REMOVING THE CLOAK: THE CORPORATE TRANSPARENCY ACT OF 2021 – NEW U.S. LEGISLATION TARGETING GLOBAL CORRUPTION

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FinCEN Identifiers
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INTRODUCTION[1]

In the last decade, the United States lagged behind the rest of the world in requiring business entities to report identifying information on their owners as a measure to attack tax evasion, terrorist financing, and money laundering. While a U.S. corporation or a foreign corporation reporting effectively connected income must report the ultimate 25% beneficial owner on Form 5472 (*Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*) when it engages in certain transactions with a related party, Congress was concerned that bad actors overseas could hide behind U.S. entities when engaging in illicit activity.

Over the years, a consensus developed overseas that the U.S. did not adhere to international beneficial ownership reporting standards. The U.S. is a member of the Financial Action Task Force but did little to adopt the Task Force's recommendations. In part, this changed in 2016 when the Financial Crimes Enforcement Network ("FinCEN")[2] instituted a regulation requiring U.S. financial institutions to determine the natural persons who are the beneficial owners of entities.[3]

Because the U.S. has been slow to implement rules and regulations put into place by other countries, some have regarded the U.S. as a tax haven. This perception has been based on the lack of transparency that has historically existed around the actual control of entities in the U.S. A 2011 study by the World Bank found that the U.S. performed worst among all countries reviewed in collecting beneficial ownership information.[4] That information can be used by U.S. law enforcement agencies in identifying entities established for illegal purposes, such as corruption, human smuggling, drug and arms trafficking, and terrorist financing.

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1 The author acknowledges the assistance of Charli Beam, a Junior Associate at The Zahn Law Group, who provided invaluable contributions to the research and writing of this Article.

2 FinCEN is a bureau of the U.S. Department of the Treasury that collects and analyzes information about financial transactions in order to combat domestic and international money laundering, terrorist financing, and other financial crimes. FinCEN is generally best known for its role in collecting information on FinCEN Form 114 (*Report of Foreign Bank and Financial Accounts (FBAR)*), which must be filed by U.S. persons having a financial interest or signatory authority over a foreign financial account.

3 M. Read Moore & Nancy G. Henderson, "America the Gradual: An Update on How Anti-Money Laundering Initiatives Affect Estate Planners," pg. 10-3 (2023).

4 Emile van der Does de Willebois, Emily M. Halter, Robert A. Harrison, Ji Won Park, and J.C. Sharman, "The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It" (October 24, 2011).

CORORATE TRANSPARENCY ACT OF 2021

The Corporate Transparency Act of 2021 ("C.T.A.") was enacted as part of the National Defense Authorization Act for Fiscal Year 2021. The purpose of the C.T.A. is to create a national database of information regarding individuals who directly or indirectly hold substantial control over, or own a substantial interest in, certain domestic or foreign legal entities.[5]

The Beneficial Ownership Rule (the "B.O. Rule") implements Section 6403 of the C.T.A., and describes who must file a report, what information must be provided, and when a report is due. The proposed Beneficial Ownership Information Reporting Rule was published on December 7, 2021, and the final rule was published on September 30, 2022. The rules are effective January 1, 2024. However, companies created before January 1, 2024, have until January 1, 2025, to file initial reports. Companies created after January 1, 2024, will have 30 days from official notice of creation or registration to file initial reports.

The B.O. Rule is notably different from the Customer Due Diligence Rule ("C.D.D. Rule"), FinCEN's existing due diligence rule. The C.D.D. Rule has four core requirements. It requires covered financial institutions to establish and maintain written policies and procedures that are reasonably designed to

- identify and verify the identity of customers,
- identify and verify the identity of the beneficial owners of companies opening accounts,
- understand the nature and purpose of customer relationships to develop customer risk profiles, and
- conduct ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.

With respect to the requirement to obtain beneficial ownership information, financial institutions will be required to identify and verify the identity of its beneficial owner ("B.O."), which is (i) any individual who owns 25% or more of a legal entity and (ii) any individual who controls the legal entity.

The new B.O. Rule defines a beneficial owner more broadly and requires identification of all individuals who control a company, rather than just a single individual exercising control. Additionally, the B.O. Rule provides more exemptions than the definition of a legal entity customer in the C.D.D. Rule.[6] This means that banks and other financial institutions may currently be collecting beneficial ownership information ("B.O.I.") from entities that will not be required to report this information under the Rule.

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[5] FinCEN Beneficial Ownership Information Reporting Requirements, 31 C.F.R. 1010 (2022).

