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The Corporate Transparency Act – Preparing for the Federal Database of Beneficial Ownership Information

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| 2 days ago

TABLE OF CONTENTS:[1]

Conclusion

The Anti-Money Laundering Act of 2020, which is part of the National Defense Authorization Act for Fiscal Year 2021 ("NDAA") and includes the Corporate Transparency Act, became law effective with Congress' override on January 1, 2021 of former President Trump's veto of the NDAA.[2] The Corporate Transparency Act requires certain business entities (each defined as a "reporting company") to file, in the absence of an exemption, information on their "beneficial owners" with the Financial Crimes Enforcement Network ("FinCEN") of the U.S. Department of Treasury ("Treasury"). The information will not be publicly available, but FinCEN is authorized to disclose the information:

- to U.S. federal law enforcement agencies,
- with court approval, to certain other enforcement agencies,
- to non-U.S. law enforcement agencies, prosecutors or judges based upon a request of a U.S. federal law enforcement agency, and
- with consent of the reporting company, to financial institutions and their regulators.

The Corporate Transparency Act represents the culmination of more than a decade of congressional efforts to implement beneficial ownership reporting for business entities. When fully implemented in 2023, it will create a database of beneficial ownership information within FinCEN. The purpose of the database is to provide the resources to "crack down on anonymous shell companies, which have long been the vehicle of choice for money launderers, terrorists, and criminals."[3] Prior to the implementation of the Corporate Transparency Act, the burden of collecting beneficial ownership information fell on financial institutions, which are required to identify and verify beneficial owners through the Bank Secrecy Act's customer due diligence requirements.[4] The Corporate Transparency Act will shift the collection burden from

financial institutions to the reporting companies and will impose stringent penalties for willful non-compliance and unauthorized disclosures.

The Secretary of the Treasury is required to prescribe regulations under the Corporate Transparency Act by January 1, 2022 (one year after the date of enactment). It is expected that any implementing regulations will be promulgated by FinCEN pursuant to a delegation of authority from the Secretary of the Treasury. The effective date of those regulations will govern the timing for filing reports under the Corporate Transparency Act.[5]

This article describes the proposed federal legislation that evolved into the Corporate Transparency Act, summarizes the terms of the Corporate Transparency Act, and discusses points that should be considered in prescribing the regulations under the Corporate Transparency Act.

BACKGROUND

Legislative proposals relating to the reporting of beneficial ownership information for entities have a lengthy history. In June 2006, the Financial Action Task Force ("FATF")[6] issued a report that criticized the United States for failing to comply with a FATF standard on the need to collect beneficial ownership information and urged the United States to correct this deficiency by July 2008.[7] In May 2008, Senators Levin, Coleman and Obama introduced the Incorporation Transparency and Law Enforcement Assistance Act in response to this criticism.[8] The stated purpose of the bill was to "ensure that persons who form corporations in the United States disclose the beneficial owners of those corporations, in order to prevent wrongdoers from exploiting United States corporations for criminal gain, to assist law enforcement in detecting, preventing, and punishing terrorism, money laundering, and other misconduct involving United States corporations, and for other purposes."[9] The Incorporation Transparency and Law Enforcement Assistance Act would have amended the Homeland Security Act of 2002 to require those forming business entities to document, verify, and make available to

law enforcement authorities the record of beneficial ownership of those business entities, putting the burden of collecting the information on the states and regulating the "formation agents"[10] of business entities, including subjecting formation agents to anti-money laundering obligations. Congress never acted upon the Incorporation Transparency and Law Enforcement Assistance Act.

In the decade that followed, criticism of the lack of beneficial ownership reporting continued[11] and various versions of proposed federal legislation providing for the reporting of beneficial ownership information were introduced in Congress, including:

