S. Beneficial Ownership Reporting Requirements

by Christina S. Hammervold

Reprinted from *Tax Notes Federal*, April 18, 2022, p. 439

Removing Anonymity: New U.S. Beneficial Ownership Reporting Requirements

by Christina S. Hammervold



Christina S. Hammervold

Christina S. Hammervold is senior counsel in the international trust and estate planning practice of Loeb & Loeb LLP in Chicago.

In this article, Hammervold outlines the new beneficial ownership reporting requirements for U.S. and foreign entities enacted by the United States in the Corporate Transparency Act.

For more than a decade, the international community has worked to develop standards to enhance beneficial ownership transparency across jurisdictions. Many countries (including all EU states and the United Kingdom) have incorporated those standards into their domestic laws.

Until recently, the United States had not incorporated those transparency standards, which the U.S. Treasury Financial Crimes Enforcement Network said created “a weak link in the integrity of the global financial system.” That lack of beneficial ownership reporting requirements made the United States a jurisdiction of choice for those desiring to establish shell companies to hide the ultimate beneficiaries. Aware of that gap, Congress enacted the Corporate Transparency Act (CTA) on January 1, 2021. On December 7, 2021, FinCEN released proposed regulations implementing the CTA’s beneficial ownership reporting requirements.

Any entity subject to the CTA (called a “reporting company”) will soon be required to report information about its beneficial owners to

FinCEN and will have a continuing obligation to file updates to report changes in beneficial ownership. The new reporting requirements were designed to provide governmental agencies with information they can use to detect and combat illegal activities, including money laundering, terrorism financing, serious tax fraud, and other financial crimes.¹ Given that purpose, the CTA’s reporting requirements are broadly written. Consequently, millions of businesses (including limited liability companies) will soon be subject to beneficial ownership reporting obligations.

This article covers some of the key components of the new reporting regime, including:

- who must file beneficial ownership reports;
- who must be identified in the reports;
- what information must be provided;
- when the reports must be filed;
- who will have access to the information; and
- what penalties may be imposed for noncompliance.

No reporting is required yet: The reporting requirements will not take effect until FinCEN issues final regulations, which will likely be soon (although the exact timing is unclear).

I. Reporting Regime

A. Who Must File

The CTA imposes filing obligations on domestic and foreign reporting companies. Domestic reporting companies include corporations, LLCs, and other entities formed by

¹ See generally William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, P.L. 116-283, section 6402(1)-(5) (NDAA).

filing a document with a secretary of state or any similar office under the law of a state or Native American tribe. Foreign reporting companies include non-U.S. entities registered to do business in the United States or with any Native American tribe.

Importantly, only an entity created (or registered to do business) by filing a document with a secretary of state or similar office falls within the definition of a reporting company. Limited liability partnerships, limited liability limited partnerships, business trusts (for example, statutory trusts or Massachusetts trusts), and most limited partnerships would likely be considered domestic reporting companies. States may differ, however, on whether some other types of entities are created by a filing (for example, general partnerships, other types of trusts, and sole proprietorships).

Because most trusts used for estate planning purposes (as well as partnerships) are not created (or registered to do business) by filing a document, they should generally not be classified as reporting companies. That does not mean that FinCEN will not ultimately receive information about trusts. For example, if a trust directly or indirectly owns an interest in a reporting company, information about the trust's beneficial owners might be reported to FinCEN.

The CTA requires a report be submitted to Congress by the U.S. comptroller general within two years of the effective date of final regulations regarding the wisdom of requiring beneficial ownership information for trusts and partnerships.² The report must evaluate whether the lack of beneficial ownership information for U.S. partnerships and trusts "has elicited international criticism."³ Thus, trusts and partnerships could have a direct obligation to report their beneficial ownership soon. In fact, other countries already require beneficial ownership information to be submitted for trusts — for example, the EU fifth anti-money-laundering directive (Directive 2018/843/EU, known as 5AMLD) requires beneficial ownership

reporting for trusts and similar legal arrangements.