[6] FinCEN publishes final rule on beneficial ownership, Davis Polk, October 6, 2022.

DETAILS OF THE B.O. RULE

Scope of Coverage

The final regulations[7] apply to domestic companies and, when engaged in business in the U.S., foreign companies. Also subject to the B.O. Rule are limited liability companies, corporations, and any entity that comes into existence through registration with a secretary of state at the level of any state or the District of Columbia, or a similar office in the U.S. General partnerships, sole proprietorships, and trusts generally are not reporting companies under the C.T.A. because they are not created by filing a document with an applicable agency.

Exempt Entities

Not all entities are covered. The B.O. Rule excludes twenty-three types of corporate entities from the definition of reporting company:

- Securities issuers
- Other entities registered pursuant to the securities exchange act of 1934 entities
- Financial market utilities
- Domestic governmental authorities
- Registered investment companies and advisers
- Pooled investment vehicles
- Banks
- Venture capital fund advisers
- Tax exempt entities
- Domestic credit unions
- Insurance companies
- Entities assisting tax exempt entities
- Depository institution holding companies
- State licensed insurance producers
- Large operating companies
- Money transmitting businesses
- Entities registered pursuant to the commodity exchange act
- Subsidiaries of certain exempt entities
- Brokers or dealers in securities

[7] 31 C.F.R. § 1010.380.

- Accounting firms
- Inactive businesses
- Securities exchange or clearing agencies
- Public utilities

The reason for exempting the foregoing entities is that they already are required to provide B.O.I. to a governmental authority.[8]

Obligation to Report

Reporting companies that are not excluded must provide an initial report ("B.O. Report") that contains information identifying the company, its B.O.'s, and the company applicant. Corrected or updated reports are required if the beneficial ownership changes or is found to be incorrect. This is discussed in greater detail below.

A foreign individual is a B.O. if he or she (i) exercises substantial control over a reporting company (ii) or owns or controls 25% or more of the ownership interests of a reporting company.

Individuals Exercising Substantial Control

Under the regulations, an individual exercises substantial control over the reporting corporation where the individual

- serves as a senior officer;
- has authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body);
- directs, determines, or has substantial influence over important decisions made by the reporting company; or
- has any other form of substantial control over the reporting company.

Important Decisions

The following decisions are viewed to be important decisions of a reporting corporation:

- Decisions regarding the nature, scope, and attributes of the business of the reporting company, including the sale, lease, mortgage, or other transfer of any principal assets of the reporting company
- Decisions regarding the reorganization, dissolution, or merger of the reporting company
- Major expenditures or investments, issuances of any equity, incurrence of any significant debt, or approval of the operating budget of the reporting company
- Decisions regarding the selection or termination of business lines or ventures, or geographic focus, of the reporting company
- Decisions regarding compensation schemes and incentive programs for senior officers

[8] 31 U.S.C. 5336(a)(11)(B)(i)-(xxiii).

- Decisions regarding the entry into or termination, or the fulfillment or non-fulfillment, of significant contracts
- Decisions regarding amendments of any substantial governance documents of the reporting company, including the articles of incorporation or similar formation documents, bylaws, and significant policies or procedures

Substantial Control

An individual, including a trustee of a trust or similar arrangement, may directly or indirectly exercise substantial control over a reporting company through

- board representation;
- ownership or control of a majority of the voting power or voting rights of the reporting company;
- rights associated with any financing arrangement or interest in a company;
- control over one or more intermediary entities that separately or collectively exercise substantial control over a reporting company;
- arrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees; or
- any other contract, arrangement, understanding, or relationship.

". . . the identity of an individual who owns or controls at least 25% of the ownership interests of a reporting company must be reported to FinCEN."

Ownership Interests

As previously mentioned, the identity of an individual who owns or controls at least 25% of the ownership interests of a reporting company must be reported to FinCEN. For this purpose, the term "ownership interest" means the following:

- Any equity, stock, or similar instrument; preorganization certificate or subscription; or transferable share of, or voting trust certificate or certificate of deposit for, an equity security, interest in a joint venture, or certificate of interest in a business trust in each such case, without regard to whether any such instrument is transferable, is classified as stock or anything similar, or confers voting power or voting rights
- Any capital or profit interest in an entity
- Any instrument convertible, with or without consideration, into any share or instrument described in the two preceding bulleted paragraphs (including any future on the instrument), or any warrant or right to purchase, sell, or subscribe to a share of the ownership interest, even if characterized as debt
- Any put, call, straddle, or other option or privilege of buying or selling any of the interests described in the three preceding bulleted paragraphs without being bound to do so, except to the extent that such option or privilege is created and held by a third party without the knowledge or involvement of the reporting company
- Any other instrument, contract, arrangement, understanding, relationship, or mechanism used to establish ownership

