

Reporting beneficial owners of certain US companies: details of new Corporate Transparency Act

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Introduction

The Corporate Transparency Act (CTA) became law on 1 January 2021. Once implementation regulations are issued, the CTA will require certain new and existing US companies to disclose information about their beneficial owners to the US Department of the Treasury's Financial Crimes Enforcement Network (FinCEN). Information collected under the CTA will be held in a national registry of beneficial ownership information, the first of its kind in the United States, established and maintained by FinCEN. The registry will not be available to the public, but FinCEN is permitted to disclose beneficial ownership information in certain circumstances. There are both civil and criminal penalties for violations of CTA requirements. Given that family succession planning structures may include entities established under the laws of a US state, advisers to international families should familiarise themselves with this new disclosure requirement.

Why was the CTA enacted?

The CTA's purpose is to combat abuse of anonymous companies, money laundering, terrorist financing and other illicit activity. Prior to its enactment, a corporation or limited liability company (LLC) could be created in many US states without providing the registered agent with any ownership information. Such an entity was established by an 'authorised representative' who did not necessarily have any ownership interest or control over the entity. Notwithstanding this, there have been some governmental efforts to gather beneficial ownership information to help prevent money laundering (for further details please see "[Panama Papers and US initiatives to identify entity beneficial owners](#)"). For example, in 2016 FinCEN issued the Customer Due Diligence Rule, which imposes obligations on US financial institutions to identify and verify beneficial ownership information for their legal entity customers at the time of opening a new account. To date, these initiatives have placed the burden of obtaining beneficial ownership information on financial institutions, instead of companies. The CTA now makes it the responsibility of companies to provide details on their beneficial owners.

By targeting small businesses, start-ups and shell or holding companies, the government hopes that the CTA will prevent wrongdoers from exploiting US corporate entities and LLCs for criminal gain and assist law enforcement in detecting and preventing terrorist financing, money laundering and other misconduct. In addition, the CTA is a step towards addressing international pressure on the United States to comply with rising global standards designed to thwart money laundering and counter terrorist financing, including other countries' transparency rules, and avoid being added to the blacklists of other countries.

Which entities must report?

Only an entity that meets the definition of a reporting company is subject to the requirements of the CTA. A 'reporting company' is defined as any corporation, LLC or other similar entity that is:

- created by filing a document with a US state; or

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- formed under the law of a foreign country and registered to do business in the United States.

Thus, traditional succession planning trusts that are not statutory business trusts created by a state filing should not fall within the scope of the CTA. Likewise, a sole proprietorship or unincorporated association that has no legal existence separate from the associated individual or individuals should not be considered a reporting company for CTA purposes.

In addition, since the CTA primarily targets companies with limited or no active business operations, certain companies are exempt from the CTA reporting requirements. The CTA generally exempts the following companies by excluding them from the definition of a reporting company:

- publicly traded companies regulated by the US Securities and Exchange Commission (SEC);
- companies that are otherwise regulated by government agencies (eg, banks, commodity brokers, registered investment advisers, non-profits, entities that operate exclusively to provide financial assistance to exempted non-profits, insurance companies and pooled investment vehicles that are operated by banks or registered investment advisers);
- government entities;
- companies that employ more than 20 full-time employees in the United States; filed a US tax return in the previous year reporting more than \$5 million in gross receipts or sales to the Internal Revenue Service (including sales of underlying entities); and have an operating presence at a physical office within the United States;
- companies that exist for more than one year; are not engaged in active business; are not owned, directly or indirectly, by a foreign person; have not had a change in ownership or received funds in excess of \$1,000 in the preceding 12 months; and do not otherwise hold any kind or type of assets, including any ownership interests in any corporation, LLC or other similar entity; and
- any entity owned or controlled, directly or indirectly, by an entity otherwise exempt.

Practically speaking, several of the exclusions apply to entities that are regulated and hence file reports with other government agencies that contain similar information to that required under the CTA. Other exclusions apply to entities that are considered to be legitimate, real companies (instead of shell or holding companies), often evidenced by their larger size with actual and substantial operations in the United States.

Who and what information must be disclosed?

Once a company is identified as a reporting company, it must submit a report to FinCEN (perhaps through the FinCEN e-filing system that currently accepts foreign bank account reports) identifying each "applicant" and, more importantly, each "beneficial owner" with respect to that reporting company.

Applicant

An 'applicant' is defined as any individual who files an application to form a corporation, LLC or other similar entity in the United States or any individual who registers or files an application to permit such a foreign entity to do business in the United States. Thus, the traditional 'authorised representative' used to create an entity will now have to provide details beyond just that individual's name.

Beneficial owner

An entity's 'beneficial owner' is defined as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise:

- exercises substantial control over the entity; or
- owns or controls no less than 25% of the ownership interests of the entity.

The term 'substantial control' is not defined in the statute and it is currently uncertain how trust ownership of a reporting company will be treated.

