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The Corporate Transparency Act

The Corporate Transparency Act (“CTA”) requires reporting entities (generally corporations, LLCs and similar entities that are formed in the United States through a filing with state agencies, plus foreign entities with a presence in the United States) to report details of beneficial ownership to FinCEN, the Financial Crimes Enforcement Network established under the auspices of the Department of the Treasury.

This information is to be held in a secure registry. Data may be shared with federal law enforcement agencies and, under certain circumstances, with state and foreign law enforcement agencies, and with certain financial institutions. The expressed aim of the CTA is to assist in the prevention of money laundering, the financing of terrorism and to assist law enforcement in rooting out other crimes.

The CTA became law on January 1, 2021, after both houses of Congress overrode President Trump’s veto of the National Defense Authorization Act, of which the CTA was a part.

Although the CTA is aimed at curtailing criminal activity, its wide application necessarily results in the loss of some measure of anonymity and privacy for companies that would never be considered in the same sentence with the word “criminal.”

Companies can desire anonymity for purposes that have nothing to do with the aims of the CTA. For instance, it is generally acknowledged that the Walt Disney Company assembled its large real estate holdings near Orlando, Florida, through the use of anonymous companies in the hope of avoiding upward pressure on land prices that would have resulted from potential sellers learning the identity of the ultimate buyer and the purpose of the purchases.

On the other hand, anonymous entities are routinely used to hide questionable activity. For instance, the hush money payoff to Stormy Daniels was made through an anonymous Delaware limited liability company that was formed by Michael Cohen virtually overnight.

The disclosures required by the CTA are supposed to be maintained in a secure database accessible only by law enforcement agencies and not subject to release pursuant to any freedom of information requests. Nevertheless, companies must consider the possibility that information regarding their beneficial ownership may become public knowledge through avenues that cannot presently be clearly foreseen.

The Purpose of the CTA

In a “Sense of Congress” portion of the bill establishing the need for intervention, the CTA decries that most states do not require any information about the beneficial owners of the myriad of corporations, limited liability companies, or other similar entities being formed within their respective jurisdictions. Although not pointed out by Congress in the CTA itself, it is fairly common knowledge that in many jurisdictions it is likely to be easier to form a company anonymously than to obtain a library card.

The statute expresses the concern that malign actors seek to conceal their ownership of corporations, limited liability companies or other similar entities in the US to facilitate illicit activity, including money laundering, the financing of terrorism, proliferation financing, serious tax fraud, human and drug trafficking, counterfeiting, piracy, securities fraud, financial fraud, and acts of foreign corruption, harming the national security interests of the United States and allies of the United States.

The CTA is aimed at developing a database of information that is neutral as to the purpose that owners may have in mind for setting up entity ownership in one way or another. It matters not that a beneficial owner of a company may have created an anonymously owned company for non-nefarious reasons. That beneficial ownership must still be disclosed. As a result, even the most innocuous family-owned corporation or LLC will be required to file.

The Secure Database

To combat the perceived problem, the CTA establishes procedures to implement a secure, nonpublic database of beneficial ownership information.

FinCEN is responsible for receiving reports of beneficial ownership and administering the database. FinCEN is the arm of the Treasury Department that is tasked with tracking information relating to financial crimes. It is known for its involvement with receiving reports of Foreign Bank and Financial Accounts, Currency Transaction Reports and Suspicious Activity Reports.

The information collected is considered highly sensitive and so will be directly available only to authorized government authorities (federal, state and in some cases foreign agencies) subject to effective safeguards and controls. The Secretary of the Treasury is directed to maintain the security of the database using methods and techniques that are appropriate to protect non-classified information systems at the highest security level.

Disclosures will not be shared with the general public and cannot be requested under the Freedom of Information Act.

Access to Database by Financial Institutions

Financial institutions will have access to the database to assist in their own “know your customer” responsibilities, with customer consent.

Query: If a bank asks a new customer for permission to access the FinCEN database for verification of beneficial ownership but the customer refuses to give consent, what effect might that have on the relationship between the customer and the bank? One might imagine that a potential customer’s refusal to give such consent would be a red flag to the bank, alerting it that maybe it should not do business with the applicant.

Note that any information in the custody of a bank, although the subject of bank secrecy laws, could nevertheless be the target of a subpoena. This would be the case whether the information is obtained by the bank through the FinCEN database or by any other means.

What kind of entities must file reports of beneficial ownership?

“Reporting companies” must report. The term “reporting company” is defined by the CTA as a corporation, limited liability company or other similar entity that is created in the United States or is formed under the law of a foreign country and is registered to do business in the United States.

What is meant by “other similar entity?”

Until regulations are promulgated, we won’t know what the term “other similar entity” ultimately means. It is quite possible that regulations may include limited partnerships as reporting entities, because although they are not explicitly mentioned in the CTA they are generally formed through a filing with a state office.