- The Closing Loopholes Against Money-Laundering Practices ("CLAMP") Act,[12] introduced in 2016 by Senators Carper, Coons[13] and Heller, which would have amended the Internal Revenue Code to require that every "United States entity" obtain an employer identification number, or EIN, and to submit IRS Form SS-4, which would have included the name of a "responsible party" within the business, and would have made that information available to federal law enforcement agencies for use in anti-money laundering and counterterrorism prosecutions and investigations. No action was taken with respect to the CLAMP Act.
- The Counter Terrorism and Illicit Finance Act,[14] which would have required corporations and limited liability companies, and many of their lawyers, to submit extensive information about the companies' beneficial owners to FinCEN and which would have required FinCEN to disclose the information to other federal and foreign governmental agencies and financial institutions upon request. A version of the Counter Terrorism and Illicit Finance Act, which lacked the beneficial ownership requirement, was referred to the House Financial Services Committee, but no further action was taken.
- The True Incorporation Transparency for Law Enforcement ("TITLE") Act,[15] introduced in 2017 by Senators Whitehouse, Feinstein and Grassley, which would have required businesses and their lawyers to gather and maintain beneficial ownership information on

new corporations and limited liability companies and would have made the information available to Federal law enforcement authorities. No action was taken with respect to the TITLE Act.

- The Corporate Transparency Act (2017),[16] which was introduced by Representatives Maloney, King, Waters, Royce and Moore in the House and Senators Wyden and Rubio in the Senate, similarly would have required businesses and their lawyers to gather and maintain beneficial ownership information on new corporations and limited liability companies and would have made the information available to Federal law enforcement authorities. No action was taken with respect to the Corporate Transparency Act (2017).[17]

During the same period, while proposed federal legislation was introduced but never acted upon, other efforts were implemented to collect beneficial ownership information to carry out the purposes of the Bank Secrecy Act. Specifically, in May 2016, FinCEN issued the FinCEN CDD Requirements, with compliance required in May 2018. The FinCEN CDD Requirements require covered financial institutions (banks, brokers or dealers in securities, mutual funds, and futures commission merchants and introducing brokers in commodities) to collect identification information for the identity of beneficial owners[18] of legal entity customers when a new account is opened. In addition, the FinCEN CDD Requirements require covered financial institutions to maintain records of the beneficial ownership information obtained. Around the same time, beginning in July 2016, FinCEN issued the first of its "geographic targeting orders," which required title insurance companies to collect and report beneficial ownership information[19] of entities purchasing residential real property in identified markets (including New York City, Southern Florida, California, Honolulu, Las Vegas, Seattle, Boston, Chicago, Dallas and San Antonio) if the purchase was made without a bank loan or other similar form of external financing.[20]

THE CORPORATE TRANSPARENCY ACT OF 2019

In May 2019, Representative Maloney introduced the Corporate Transparency Act of 2019 (the "2019 Transparency Proposal"),[21] which formed the basis for the Corporate Transparency Act that has now become law as part of the NDAA. The 2019 Transparency Proposal differed in a number of significant ways from previously introduced federal legislation providing for the collection of beneficial ownership information. Those differences are summarized below.

Creation of a Federal Database of Beneficial Ownership Information

Significantly, the 2019 Transparency Proposal for the first time contemplated that all beneficial ownership information reports would be filed with FinCEN. Previously, proposed federal legislation (including the Corporate Transparency Act (2017)) had focused on state "formation systems" as the principal repository for beneficial ownership information and put the burden of collecting beneficial ownership information and making it available to parties entitled to have access on the states. In fact, the 2008 Incorporation Transparency and Law Enforcement Assistance Act required states receiving federal funding under the Homeland Security Act of 2002 to establish compliant formation systems. Under that template, information would only have been reported to FinCEN by an entity if the state of formation did not have a compliant formation system.[22] In considering proposed federal legislation contemplating reliance on state formation systems, many states indicated that their reporting systems were not designed to collect the beneficial ownership information contemplated and that they lacked enforcement resources to pursue delinquent and deficient reporting. The 2019 Transparency Proposal removed the primary responsibility for collecting beneficial ownership information from the states and introduced the federal database for beneficial ownership information that has been implemented by the NDAA.[23]

