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We May Not Know Who You Are or Where You Live, But We Intend to Find Out: The Corporate Transparency Act of 2020

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One of the more significant pieces of legislation passed by the U.S. Congress each year is the National Defense Authorization Act. The William M.(ac) Thornberry National Defense Authorization Act for Fiscal Year 2021 (the “NDAA”) includes the Anti-Money Laundering Act of 2020 (the “AMLA”). Nestled between the Artificial Intelligence Act of 2020 and the Elijah E. Cummings Coast Guard Act, the AMLA is a serious piece of legislation intent on improving coordination and information sharing among the agencies tasked with advancing the anti-money laundering efforts of the U.S. government. It modernizes anti-money laundering and anti-terrorism financing laws, and for these ends it encourages technological innovations and reinforces related policies, procedures, and controls of financial institutions. In furtherance of these ambitions, the AMLA includes the Corporate Transparency Act of 2020 (“CTA”).² The express purpose of the CTA is to “establish uniform beneficial ownership information reporting requirements” so as to improve transparency for national security, intelligence, and law enforcement

agencies and financial institutions, “discourage the use of shell companies as a tool to disguise and move illicit funds,” and “protect the national security of the United States.”³ The unarticulated purpose is for the United States to join the rest of the civilized world in adopting a legal and regulatory regime to establish and maintain a registry of beneficial owners of business entities, including corporations, limited liability companies, and “other similar entities.” The CTA requires disclosure of identifying information regarding not only on those who own business entities, but also those who form business entities.

ENTITIES SUBJECT TO CTA REPORTING

Inasmuch as corporations and limited liability companies are limited liability entities organized under state law, it is reasonable to assume that similar entities drawn within the net of the CTA will be any form of limited partnership (LP, LLP, or LLLP) organized under state law (addressed by the CTA as “reporting companies”). Also brought within the scope of “reporting companies” are corporations, limited liability companies, and similar entities organized under the laws of an Indian tribe (as defined in §102 of the Federally Recognized Indian Tribe List Act of 1994)⁴ or under the laws of a foreign country that has registered to do business in the United States through filings with agencies of a state or Indian tribe.

ENTITIES NOT SUBJECT TO CTA REPORTING

Many business entities are excluded from the definition of a “reporting company.” Most of the excluded companies and organizations (with a rather significant exception) are regulated entities such as issuers of securities registered under §12 of the Securities Exchange Act of 1934,⁵ companies registered and regulated under the securities, investment, and bank-

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² The CTA is codified by amendment of Subtitle IV, Chapter 53 (Monetary Transactions) of Title 31 of the United States Code. All citations to provisions of the CTA are as codified unless otherwise indicated.

³ NDAA, Pub. L. No. 116-283 (Jan. 1, 2021), Div. F, §6002.

⁴ 25 U.S.C. §5130(2).

⁵ 15 U.S.C. §781.

ing laws of the United States, money-transmitting businesses registered with the Secretary of the Treasury under §5330 of the NDAA, insurance companies, commodities dealers, public accounting firms registered in accordance with §102 of the Sarbanes-Oxley Act of 2002,⁶ utility companies, tax code §501(c)(3) organizations and charitable trusts described in §4947(a)(1) and §4947(a)(2) (including charitable lead trusts and charitable remainder trusts), political organizations, and most parent and subsidiary companies of the exempted entities. Also excluded is any entity that

- employs more than 20 employees on a full-time basis in the United States,
- filed a federal income tax return in the previous year reporting more than \$5 million in gross receipts or aggregate sales, and
- has a physical office in the United States.⁷

Certain grandfathered entities are also excluded: specifically, any corporation, limited liability company, or similar entity that

- has been in existence for more than one year from the date of enactment,
- is not engaged in active business,
- is owned by a U.S. person,
- has not experienced a change in ownership or distributed or received funds in any amount greater than \$1,000 in the preceding 12 months, and
- does not otherwise own any kind or type of assets, including interests in subsidiaries.⁸