An individual may directly or indirectly own or control an ownership interest of a reporting company through any contract, arrangement, or otherwise. Included ownership arrangements are the following:

- Joint ownership with one or more other persons of an undivided interest in such ownership interest
- Ownership through another individual acting as a nominee, intermediary, custodian, or agent
- With regard to a trust or similar arrangement that holds such ownership interest, ownership as (i) a trustee of the trust or other individual (if any) with the authority to dispose of trust assets; (ii) a beneficiary who is the sole permissible recipient of income and principal from the trust, or has the right to demand a distribution of or withdraw substantially all of the assets from the trust; or (iii) a grantor or settlor who has the right to revoke the trust or otherwise withdraw the assets of the trust
- Through ownership or control of one or more intermediary entities, or ownership or control of the ownership interests of any such entities, that separately or collectively own or control ownership interests of the reporting company

Calculation of Total Ownership Interest

In determining whether an individual owns or controls 25% or more of the ownership interests of a reporting company, the total ownership interests that an individual owns or controls, directly or indirectly, is calculated as a percentage of the total outstanding ownership interests of the reporting company in the following way:

- Ownership interests of the individual shall be calculated at the present time, and any options or similar interests held by the individual are treated as exercised.
- For reporting companies that issue capital or profit interests, including entities treated as partnerships for U.S. Federal income tax purposes, the individual's ownership interests are the individual's capital and profit interests in the entity, calculated as a percentage of the total outstanding capital and profit interests of the entity.
- For corporations, entities treated as corporations for U.S. Federal income tax purposes, and other reporting companies that issue shares of stock, the applicable percentage is the greater of (i) the total combined voting power of all classes of ownership interests of the individual as a percentage of total outstanding voting power of all classes of ownership interests entitled to vote and (ii) the total combined value of the ownership interests of the individual as a percentage of the total outstanding value of all classes of ownership interests.
- If the facts and circumstances are such that the calculations described in either of the two preceding bulleted paragraphs cannot be performed with reasonable certainty, any individual who owns or controls 25% or more of any class or type of ownership interest shall be deemed to own or control 25% or more of the ownership interests of the reporting company.

Exceptions to Beneficial Owner Status

Certain exceptions exist so that no person described below is treated as to the term beneficial owner:

- A minor child, as defined under the law of the State or Indian tribe territory in which a domestic reporting company is created or a foreign reporting company is first registered, where the reporting company reports the required information of a parent or legal guardian of the minor child
- An individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual
- An employee of a reporting company other than a senior officer, acting solely as an employee, whose substantial control, power, or economic benefits are derived solely from the employment status of the individual employee
- An individual whose only interest in a reporting company is a future interest through a right of inheritance
- An individual who is solely a creditor of a reporting company, meaning his or her interest in the reporting company is based solely on the anticipated payment of a predetermined sum of money, such as a debt incurred by the reporting company or a loan covenant intended to secure the right to receive payment

"The due date for initial reports is modified in the final regulations."

REPORTS

Timing

The due date for initial reports is modified in the final regulations. The statute provides that initial reports must be filed in a timely manner, but not later than two years after the effective date of final regulations. The proposed regulations adopted an initial due date of one year after the effective date of final regulations, looking at the two-year period as discretionary but not mandatory. Newly formed entities were required to file reports within 14 days of creation or registration.

The final regulations adopt the following rules:

- The effective date of the regulations is January 1, 2024.
- Reporting companies created or registered before January 1, 2024, will have one year until January 1, 2025 to file their initial reports, while reporting companies created or registered after January 1, 2024, will have 30 days after receiving notice of their creation or registration to file their initial reports.
- Reporting companies have 30 days to report changes to the information in their previously filed reports and must correct inaccurate information in previously filed reports within 30 days of when the reporting company becomes aware or has reason to know of the inaccuracy of information in earlier reports.