Regulation of Applicants Instead of Formation Agents

Prior to the introduction of the 2019 Transparency Proposal, proposed federal legislation regarding beneficial ownership information reporting (including the Corporate Transparency Act (2017)) had provided for the regulation of formation agents. The Corporate Transparency Act (2017) defined a formation agent as "a person who, for compensation, (A) acts on behalf of another person to assist in the formation of a corporation or limited liability company under the laws of a State; or (B) purchases, sells, or transfers the public records that form a corporation or a limited liability company."[24] This legislation would have required persons who assisted in the formation process, including lawyers and filing agents, to report their clients' beneficial ownership information and to be classified as financial institutions under the Bank Secrecy Act with the consequent obligation to file suspicious activity reports against their clients. The 2019 Transparency Proposal did not refer to formation agents and instead defined an applicant as "any natural person who files an application to form a corporation or limited liability company under the laws of a State or Indian Tribe."[25] A reporting company was required to include information (full legal name, date of birth, residential or business street address and unique identifying number from an acceptable source, such as a passport, driver's license or other government issued identifying number) regarding its applicant in its report to FinCEN, but the applicant did not have specific obligations under the 2019 Transparency Proposal aside from being permitted to file an exempt entity report on behalf of the reporting company.

Reporting Company, Defined

The two most significant definitions in the 2019 Transparency Proposal were the definitions of "reporting company" and "beneficial owner," both of which had continued to evolve from the formulations in previously proposed federal legislation. Consistent with previously proposed federal legislation, the 2019 Transparency Proposal required reporting of beneficial ownership information with respect to corporations and limited liability companies,[26] with those terms having the meanings given to those terms

under the laws of the applicable states.[27] But, in the 2019 Transparency Proposal, those terms were expanded to include any non-United States entity eligible for registration or registered to do business as a corporation or limited liability company under the laws of a state.[28] On the other hand, the 2019 Transparency Proposal also expanded the list of entities exempt from its reporting requirements to include: (i) a more extensive list of entities otherwise subject to a Federal regulatory regime; (ii) any business concern that employs more than 20 employees on a full-time basis in the United States, files income tax returns demonstrating more than $5,000,000 in gross receipts or sales, and has an operating presence at a physical office within the United States; (iii) any corporation or limited liability company formed and owned by an entity that is otherwise identified as an entity not subject to the reporting requirements of the 2019 Transparency Proposal; [29] and (iv) other business concerns designated as exempt entities by the Secretary of the Treasury and the Attorney General of the United States.

Beneficial Owner, Defined

The definition of "beneficial owner" in federal legislation providing for the reporting of beneficial ownership information has been a topic of significant debate. The 2008 Incorporation Transparency and Law Enforcement Assistance Act defined a beneficial owner as "an individual who has a level of control over, or entitlement to, the funds or assets of a corporation or limited liability company that, as a practical matter, enables the individual, directly or indirectly, to control, manage, or direct the corporation or limited liability company."[30] Subsequent definitions of beneficial owner in proposed federal legislation and rules providing for the reporting of beneficial ownership information have been drafted in a manner that provides greater clarity for an entity in identifying its beneficial owners. For example, the FinCEN CDD Requirements define a beneficial owner as (i) each individual, if any, who directly or indirectly owns 25% or more of the equity interests of a legal entity customer (the ownership prong); and (ii) a single individual with significant responsibility to control, manage,

or direct a legal entity customer, including an executive officer or senior manager or any other individual who regularly performs similar functions (the control prong). Even more specific is the definition of beneficial owner in the geographic targeting orders, which includes "each individual who, directly or indirectly, owns 25% or more of the equity interests" of the purchaser.[31]

The 2019 Transparency Proposal drew on the framework from previous proposed legislation as well as the FinCEN CDD Requirements and defined a beneficial owner as "a natural person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise":

(i) exercises substantial control over a corporation or limited liability company;

(ii) owns 25% or more of the equity interests of a corporation or limited liability company; or

(iii) receives substantial economic benefits from the assets of a corporation or limited liability company.[32]

The 2019 Transparency Proposal went on to provide exclusions from the definition, including minors, nominees and agents, employees in their status as such, and creditors unless they meet the requirements of one of the clauses of the definition.[33]

THE CORPORATE TRANSPARENCY ACT INCLUDED IN THE NDAA

The following is a summary of the principal terms of the Corporate Transparency Act included in the NDAA that relate to the reporting and use of beneficial ownership information.[34]

What is a Reporting Company?