The CTA exempts 23 categories of entities from its reporting requirements, which the proposed regulations adopt. For example, exemptions exist for entities that are already highly regulated or subject to governmental supervision (such as banks and charitable trusts); large operating companies with a physical presence in the United States; dormant entities that were in existence on or before January 1, 2020; and specific entities that are owned or controlled by an exempt entity. The CTA grants the Treasury secretary (with the written concurrence of the attorney general and the secretary of homeland security) discretion to exempt additional categories.

B. Who Must Be Identified

Two categories of individuals are reportable under the CTA: beneficial owners and applicants.⁴

1. Beneficial Owners

The CTA broadly defines the term "beneficial owner" to include any individual who directly or indirectly through any contract, arrangement, understanding, relationship, or otherwise either exercises substantial control over an entity (substantial control test) or owns or controls at least 25 percent of the entity's ownership interests (ownership test). Some individuals are excluded from the definition, including:

- minors (if information for a parent or guardian is provided);
- nominees, intermediaries, custodians, and agents acting on behalf of another individual;
- individuals acting solely as employees (and not as senior officers);
- individuals whose only interest is a future interest through a right of inheritance; and
- creditors.

The proposed regulations clarify the definition of beneficial owner by providing further guidance on the terms "substantial control" and "ownership interests."

² *Id.* at section 6502(d).

³ NDAA, section 6502(d)(4).

⁴ Although the CTA uses the term "applicant," the proposed regs use the term "company applicant." For simplicity, this article uses the term "applicant" when referring to either definition.

a. Substantial Control Test

The proposed regs enumerate four categories of substantial control:

- service as a senior officer;
- authority to appoint or remove a senior officer, or a majority or dominant minority of the board of directors (or similar body);
- control of direction, determination, or decision of (or substantial influence over) important company matters; and
- any other form of substantial control.

Each and every individual who has the right or ability to exercise substantial control must be identified and disclosed. According to the regs:

A reporting company would not need to spend significant time assessing which of its beneficial owners would be the most appropriate to report as being in substantial control. Rather, entities would simply report all persons in substantial control as beneficial owners, with no need to distinguish among them.

Based on the breadth of the substantial control definition, FinCEN expects that a reporting company would identify at least one individual under the substantial control prong.

b. Ownership Test

In setting the reporting threshold at 25 percent, the CTA follows the approach adopted by many countries.⁵ However, some countries adopt lower reporting thresholds — for example, Argentina, Botswana, Ecuador, and Saudi Arabia impose no threshold at all. That is, in those countries, beneficial ownership reporting is required for all owners, no matter how minimal an owner's ownership percentage.

In determining whether an individual owns or controls at least 25 percent of the ownership interests of a reporting company, the proposed regs define ownership interests broadly to include various types of interests in companies, including equity interests and some convertible instruments, options, futures, and warrants.

An ownership interest can be owned or controlled through various means, including through a trust. According to the regulations, if an ownership interest is held through a trust, the following individuals would be considered to have an ownership interest in the reporting company:

- a grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust;
- a beneficiary who is the sole permissible recipient of income and principal from the trust;
- a beneficiary who has the right to demand a distribution of or withdraw substantially all of the assets from the trust;
- a trustee of the trust; and
- any other individual who has the authority to dispose of trust assets.

According to the above framework, discretionary beneficiaries would generally not be reportable as beneficial owners unless they are the sole permissible recipient of income and principal, they have the right to demand substantially all the trust fund, or otherwise have substantial control.

However, FinCEN might change those rules in the final regulations, having acknowledged in its notice of proposed rulemaking that “these concepts do not map easily onto every trust” and asked for comment on its general approach to trusts.