The CTA specifically excludes the following individuals from the definition of beneficial owner:

- a minor child, if the information of the parent or guardian is reported;
- individuals acting as a nominee, intermediary, custodian or agent on behalf of another individual;
- an employee of a reporting company whose control or economic benefit with respect to the entity is derived solely from their employment;
- an individual whose only interest in a reporting company is through a right of inheritance; and
- creditors of a reporting company.

Information to be reported

Once the applicant and beneficial owner are identified, the reporting company must report to FinCEN the individual's:

- full legal name;
- date of birth;
- residential or business street address; and
- unique identifying number from an acceptable identification document (eg, a US passport, US state-issued identification document or non-US passport).

Alternatively, if the above information regarding the applicant or beneficial owner has been previously provided to FinCEN, a unique FinCEN identifier associated with such person would be issued upon request, and that could be used instead. Other than the foregoing information, no further financial or business information need be reported.

When must beneficial ownership information be reported?

FinCEN must issue regulations by 31 December 2021, implementing the CTA reporting requirements. Once the effective date of these regulations is known, the timing of the required disclosure by a reporting company under the CTA will depend on whether the reporting company is a newly formed entity or an existing entity at the time of the effective date of the FinCEN regulations.

Newly formed reporting companies

Entities formed or registered after the effective date of the FinCEN regulations will be required to report beneficial ownership information at the time of formation or registration.

It is also worth noting that the CTA prohibits newly formed corporations and LLCs from issuing bearer shares (ie, unregistered equity securities owned by the possessor of the physical share documents) in an effort to better identify beneficial owners of the reporting companies.

Existing reporting companies

Entities formed or registered before the effective date of the FinCEN regulations will need to report beneficial ownership information within two years of the effective date of the regulations.

Updates

Reporting companies will then be required to update any changes in beneficial ownership information within one year of such change in the reported information. This update is required only upon the occurrence of any change in beneficial ownership information and there is no periodic requirement or obligation to update otherwise. However, it is worth noting that the future regulations may require reporting companies to update any changes in beneficial ownership information within a shorter period than statutorily required (ie, one year).

Who can access the registry?

Once a reporting company has reported its beneficial ownership information, such information will be retained confidentially in a registry maintained by FinCEN, which will not be publicly available. The CTA imposes penalties for the unauthorised disclosure or use of collected information, so there is some safeguard in place. However, the CTA also sets out several situations where the beneficial ownership information is permitted to be disclosed. Upon request through appropriate protocols, FinCEN may disclose beneficial ownership information to:

- US federal agencies engaged in national security, intelligence or law enforcement activity, for use in furtherance of such activity;
- US federal agencies requesting information on behalf of a non-US law enforcement agency;
- financial institutions subject to customer due diligence (CDD) requirements, with the consent of the reporting company, to meet CDD requirements; or
- state and local law enforcement agencies pursuant to a court order authorising the agencies to seek the requested information.

The intention is for beneficial ownership information to remain non-public and secure, but advisers should nonetheless address privacy concerns and potential misuse of information with their family clients.

What are the penalties for failure to comply?

The CTA provides civil penalties of \$500 per day for each day that the violation continues and/or criminal penalties of up to \$10,000 and/or two years in prison for any person who wilfully submits false or fraudulent beneficial ownership information or wilfully fails to provide complete or updated beneficial ownership information. As far as the question of who is subject to the foregoing penalties, the statute is not entirely clear on this point. However, since the filing obligation belongs to the reporting company, it is likely that the penalty

would be imposed on the reporting company. However, penalties could also be imposed on individuals who wilfully submit false or fraudulent reports.

There is a safe harbour from civil or criminal liability for the submission of inaccurate information. If a person has reason to believe that any reports submitted contain inaccurate information, and that person voluntarily and promptly (but no later than 90 days after the submission of the original inaccurate report) submits a report containing corrected information, that person is exempt from the penalty. However, if the person acts for the purpose of evading the reporting obligations and has actual knowledge that any information contained in the report is inaccurate, the person cannot be rescued by the safe harbor provision. As a safety measure, the CTA provides higher criminal penalties for any person who makes an unauthorised disclosure of information reported to FinCEN or disclosures made by FinCEN to such person (ie, government employees or third parties with access).

Comment

Over the next few months, family succession planning structures that include US corporations or LLCs or non-US companies registered to do business in the United States should determine whether those companies will be considered 'reporting companies' under the CTA. Holding companies often used in family succession planning structures with 20 or fewer employees, which are generally not owned by any exempt companies (eg, a large public corporation), will likely be reporting companies. Accordingly, the CTA reporting requirements should be reviewed carefully as failure to comply accurately may lead to the imposition of penalties. To properly comply with this new reporting regime, advisers to international families should be on the lookout for upcoming FinCEN regulations providing additional guidance, details and exceptions. In many structures, it may not be immediately clear who will be reported as a beneficial owner or owners under the CTA's two-prong definition, especially given the fact that 'substantial control' is not defined. Advisers should begin discussing with their family clients the broad definition of beneficial owner, privacy concerns and yet another compliance obligation that must not be taken lightly.

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