A reporting company is a corporation, limited liability company or other similar entity that is created by the filing of a document with a secretary of state or similar office under the law of a state, or formed under the law of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or similar office under the laws of a state.[35]

A reporting company does not include the following entities (the "exempt entities"):

- an issuer of securities registered under Section 12 of the Securities Exchange Act of 1934 (the "Exchange Act") or that is required to file supplementary and periodic information under Section 15(d) of the Exchange Act;
- an entity established under the laws of the United States, a state, or a political subdivision of a state, or under an interstate compact between two or more states and that exercises governmental authority on behalf of the United States or any such state or political subdivision;
- a bank;
- a Federal or state credit union;
- a bank or savings and loan holding company;
- a registered money transmitting business;
- a broker or dealer registered under Section 15 of the Exchange Act;
- an exchange or clearing agency registered under Section 6 or Section 17A of the Exchange Act;
- any other entity registered with the Securities and Exchange Commission (the "SEC") under the Exchange Act;
- an investment company or investment adviser registered with the SEC;
- an investment adviser that has made certain required filings with the SEC;
- an insurance company as defined in the Investment Company Act of 1940;
- an insurance producer that is authorized by a state and subject to supervision by the insurance commissioner or a similar official or agency of a state and has an operating presence at a physical office within the United States;

- certain entities registered with the Commodity Futures Trading Commission under the Commodity Exchange Act;
- a public accounting firm registered under the Sarbanes-Oxley Act of 2002;
- a public utility that provides telecommunication services, electrical power, natural gas, or water and sewer services within the United States;
- a financial market utility designated by the Financial Stability Oversight Council;
- a pooled investment vehicle that is operated or advised by certain entities described in other clauses above;
- a tax-exempt Section 501(c) corporation, political organization, charitable trust or split-interest trust exempt from tax;
- certain corporations, limited liability companies or other similar entities that operate exclusively to provide financial assistance to, or hold governance rights over, tax-exempt Section 501(c) corporations, political organizations, charitable trusts or split-interest trusts exempt from taxation;
- an entity that: (i) employs more than 20 employees on a full-time basis[36] in the United States; (ii) filed in the previous year Federal income tax returns in the United States demonstrating more than $5,000,000 in gross receipts or sales; and (iii) has an operating presence at a physical office within the United States;[37]
- a corporation, limited liability company or other similar entity of which the ownership interests are owned or controlled, directly or indirectly, by one or more aforementioned exempt entities ("exempt subsidiaries");
- a corporation, limited liability company or other similar entity: (i) in existence for over one year; (ii) that has not engaged in active business; (iii) that is not owned, directly or indirectly, by a foreign person; (iv) that 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 (v) that does not otherwise hold any kind or type of assets,[38] including an ownership interest in any corporation, limited liability company or other similar entity (an "exempt grandfathered entity"); and

- any entity or class of entities that the Secretary of the Treasury has determined by regulation, with the written concurrence of the Attorney General of the United States and the Secretary of Homeland Security, should be exempt because requiring beneficial ownership information would not serve the public interest and would not be highly useful in national security, intelligence and law enforcement efforts to detect, prevent or prosecute money laundering, the financing of terrorism, proliferation finance, serious tax fraud or other crimes.[39]

Generally, exempt entities are not required to report information to FinCEN, subject to the following exceptions:

- a pooled investment vehicle formed under the laws of a foreign country must file a written certification with FinCEN that provides the identification information of an individual who exercises substantial control over the pooled investment vehicle;
- an exempt subsidiary that no longer meets the criteria necessary to qualify as an exempt subsidiary must submit beneficial ownership information to FinCEN; and
- an exempt grandfathered entity that no longer meets the criteria necessary to qualify as an exempt grandfathered entity must submit beneficial ownership information to FinCEN.[40]

What Information Must be Reported?

A reporting company must provide the following information for each beneficial owner and each applicant[41] with respect to the reporting company ("beneficial ownership information"):[42]

- full legal name;
- date of birth;
- current residential or business street address; and
- a unique identifying number from an acceptable identification document (passport, driver's license or other government issued identification document) or a FinCEN identifier.[43]

If an exempt entity has a direct or indirect ownership interest in a reporting company, the reporting company or the applicant must only report the name of the exempt entity instead of the beneficial ownership information set forth above.[44] The Corporate Transparency Act does not quantify the level of ownership by an exempt entity that requires reporting. In prescribing regulations under the Corporate Transparency Act, Treasury should set forth a minimum level of ownership (such as 25%) that would give rise to a reporting obligation by the reporting company or an applicant.

Who is a Beneficial Owner?