Notably, the approach adopted by the proposed regulations is narrower than that seen in other contexts. For example, in defining the term “equity interest” in the context of trusts, the Model 1 intergovernmental agreement of the U.S. Foreign Account Tax Compliance Act identifies the relevant stakeholders in a trust as:

a settlor or beneficiary of all or a portion of the trust, or any other natural person exercising ultimate effective control over the trust. A Specified U.S. Person will be treated as being a beneficiary of a foreign trust if such Specified U.S. Person has the right to receive directly or indirectly (for example, through a nominee) a mandatory distribution or may receive,

⁵ Andres Knobel, “The US Beneficial Ownership Law Has Its Weaknesses, but It’s a Seismic Shift,” Tax Justice Network, Jan. 20, 2021.

directly or indirectly, a discretionary distribution from the trust.

The Financial Action Task Force recommends an even broader approach: Beneficial ownership information should be kept for the settlor, trustee, protector (if any), beneficiary or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust.⁶ That approach has been implemented by Belgium, Bulgaria, Cyprus, Luxembourg, Malta, and the United Kingdom.⁷

2. Applicants

The proposed CTA regulations define the term “applicant” broadly. For a domestic reporting company, an applicant includes any individual who files the document that creates the entity. For a foreign reporting company, an applicant includes any individual who files the document that first registers the entity to do business in the United States.

Importantly, the proposed regs also include as an applicant any individual who directs or controls the filing of a document by another person. FinCEN was aware that, in many cases, the individual who files the document to form or register a reporting company may be merely an agent, employee, or family member who is filing the document on behalf of another individual. The additional requirement was imposed because FinCEN wants a reporting company to identify the individuals who are responsible for the decision to form the reporting company, information it believes will be of use to law enforcement.

An example is illustrative. Consider a reporting company formed by a law firm on behalf of a client. Under the proposed regulations, the reporting company may have to identify the paralegal who made the filing to form the entity, the attorney who directed the filing, the client representative who directed the law firm to form the entity (such as a family office employee), and the client representative who made the decision to form the entity (such as the family matriarch).

⁶ Financial Action Task Force, “Transparency and Beneficial Ownership,” at para. 59 (Oct. 2014).

⁷ Open Ownership, “Beneficial Ownership Transparency of Trusts,” at 20 (July 2021).

C. Required Information

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

- full legal name;
- date of birth;
- current address:
 - the business street address for an applicant who forms or registers a company in the course of business; or
 - the residential street address the individual uses for tax residency purposes for all other cases;
- identification number from an acceptable, unexpired identification document; and
- an image of the identification document that shows both the identification number and the individual’s photograph.

In lieu of providing the full list of required information in each report, individuals and entities can apply for a FinCEN identifier and provide that to the reporting company.

The proposed regs also require reporting companies to include specific information about themselves, including the full name of the reporting company; any trade or doing-business name; the business street address; the jurisdiction of formation or registration; and the IRS taxpayer identification number. If a reporting company has not yet been issued a TIN, it must provide a Dun & Bradstreet Data Universal Numbering System Number or a Legal Entity Identifier.

D. When to File

The new beneficial ownership reporting requirements are not yet effective and will not be until FinCEN issues final regulations. It is unclear when FinCEN will do so or when the reporting requirements will become effective — FinCEN is seeking views on the timing of the effective date.

New and existing entities have different filing deadlines. Entities formed or registered after the effective date of the final regs must file initial reports within 14 days of the date they are formed or registered. According to the proposed regulations, reporting companies formed or registered before the effective date must file initial reports no later than one year after the effective date. That is a change from the CTA, which

allowed existing entities two years to file. A previously exempt entity that no longer qualifies must file a report within 30 days of no longer meeting the exemption criteria.

Reporting companies must also timely update information and correct any inaccurate information. The proposed regs give reporting companies 30 days to file updates to previously filed reports — for example, to report changes in beneficial ownership or in information reported for any beneficial owner or applicant — and 14 days to correct inaccurate reports.

E. Access to Information

The beneficial ownership information reported to FinCEN will be stored in a secure private database maintained by FinCEN and will not be available to the public. To ensure security, the CTA imposes penalties for unauthorized information disclosure or use: A person may be fined up to \$250,000 and/or imprisoned for up to five years for knowingly disclosing or using beneficial ownership information received by or through FinCEN in an unauthorized manner.

