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Reporting Requirements of the Corporate Transparency Act of 2021: Compliance Challenges, Beneficial Owners, Penalties

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EisnerAmper

Corporate Transparency Act ("CTA")

Harold Adrion
International Tax Counsel to
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The law comes after years of proposed legislation and international pressure for the United States to conform to standards set by the Financial Action Task Force (FATF) – the global money laundering and terrorist financing watchdog created in 1989 by the G-7. Similar legislation has been in place for several years now in the United Kingdom and throughout the EU as a result of the European Fourth and Fifth Anti-Money Laundering Directives which required EU member states to create central national registries for corporations and trusts. For now, trusts are not included under CTA as reporting entities (although statutory trusts may be required to report).

European Union Standards

The most developed and targeted standards exist at the EU level. They are set forth in the Fourth and Fifty Anti-Money Laundering Directives (AMLD).

The 4AMLD stipulated that Member states had to introduce beneficial ownership registers in 2017 to be accessible to persons with a "legitimate interest" This was updated in 2018 with the introduction of the 5AMLD, which mandated that Member states establish centralised beneficial ownership registers for companies that are available to the public by 10 January 2020. It also stipulates that registers of beneficial ownership for trusts and similar legal arrangements are to be established by March 2020, accessible to competent authorities and those with legitimate interest. The national registers will be interconnected directly to facilitate cooperation and exchange information between EU Member states, with the registers envisioned to have information verification mechanisms to improve the accuracy and reliability of information (EC 2019).

Although the 4AMLD represents an attempt to create unanimity across all Member states with respect to registers, significant differences remain in the extent of public access and the reliability of information available (see annex 1). Moreover, recent analysis (Global Witness 2020) shows that most Member states are late in transposing the directive and failed to comply with the January 2020 deadline.

UK Overseas Territories are expected to implement publicly accessible registers by the end of 2023.

Country	Public register of beneficial ownership	Private register of beneficial ownership
Alderney Island		ü
Austria	ü	
Brazil		ü
Belgium	ü	
Bermuda		ü
British Virgin Islands		ü
Bulgaria	ü	
Cayman Islands		ü
Costa Rica		ü
Croatia		ü
Cyprus		ü
Czechia		ü
Denmark	ü	
Ecuador	ü	
Estonia	ü	
Finland		ü
France		ü
Germany	ü	
Gibraltar		ü
Greece		ü
Guernsey		ü
Hungary		ü
Indonesia		ü
Ireland	ü	
Isle of Man		ü
Latvia	ü	
Lichtenstein		ü
Lithuania		ü
Luxembourg	ü	
Malta		ü
Netherlands		ü
Poland[1]	ü	
Portugal		ü
Romania	ü	
Slovakia		ü
Slovenia	ü	
Spain	ü	
Sweden	ü	
Trinidad and Tobago	ü	
Turks and Caicos		ü
Ukraine	ü	
United Kingdom	ü	
United Arab Emirates		ü
Uruguay		ü

*UK Overseas Territories are required to implement by the end of 2023 – includes Cayman Islands and BVI's.

OVERVIEW OF 31 U.S.C. §5336

1. <u>Definitions</u>
   - A “reporting company” must identify its “beneficial owners” and “applicants” to FinCEN.

OVERVIEW OF 31 U.S.C. §5336

2. <u>Beneficial Ownership Information Reporting</u>
   - Reporting of existing entities.
   - Reporting of new entities.
   - Reporting of exempt entities having a direct or indirect ownership interest in a reporting company.
   - Changes in beneficial ownership.
   - Required Information.
   - Secretary of Treasury's review of updated reporting for changes in beneficial ownership, regulation requirements, and report to Congress.

OVERVIEW OF 31 U.S.C. §5336

3. Retention and Disclosure of Beneficial Ownership Information by FinCEN
   - Retention period.
   - Disclosure of information upon agency's request.
   - Denial of agency's request.
   - Department of Treasury's access.
   - Secretary of Treasury's obligation to establish protocol, maintain information security, and report to Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives.
   - Audit by the Comptroller General.

OVERVIEW OF 31 U.S.C. §5336

4. Agency Coordination.
   - Calling Federal, State, and Tribal agencies to cooperate.

5. Notification of Federal Obligations
   - The Secretary of the Treasury has an obligation to provide notice to persons of their obligations to report beneficial ownership information.
   - State and Indian Tribes' obligation to notify.

OVERVIEW OF 31 U.S.C. §5336

6. No bearer share corporations or limited liability companies.

7. Director of FinCEN's obligation to reach out to members of the small business community and other appropriate parties to ensure efficiency and effectiveness of the process.

OVERVIEW OF 31 U.S.C. §5336

8. Penalties.
   - Reporting violations.
   - Unauthorized disclosure of use.
   - Safe Harbor
   - The Inspector General of the Department of Treasury's report and investigation in the event of cybersecurity breach.

OVERVIEW OF 31 U.S.C. §5336

9. Continuous review of exempt entities.
10. Authorization of appropriations.

Key Provisions of the CTA

How Does This Affect You and Your Practice?