WHEN AND HOW REPORTING IS REQUIRED

The Secretary of the Treasury is directed to issue regulations that will require reporting from both existing and newly formed reporting companies. Existing entities must report within two years after the effective date of regulations.⁹ In the case of reporting companies formed or registered after the effective date of regulations, reporting will be required at the time of formation or registration. All reporting is to the Financial Crimes Enforcement Network (FinCEN).¹⁰ The CTA directs regulations to require reporting of changes in beneficial ownership and other required information not later than one year after the date on

which such change occurs.¹¹ If, in the Treasury Secretary's opinion upon consultation with the Attorney General and Homeland Security Secretary, changes in ownership should be reported more immediately after they occur, the Treasury Secretary is directed to incorporate such changes into the regulations within two years from enactment of the CTA. As much as possible, such information is to be collected through "existing Federal, State, and local processes and procedures" in a form and manner to facilitate confirmation of beneficial ownership information provided to financial institutions and activities of law enforcement, national security, and intelligence agencies.¹²

INFORMATION TO BE REPORTED

While the obligation to report is imposed on those corporations, limited liability companies, and other similar entities that fall within the definition of a "reporting company," the information reported relates solely to the individuals who own or form those companies. The CTA requires the full legal name, date of birth, current residential or business street address, and an identification number from certain specified identification documents for each beneficial owner of the reporting company and each applicant directly involved in formation of the reporting company to be disclosed to FinCEN. A FinCEN identifier issued pursuant to the provisions of the CTA may be used in lieu of the required information.¹³ Non-reporting companies (referred to as "exempt entities") that have or will have a "direct or indirect ownership interest" in a reporting company must also be identified by name, but no further information regarding the exempt entity is required.

Any individual who owns or controls 25% or more of the "ownership interests" of a reporting entity or who exercises substantial control over the entity through "any contract, arrangement, understanding, relationship, or otherwise" is defined as a "beneficial owner" whose identity and information is required to be reported.¹⁴ However, "beneficial owners" does not include

- minor children if the information of the parent or guardian of the minor child is reported,
- individuals acting as nominees, intermediaries, custodians, or agents on behalf of other individuals (who presumably are required to be identified as a result of their indirect control),
- employees of reporting companies whose "control over or economic benefits from" the report-

⁶ 15 U.S.C. §7212.

⁷ 31 U.S.C. §5336(a)(11)(B)(xxi).

⁸ 31 U.S.C. §5336(a)(11)(B)(xxii).

⁹ 31 U.S.C. §5336(b)(1)(B).

¹⁰ 31 U.S.C. §5336(b)(1)(C).

¹¹ 31 U.S.C. §5336(b)(1)(D).

¹² 31 U.S.C. §5336(b)(1)(F)(ii).

¹³ 31 U.S.C. §5336(b)(2)(A)(iv)(II).

¹⁴ 31 U.S.C. §5336(a)(3)(A).

ing company is solely derived by virtue of their employment,

- individuals whose only interest in the reporting company is through an expectancy of inheritance, and
- creditors of the reporting company unless the creditor exercises substantial control over the reporting company.¹⁵

Any individual who files an application to form a corporation, limited liability company, or other similar entity under the laws of a state or Indian tribe or who registers (or files an application to register) a foreign corporation, limited liability company, or similar entity to do business in the United States with the Secretary of State (or similar office) of a state or Indian tribe is defined as an “applicant”¹⁶ whose identifying information must be disclosed by the reporting company to FinCEN. As defined, the term “applicants” clearly includes professionals engaged to form reporting companies. *Query*: Can applicant status be avoided simply by using a company such as CT Corporation to register the reporting company?

Certain exempt entities are subject to special reporting requirements. Pooled investment companies organized under the laws of a foreign country are required to file with FinCEN a certification that provides the CTA-required identification information for an individual who “exercises substantial control over the pooled investment vehicle in the same manner.”¹⁷ As noted above, subsidiaries of exempt entities are not subject to CTA reporting. However, such entities must nonetheless report when no longer owned or controlled by an exempt entity.¹⁸ Similarly, inactive entities must deliver the required reporting information once those companies no longer satisfy the indicia for inactive status.¹⁹

RETENTION AND DISCLOSURE OF REPORTED INFORMATION

Information gathered by the CTA is required to be maintained for at least five years after the date on which the existence of the reporting company terminates. The information may be disclosed by FinCEN only on receipt of a request “through appropriate protocols” from federal agencies engaged in national security, intelligence, or law enforcement activities for

use “in furtherance of those activities” or from state, local, or tribal law enforcement agencies that have obtained authorization to request the information for a civil or criminal investigation authorized by a court of competent jurisdiction.²⁰ In addition, CTA-obtained information may be disclosed to law enforcement agencies, prosecutors, and judges of other countries with which the United States has a treaty, convention, or similar agreement when request is made through a “Federal agency.”²¹ In the case of a foreign government with which no information exchange agreement exists, CTA reporting information may be provided on request of a Federal agency for use in investigations and prosecutions or national security or intelligence activity if the country from which the request emanates is a “trusted” foreign country.²² CTA-acquired information may also be provided on request to financial institutions with the consent of the reporting company or on request of a “federal functional regulator” authorized by law to oversee compliance of the financial institution.²³