Content

The B.O.I. Report must contain the following four pieces of information about each Beneficial Owner:

- The B.O.'s name
- The B.O.'s birthdate
- The B.O.'s address
- The B.O.'s unique identifying number and issuing jurisdiction from an acceptable identification document (and the image of such document). An example is a passport or residence identity card

In addition, the B.O.I. Report must include the following information regarding the reporting company:

- Its full legal name
- All trade names and "doing-business-as" names used by the reporting company
- The address of the principal place of business of the reporting company
- Its jurisdiction of formation
- Its tax identification number[9]

A domestic reporting company must use its U.S. tax identification number. If the reporting company is foreign, it must use its U.S. tax identification number, if one exists. If a U.S. tax identification number has not been obtained for any reason, it must provide a foreign tax identification number.

Company Applicant

The person who files a B.O. Report is referred to as a "Company Applicant." A Company applicant may be one of two persons:

- The individual who directly files the document that creates the entity, or in the case of a foreign reporting company, the document that first registers the entity to do business in the United States.
- The individual who is primarily responsible for directing or controlling the filing of the relevant document by another.[10]

Comments received by FinCEN identified practical issues in identifying a company applicant who actually filed documents creating a company. In many cases, a company applicant may be an employee of a law firm or business formation service. For example, if an attorney is responsible for the preparation and filing of incorporation documents and a paralegal files these documents directly with the state office, both the attorney and paralegal would be reported as company applicants. Consequently, the final regulations provide that a reporting company existing or registered at the

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[9] 31 C.F.R. §1010.380(b)(1)(i)(A)-(C).

[10] 31 C.F.R. §1010.380(e).

time of the effective date of the rule has until January 1, 2025, to file the initial report. In addition, reporting companies formed or registered after the effective date of the rule also do not need to update company applicant information.

Reporting companies must report a business address for a company applicant who forms or registers an entity in the normal course of the applicant's business. However, a B.O. Report need not include the address an individual uses for tax residency purposes.[11]

Certifications

The regulations require a reporting company to certify that reports submitted to FinCEN are true, correct, and complete.[12] The certification requirement applies to all reports and applications submitted to FinCEN, not just to a B.O.I. Report.

INDIVIDUAL FINCEN IDENTIFIERS

Reporting companies concerned about furnishing a B.O.I. Report with personal information of a B.O. may report a FinCEN identifier instead of a B.O.I. Report. There may also be an administrative benefit if an individual is likely to be identified as a B.O. of numerous reporting companies.

A FinCEN identifier is a unique identifying number that FinCEN will issue to individuals or entities upon request. To obtain a FinCEN identifier, the same information that would appear in a B.O.I. Report is furnished directly to FinCEN by the individual. An individual who chooses this method is responsible for keeping the B.O.I. updated.

LAWYERS' OBLIGATIONS

Although the F.A.T.F. has published guidance relating to a lawyer's role in anti-money laundering efforts over the last decade, no U.S. Federal or state laws or regulations require lawyers to act as gatekeepers to the financial system. While lawyers in the U.S. clearly may not engage in or aid money laundering in any way, they are not required to conduct due diligence or file suspicious activity reports. While this is not changed under the C.T.A., attorneys, paralegals, or other persons who file documents with an applicable agency to create any kind of legal entity will file a B.O. Report. That reporting obligation provides information not significantly different from information included on line 6 of Part II of I.R.S. Form 5472 (Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business). There, the I.R.S. receives the name, address, U.S. tax identifying number, foreign tax identifying number, name of country where business is conducted principally, country of citizenship, and country of residence of the ultimate 25% shareholder. The driver for providing the information is that the U.S. entity enters into a monetary transaction with a foreign related party determined using the standard of 25% ownership.

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[11] 31 C.F.R. §1010.380(b)(1)(ii).

[12] 31 C.F.R. §1010.380(b).

OVERALL IMPACT OF THE B.O. RULE

The overall impact the B.O. Rule will have on compliance and financial transparency remains unclear. While the B.O. Rule intends to streamline compliance and create a more effective way of gathering information, there is speculation that the requirements will add to the compliance burden banks and other covered financial institutions face already. The Rule will exclude a wider range of entities from reporting requirements than the C.D.D. Rule currently does, including large operating companies.

IMPACT OF THE B.O. RULE ON TRUSTS

The majority of trusts used for estate planning purposes will not fall under the definition of a reporting entity. However, if the trust invests in a U.S. entity, information about the trust's Beneficial Owners will need to be reported to FinCEN as discussed above.

NEXT STEPS

FinCEN's next step is to draft rules that address access to B.O.I. maintained by FinCEN. Questions that must be decided include the following:

- Who may access B.O.I.?
- For what purposes may B.O.I. be accessed?
- What safeguards to protect B.O.I. of specific persons will be adopted?

"The majority of trusts used for estate planning purposes will not fall under the definition of a reporting entity."