Specific governmental entities will have access to the information. The U.S. Treasury has broad authority to access beneficial ownership information, including for tax-related purposes. The CTA also allows FinCEN to disclose beneficial ownership information to some governmental agencies on request, including:

- 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;
- financial institutions that have the consent of the reporting company; and
- specified federal regulatory agencies.

Many countries have gone so far as to provide public access to beneficial ownership information — for example, in accordance with 5AMLD, EU countries must provide public access to their beneficial ownership registries. Some observers argue that allowing public access to that information would stimulate broader data use

and scrutiny that could increase its effect and possibly even deter wrongdoing and misuse.⁸ However, even those that advocate for public registries acknowledge that they pose legitimate privacy concerns. An alternative approach would be to provide limited access to members of the public who demonstrate a “legitimate interest,” which is the 5AMLD approach for trusts.

In its notice of proposed rulemaking, FinCEN addressed public disclosure and acknowledged privacy concerns:

While FinCEN’s approach could be viewed to raise concerns about the disclosure of personal information about a broader range of individuals, the privacy impact of reporting [beneficial ownership information] to FinCEN is relatively light, because, unlike beneficial ownership registries in many other countries, FinCEN’s database will not be public and will be subject to stringent access protocols.

F. Penalties for Noncompliance

While only reporting companies have direct filing obligations, the proposed regulations clarify that penalties may also apply to responsible individuals and other entities. Any person who willfully⁹ fails to report complete or updated beneficial ownership information to FinCEN faces criminal penalties of up to \$10,000 and/or imprisonment for up to two years. Penalties may apply to individuals who willfully direct a company not to report, or substantially control a reporting company when it willfully fails to report complete or updated beneficial ownership information. The same penalties also apply to any person who willfully provides or attempts to provide false or fraudulent beneficial ownership information.

The wide scope of the CTA’s penalty provisions may be cause for concern for those in the business of forming or registering companies in the United States. Indeed, the proposed regs suggest that applicants (which could include

⁸ *Id.* at 22.

⁹ In this context, the term “willfully” means the voluntary, intentional violation of a known legal duty.

attorneys) could be liable for potential CTA violations if they file beneficial ownership reports with FinCEN on behalf of a reporting company.¹⁰

Finally, 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 United States.

II. Conclusion

For some, the passage of the CTA marks an important step in making the world more transparent by providing needed information to governmental agencies combating money laundering, terrorism financing, serious tax fraud, and other financial crimes. But others argue that the CTA does not go far enough. They say beneficial ownership information should be made public, all legal entities (including trusts and partnerships) should be required to provide beneficial ownership information, and the definition of beneficial owner should be broader (for example, the 25 percent threshold adopted by the CTA is too high).¹¹

Further, some critics think the CTA implicates privacy and data security concerns by requiring an unprecedented amount of information to be collected by FinCEN. They argue that while the CTA's goals are legitimate, bad actors may be unlikely to meaningfully comply with the act's requirements, thereby frustrating its purpose. They may even argue that the CTA's biggest impact would be the imposition of burdensome reporting requirements on good actors. Even if FinCEN is provided with reliable, actionable data, critics may doubt FinCEN's ability to make good use of them.

Regardless of which side of the debate one is on, what is clear is that millions of entities will soon be subject to beneficial ownership reporting obligations in the United States. ■

¹⁰"It may also give a company applicant executing the filing an incentive to reasonably satisfy himself or herself that the [beneficial ownership information] being submitted to FinCEN at the direction of another is accurate because they could also be held accountable, thereby improving data quality."

¹¹Knobel, *supra* note 5.

taxnotes®

Federal | State | International



Weekly Updates With Tax Notes Geo.

Choose any U.S. state
or country and receive
a full year of tax news
for just \$100.

Whether your focus area is New England or England, Tax Notes Geo helps you stay on top of important developments in the tax world so you don't miss a thing.

taxnotes.com/country
taxnotes.com/state

News where
it matters most.