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## Knock-Knock, Who's There? Beneficial Owner Disclosures

By Edward Tanenbaum\*  
Alston & Bird LLP  
New York, NY

After many attempts over the past few years, the United States is finally joining most of the rest of the world in strengthening its laws regarding disclosure of beneficial owners of corporations, limited liability companies, and similar entities.

As a result of veto overrides by the House in late 2020 and the Senate on January 1, 2021, the William M. (MAC) Thornberry National Defense Authorization Act for Fiscal Year 2021 (NDAA) became law.<sup>1</sup> Contained within this massive defense act is the Corporate Transparency Act (CTA) governing the required disclosure of beneficial owners of the types of entities mentioned above.<sup>2</sup>

Until the NDAA, the Bank Secrecy Act has, for the past few years, only required financial institutions to apply certain “know your customer” (KYC) and anti-money laundering (AML) procedures to account openings by entities. Now, the disclosure obligation to report beneficial owners of the entities falls squarely on the entity itself.

The sense of Congress is set forth in Section 6402 of the CTA:

- a) More than 2 million entities are formed annually under state law;

\* Edward Tanenbaum is a tax partner in the Federal and International Tax Practice Group at Alston & Bird in New York, NY. He represents both foreign and U.S. multinational corporations and high-net-worth families in connection with cross-border tax structuring and planning.

<sup>1</sup> H.R. 6395, enacted as Pub. L. No. 116-283 (116<sup>th</sup> Cong.).

<sup>2</sup> NDAA, Sections 6401-6403.

b) Most states don't require identification of owners of these entities;

c) “Bad actors” seek to conceal their ownership to facilitate illegal commercial activities, terrorism, money laundering, tax fraud, etc., that harm the natural security interests of the United States and its allies;

d) These “bad actors” seek to avoid detection across secretive jurisdictions;

e) Federal legislation is needed to protect U.S. national security interests and to bring the United States in line with other jurisdictions;

f) At the same time, beneficial ownership is sensitive information that needs to be protected from disclosure except in limited situations in order to facilitate law enforcement; and

g) Regulations need to be promulgated as soon as possible to clarify the reporting requirements and in order to minimize reporting burdens for reporting entities.

The goal of the CTA is to design a general database useful for law enforcement purposes while at the same time minimizing reporting burdens on entities and providing for strict rules regarding disclosure of this information.

The general rule is that, in accordance with regulations to be published, beneficial ownership of entities must be reported and filed with the Treasury Department's Financial Crimes Enforcement Network (FinCEN) by every reporting company. A reporting company is any corporation, limited liability company, or similar entity that is created by a document filed under the laws of a state or Indian tribe or is formed under foreign law and registered to do business in the United States via the filing of a document.

A reporting company does not include, e.g., SEC registered companies, governmental authorities, banks, registered brokers and dealers, registered in-

vestment advisors, public accounting firms registered under Sarbanes-Oxley, certain insurance companies, certain tax-exempt organizations, and entities that have more than 20 full-time employees with prior-year reported sales of more than \$5 million with an operating presence in a physical office in the United States. The purpose of these exceptions is to carve out larger companies and certain registered companies which are assumed not to be involved in various frowned-upon activities.

For existing companies, compliance is required within two years of the effective date of the regulations. New companies will have to comply at the time of the company's formation/registration. Annual reporting updates will be required.

For purposes of the CTA, a beneficial owner with respect to an entity is an individual who directly or indirectly, through contract, arrangement, understanding relationship or otherwise, (1) owns or controls 25% or more of the ownership interests of the entity, or (2) exercises "substantial control" over the entity. It is anticipated that forthcoming regulations will shed light on the meaning of "substantial control" and even "ownership interests."

Beneficial owners do not include, e.g., minors (if parental or guardian information is reported); those acting as nominees, agents, intermediaries or custodians; individuals acting solely as employees of these entities and whose control over the economic benefits from these entities is deemed to come from the employment status; individuals whose only interest is through a right of inheritance; creditors of the entity unless the creditor meets the general definition of beneficial owner.

The information required to be disclosed includes the full name, date of birth, address, and a unique

identifying number from an acceptable identification document of each beneficial owner, and each applicant, with respect to the reporting company. This identifying number means the personal identification number appearing on the individual's U.S. passport, state ID document, driver's license (or foreign passport if none of the above exists). The CTA provides for FinCEN to issue a unique identifying number (FinCEN identifier) to individuals so they don't have to periodically supply a personal identification number from these other sources.

"Applicant" is defined to include any individual who files an application to form a corporation, limited liability company or similar entity under the laws of a state or Indian tribe, or registers or files an application to register a similar entity formed under foreign law.

FinCEN is required to retain the beneficial owner information for five years. The information must remain confidential and not subject to disclosure except in limited circumstances, e.g., requests by various federal and state law enforcement agencies or foreign governments in the course of an investigation (but with built-in limitations).

Significant civil and criminal penalties apply to reporting entities for noncompliance and for provision of incorrect or fraudulent information, as well as for unauthorized disclosure of beneficial owner information.

As a result of the new CTA provisions regarding beneficial ownership disclosures, all affected entities should begin to determine whether they are a reporting entity or whether they might fall within one of the listed exceptions. In addition, affected entities should begin documenting beneficial ownership and be prepared to report after regulations are issued.