- "Reporting Companies" Must File with FinCEN a Report of the Entity's "Beneficial Owners"
  - Are any of my clients "Reporting Companies"?
  - Are any of my clients "Beneficial Owners"?

Key Provisions of the CTA

Who are "Reporting Companies"?

- Beneficial ownership reporting requirements will apply to existing corporations, LLCs and other "similar entities" formed under the laws of a U.S. state or Indian tribe or formed under the law of a foreign country and registered to do business in a U.S. state (or tribal area), unless exempt.
  - Unclear if limited partnerships are subject to the CTA
- Formation of new entities will require the contemporaneous filing of the prescribed information.
- Existing entities will be required to file within the time prescribed by the regulations.

Key Provisions of the CTA

What Companies Are Exempt?

- Broad categories of companies are exempt. Generally, they are already subject to close regulation in the U.S., including:
  - Publicly traded companies and financial services institutions, such as insurance, investment and accounting firms, public utility companies, securities trading firms, broker-dealers, banks, bank holding companies, savings and loan holding companies and credit unions that report to and are regulated by government agencies such as the Securities and Exchange Commission;
  - commingled funds advised or managed by exempt entities and tax-exempt entities;
  - wholly-owned subsidiaries of exempt entities; and
  - churches, charities, and other tax-exempt organizations.

Key Provisions of the CTA

What Companies Are Exempt?

- Excludes companies that employ more than 20 people full time in the U.S., filed in the previous year a federal income tax return reporting more than $5 million in gross receipts or sales, and have a physical presence in the United States.
- Exempt entities still obligated to make a filing that specifies why the entity is exempt.
- Read literally, the CTA frees foreign entities that are not qualified to do business in the U.S. from the obligation to disclose their beneficial ownership. Does this make them useful as "blockers"?

Key Provisions of the CTA

Who is a "Beneficial Owner"?

- Under the Act, a "beneficial owner" is defined as an individual who, directly or indirectly, **through any contract, arrangement, understanding, relationship, or otherwise:**
  - Exercises substantial control over an entity; or
  - Owns or controls at least 25% of the ownership/equity interests in an entity (i.e., membership.

Key Provisions of the CTA

Who is a "Beneficial Owner"?

- "Beneficial owner" excludes:
  - A minor child;
  - Nominees, intermediaries, custodians, or agents acting on behalf of another individual;
  - An employee whose control is derived solely because of employment status;
  - An individual whose only interest in the entity is through a right of inheritance; and
  - A creditor of the entity, unless the creditor meets the requirements of a beneficial owner.
- Term "beneficial owner" - looks up the chain of entities owning an entity to determine the ultimate individual "natural person" beneficial owner(s) of an entity.

Key Provisions of the CTA

What information does a "Reporting Company" have to report?

- CTA requires reporting companies to file and update a report with FinCEN that provides for each "Beneficial Owner":
  - name,
  - date of birth,
  - current address and
  - unique identification number (passport or driver's license, e.g.).
- Information must be updated within one year of any changes.

Key Provisions of the CTA

Who is an "Applicant"?

- "Applicant" is any individual who "files" an application to form an entity in the U.S.
  - For a foreign entity, an individual who "registers or files" an application for the foreign entity to do business in the U.S. The terms "file" and "register" are not defined in the CTA.
- Applicants forming new entities must be disclosed in the Registry
  - Is that a problem for law firms and in-house counsel?
  - Will law firms no longer be willing to serve as "organizers" for LLCs and corporations?
  - What about service companies (CT, CSC, e.g.)?

IMPLEMENTATION

Effective Date for reporting – to be set forth in FinCEN regulations

New entities -- on or after Effective Date

Existing entities – no later than 2 years after the Effective Date

Publication in Federal Register, followed by Public Comment period

Final regulations – to be codified at 31 C.F.R. Part 1010 – must be promulgated by January 1, 2022

CTA-REQUIRED REGULATIONS

(REQUIRED BY 1/1/22)

- Procedures and standards governing reporting of beneficial ownership information and any FinCEN identifier
- Specific information required to be reported and the reporting method
- The method for reporting changes in beneficial ownership (for both entities and persons holding FinCEN identifiers)
- Reporting requirements for exempt subsidiaries and exempt grandfathered entities that cease to be exempt

ADVANCED NOTICE OF PROPOSED RULEMAKING APRIL 5, 2021

48 DETAILED QUESTIONS ON TOPICS INCLUDING:

- Definitions
  - Corporations, LLCs, “other similar entities”
  - “Reporting Company”
  - “Beneficial Owner”
  - “Own,” “Control,” “Substantial Control”
- Other exemptions?
- Reporting of Specific Beneficial Ownership Information
  - Relationship with beneficial owners?
  - Affiliates?
  - How and when changes should be reported
  - Verification or certification of accuracy

ADDITIONAL QUESTIONS RAISED IN NOTICE OF PROPOSED RULEMAKING

- FinCEN Identifier
- Security – Use of Beneficial Ownership and Applicant Information by Other Parties
- Costs on Small Business
- Outreach to Small Business Community
- How to minimize the burden on state, local, and tribal governmental agencies

OTHER CTA-REQUIRED REGULATIONS

(NOT REQUIRED BY 1/1/22)

- The form and manner in which information shall be provided by FinCEN to a financial institution for Customer Due Diligence, and to certain regulatory agencies for certain purposes
- Protocols to protect the security and confidentiality of beneficial ownership information, to include obligations on requesting agencies
- Establishment of a safe harbor for persons seeking to amend previously submitted but inaccurate beneficial ownership information

HOW MUCH REQUIRED INFORMATION FOR BENEFICIAL OWNERS?