CIVIL AND CRIMINAL PENALTIES

All reporting and disclosure is subject to protocols established by the Secretary of the Treasury. Any requesting agency employee or officer who violates those protocols will be subject to criminal and civil penalties. Those who provide false or fraudulent information or willfully fail to provide required information may incur civil penalties of \$500 for each day the violation continues, as well as criminal penalties of up to \$10,000 and imprisonment for up to two years.²⁴ Similarly, unauthorized disclosure or use of beneficial ownership information collected under the CTA is also subject to civil penalties of up to \$500 a day and criminal penalties of up to \$250,000 and imprisonment of up to five years. If the violation occurs while violating another law of the United States or as part of a pattern of illegal activity involving more than

²⁰ 31 U.S.C. §5336(c)(2)(B)(i).

²¹ The term “Federal agency” is not defined by the CTA. Consequently, it is unclear as to whether the term is limited to a federal agency of the U.S. government or also includes agencies of foreign governments. However, §9602 of the NDAA (the “Electronic Message Preservation Act”) defines “Federal agency” by reference to the definition appearing in 44 U.S.C. §2901, which applies to Title 31 (“Federal agency” means any executive agency or any establishment in the legislative or judicial branch of the Government (except the Supreme Court, the Senate, the House of Representatives, and the Architect of the Capitol and any activities under the direction of the Architect of the Capitol)). See NDAA §9602(b)(3)(C).

²² 31 U.S.C. §5336(c)(2)(B)(ii).

²³ 31 U.S.C. §5336(c)(2)(B)(iii), §5336(c)(2)(B)(iv).

²⁴ 31 U.S.C. §5336(h)(3)(A).

¹⁵ 31 U.S.C. §5336(a)(3)(B).

¹⁶ 31 U.S.C. §5336(a)(2).

¹⁷ 31 U.S.C. §5336(b)(2)(C). It is not clear from the statute whether the “same manner” refers to the means of providing the identification information or the scope of the information to be provided or both.

¹⁸ 31 U.S.C. §5336(b)(2)(D).

¹⁹ 31 U.S.C. §5336(b)(2)(E).

\$100,000 in any 12-month period, the penalty maximums are increased to \$500,000 and 10 years.²⁵

IMPLEMENTATION

The Secretary of the Treasury is directed to issue regulations implementing the provisions of the CTA not later than one year after the CTA's date of enactment (January 1, 2021). Reporting requirements will take effect on the effective date of the regulations. Each year thereafter for the following three years, the Secretary is required to submit to Congress a report describing the procedures proscribed to collect information required by the CTA and assess the effectiveness of those procedures to minimize reporting burdens and strengthen the accuracy of the information gathered.²⁶

CONCLUDING OBSERVATIONS

Depending upon one's perspective, the CTA is a giant leap forward in the quest for entity transparency

or a disturbing invasion of privacy. The latter opinion is likely to be held by owners of corporations, limited liability companies, or other similar entities (including professional services firms, such as law and accounting firms) that have less than 20 full-time employees in the United States or report less than \$5,000,000 in gross receipts or aggregate sales on their U.S. income tax returns. With regard to privacy concerns, solace may be taken from the omission of trusts from the types of entities subject to the CTA. Thus, the trustee of a trust that owns a corporation, limited liability company, or other similar entity which is regarded as a reporting company will clearly be disclosed as a "beneficial owner" of that reporting company, but the identities of the trust's settlor and beneficiaries will remain protected. . .at least until regulations are published and become effective.²⁷

²⁵ 31 U.S.C. §5336(h)(3)(B).

²⁶ 31 U.S.C. §5336(b)(6).

²⁷ In this regard, customer due diligence regulations adopted by FinCEN in 2016, which became effective in 2018 do not require disclosure of settlors and beneficiaries of trusts, settling, instead, for disclosure of the trustee. *See* 31 C.F.R. §1010.230(d)(3).