On the other hand, it is less likely, though not impossible, that regulations might specify that general partnerships, sole proprietorships, estates or trusts may be included as reporting entities. The reason for this lower likelihood is that the CTA specifically specifies entities for which a state filing is required for formation. Nevertheless, as the government studies the effectiveness of the CTA and regulations promulgated thereunder, it is conceivable that the definition of reporting entities may be expanded (either by statute or regulation) to include entities for which no state filing is required for formation.

Exceptions from the definition of being a reporting company

The statute provides some exclusions from the foregoing rather broad definition of reporting companies:

- Highly regulated entities. The CTA provides exceptions for a number of already highly regulated entities, such as banks, insurers, public utilities, and companies subject to securities laws, who are already subject to significant transparency and reporting requirements.

- Active companies. This exception applies to any entity that employs more than 20 employees on a full-time basis in the U.S., filed in the previous year federal income tax returns showing gross receipts over \$5 million in the U.S. demonstrating more than \$5 million in gross receipts of sales in the aggregate (including from other entities owned by the entity or other entities through which the entity operates), and has an operating presence at a physical office within the U.S.
- Dormant companies. This exception applies to an entity that has been in existence for over 1 year, is not engaged in active business, is not owned, directly or indirectly, by a foreign person, has not in the preceding 12-month period experienced a change in ownership or sent or received funds in an amount greater than \$1,000 and does not otherwise hold any kind or type of assets, including an ownership interest in any other reporting company.

Who is a “beneficial owner?”

The CTA defines a beneficial owner of an entity as an individual who, directly or indirectly:

- exercises substantial control over the entity, or
- owns or controls not less than 25 percent of the ownership interests of the entity.

The definition excludes creditors (but only in their capacity as such), agents, intermediaries and custodians acting on behalf of another individual as well as employees of a reporting company whose control or economic benefit with respect to the entity is derived solely from their employment.

Although we will not know full details about how the term “beneficial owner” will be interpreted until regulations are issued, it is safe to predict that a wide net will be cast. The “Sense of Congress” preamble to the CTA decries the experience where law enforcement may crack the shell of ownership of one entity, only to find another entity behind it whose shell must subsequently be cracked.

One of the main purposes of the CTA is to avoid this problem and require that information be supplied that specifies the ultimate individuals who are in control, directly or indirectly, of an entity. Accordingly, we can expect the regulations to require disclosure that clearly reveals all of the individuals who control or own 25% or more of the reporting company, no matter how many levels of ownership have to be pierced and no matter how indirect that ownership may be.

What information has to be reported about beneficial owners?

Every reporting company must submit to FinCEN a report containing the following information for each beneficial owner:

- Full legal name;
- Current residential or business street address;
- Date of birth; and
- Identification number (such as a driver's license or passport number).

When must reports be filed?

Once regulations are published (which must happen by 1/1/2022), newly-formed reporting companies will be required to file at the time of formation, and existing reporting companies will be required to file within two years of finalization of the regulations.

Following the filing of the initial beneficial ownership statement, a reporting company must file updates to reflect subsequent changes in beneficial ownership. Updates must be filed within one year of the change.

Penalties for Non-Compliance and Unauthorized Disclosure or Use

The CTA imposes both civil and criminal penalties for violations regarding non-compliance as well as unauthorized disclosure or use of information in the database.

Any person guilty of a reporting violation may be liable for a civil penalty of up to \$500 for each day that the violation continues or has not been remedied up to \$10,000, imprisoned for up to 2 years, or both.

Any person who unlawfully knowingly discloses or uses the beneficial ownership information filed with FinCEN may be liable for a civil penalty of not more than \$500 for each day that the violation continues or has not been remedied and that person may be fined up to \$250,000 or imprisoned for not more than 5 years, or both.

If a disclosure or use violation occurs while violating another law of the U.S. or as part of a pattern of any illegal activity involving more than \$100,000 in a 12-month period, the violator is subject to a fine of up to \$500,000, imprisonment of up to 10 years, or both.

It is worth noting that the penalties for unauthorized disclosure or use of FinCEN database information are far more stringent than for reporting violations. Perhaps Congress wanted to make sure that hefty civil and criminal penalties would help maintain the security of the database. If so, it is reasonable to ask whether that deterrent would have any effect on foreign actors who attempt to break the secured database through sophisticated hacking efforts.

Whistle-Blower Provisions

Legislation that accompanied the CTA in the National Defense Authorization Act establishes an anti-money laundering whistleblower program.

Effective Date

The CTA will become effective on the date that the regulations of the Act are prescribed and issued by the US Secretary of the Treasury, which are required no later than January 1, 2022.

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