Statutory required information:

1. *Full Legal Name*
2. *Date of Birth*
3. *Current residential or business street address*
4. *Unique identifying number (passport, driver's license, government-issued ID)*

Other <u>possible</u> information:

A. *Information about the reporting entity itself*
B. *Affiliates, parents, and subsidiaries*
C. *The relationship of the reporting entity to its beneficial owners*

FILING PROCEDURE

Online submission of application (presumably analogous to Customer Due Diligence reporting by financial institutions)

"FinCEN identifier" for the "Applicant"

Ongoing filing requirements

Work with your paraprofessionals

Public Comments in response to the Advance Notice of Proposed Rulemaking were due by May 5, 2021

How to obtain information to be reported?

Consider adding a requirement in the entity's governing instruments

Questions raised by the FinCEN Notice

Will entities otherwise exempt from beneficial ownership reporting be required to affirmatively establish their exempt status? On an ongoing basis?

Will reporting entities have to provide more information than the statute requires?

Does “Beneficial Owner” = the Customer Due Diligence Rule definition for financial institutions?

Although failure to comply with the CTA does not invalidate formation of the business entity, what effect will noncompliance have on the entity?

PENALTIES

Any person who willfully provides false or fraudulent beneficial ownership information or willfully fails to report complete or updated beneficial ownership information will be subject to:

- Civil penalty of not more than $500 per day of noncompliance, up to $10,000

and/or

- Imprisonment for up to 2 years

INADVERTENT ERRORS

CTA Section 5336(h)(3)(C): safe harbor from the civil and criminal penalties if a person submitting incorrect information submits a report containing corrected information not later than 90 days after the original report, provided that the person was not acting to evade the reporting requirements and did not have actual knowledge that information contained in the original report was inaccurate.

PENALTIES (CONTINUED)

Any party that unlawfully knowingly discloses any beneficial ownership information to unauthorized parties is subject to:

- Fines of up to $500 per day, up to $250,000 in the aggregate

and/or

- Imprisonment for up to 10 years

ANALOGOUS REGULATORY FRAMEWORKS

- Tax return information
- FinCEN Customer Due Diligence submissions
- FINCEN geographic targeting orders (GTOs) under the Bank Secrecy Act
- SBA “Affiliate” (Beneficial Ownership) Rules
- SEC “Affiliate” Definitions

OTHER ANALOGOUS FRAMEWORKS

- U.S. Commerce Department Bureau of Economic Analysis Reporting Requirements
- U.S. Customs C-TPAT Registration
- U.S. Citizenship and Immigration Service filings
- State annual report requirements

Retention and disclosure of beneficial ownership information (BOI) by FinCEN

- BOI reported under the CTA relating to each reporting company is required to be maintained by FinCEN for not fewer than five (5) years after the date on which the reporting company terminates.

Access to Database and Confidentiality

- Once reported, beneficial ownership information will be kept in a confidential FinCEN database and held for at least five years after the relevant Reporting Company ceases to exist. Although the beneficial ownership registry will not be publicly available, upon request, FinCEN will be authorized to share information in certain circumstances, subject to compliance with protocol, treaty, agreement, convention or official request, as applicable, with (i) financial institutions (in connection with CDD- requirements under applicable law with the consent of the Reporting Company); (ii) federal law enforcement, intelligence and national security agencies; (iii) state, local and Tribal law enforcement authorities; (iv) foreign law enforcement authorities; and (v) federal functional and other regulators.
- As noted the EU started out with a registry that had very limited access. Now most EU countries have either made the registry public or are in the process of doing so.

Practical Considerations
Special Purpose on Vehicles

Many special purpose vehicles will be considered several entities – closely held companies will generally be considered covered entities. Partnerships are explicitly listed in the CTA – however, they are similar to LLC which are considered covered entities.

<u>Family Wealth Planning</u>

Many structures involve entities that have no employees – and are caught up in planning.

A Short List of Possible “reporting companies”

- Family offices
- Joint ventures
- Subsidiaries within a portfolio
- “main street” and “mom and pop” businesses
- Businesses utilizing independent contractors rather than employees
- Law firms, accounting firms and other professional services businesses with limited “owners” or limited revenue or only a virtual presence
- Certain nonprofit entities not falling within the included exclusions (and nonprofit entities that lose their IRC §501(c) designation).