A beneficial owner of an entity is an individual[45] who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise (i) exercises substantial control over the entity;[46] or (ii) owns or controls not less than 25% of the ownership interests of the entity.[47]

A beneficial owner does not include: (i) a minor child if the information of the child's parent or guardian is reported; (ii) an individual acting as a nominee, intermediary, custodian or agent on behalf of another individual; (iii) an individual acting solely as an employee of the entity and whose control over or economic benefits from such entity is derived solely from the employment status of the person; (iv) an individual whose only interest in the entity is through a right of inheritance;[48] or (v) a creditor of the entity, unless the creditor exercises substantial control over the entity or owns or controls not less than 25% of the ownership interests of the entity.[49]

When Must Beneficial Ownership Information be Reported?

The Secretary of the Treasury is required to prescribe regulations under the Corporate Transparency Act by January 1, 2022, one year after the date of enactment. [50] The effective date of those regulations governs the timing for filing reports under the Corporate Transparency Act.

A reporting company that has been formed or registered after the effective date of the regulations must submit a report to FinCEN containing the beneficial ownership information with respect to the reporting company at the time of its formation or registration. A reporting company that has been formed or registered before the effective date of the regulations must submit a report to FinCEN no later than two years after the effective date of the regulations. If there are changes in reported beneficial ownership information, a reporting company must submit to FinCEN an updated report no later than one year after the date of the change.[51] The Corporate Transparency Act allows the Secretary of the Treasury, in consultation with the Secretary of Homeland Security, to evaluate the need to have reports updated within a shorter period of time and incorporate any changes into the regulations not later than two years after the enactment of the Corporate Transparency Act.[52]

To Whom is Beneficial Ownership Information Available?

Except as authorized under the Corporate Transparency Act or protocols promulgated thereunder, beneficial ownership information is confidential and may not be disclosed.[53] FinCEN may disclose beneficial ownership information only upon receipt of:

- a request from a federal agency engaged in national security, intelligence or law enforcement activity for use in furtherance of such activity;
- a request from a state, local or tribal law enforcement agency, if authorized by a court of competent jurisdiction to seek the information in a criminal or civil investigation;
- a request from a federal agency on behalf of a foreign law enforcement agency, prosecutor or judge under an international treaty, agreement or convention or upon an official request made by law enforcement, judicial or prosecutorial authorities in a trusted foreign country when no treaty, agreement or convention is available if certain conditions are met;
- a request made by a financial institution subject to customer due diligence requirements with the

consent[54] of the reporting company to facilitate the institution's compliance with customer due diligence requirements under applicable law; or

- a request made by a federal functional regulatory agency[55] or other appropriate regulatory agency[56] if the agency: (i) is authorized by law; (ii) uses the information solely as authorized; and (iii) enters into an agreement with the Secretary of the Treasury providing appropriate protocols governing the safekeeping of the information.[57]

The Corporate Transparency Act requires the Secretary of the Treasury to establish protocols to protect the security and confidentiality of beneficial ownership information.[58]

What are the Penalties for Violating the Corporate Transparency Act?

It is unlawful for any person to willfully provide, or attempt to provide, false or fraudulent beneficial ownership information to FinCEN, or willfully fail to report complete or updated beneficial ownership information to FinCEN. Any person violating the reporting requirements of the Corporate Transparency Act is liable for civil penalties of not more than $500 for each day that the violation continues and criminal penalties of imprisonment of up to two years and fines of up to $10,000.[59]

Section 5336(h)(3)(C) of the Corporate Transparency Act contains a safe harbor from the civil and criminal penalties if a person submitting incorrect information submits a report containing corrected information not later than 90 days after the date on which the person submitted the report originally, provided that the person was not acting to evade the reporting requirements and did not have actual knowledge that information contained in the original report was inaccurate. In prescribing regulations under the Corporate Transparency Act, Treasury should clearly define the standards for coming within the safe harbor, including how "evasion of the reporting requirements" and "actual knowledge of inaccuracies" will be interpreted.

Unauthorized knowing disclosure or use of beneficial ownership information is punishable by civil penalties[60] of $500 for each day the violation continues and criminal penalties of imprisonment of up to 10 years and fines of up to $500,000.[61]

DISCUSSION OF CLARIFYING POINTS TO BE CONSIDERED IN REGULATIONS UNDER THE CORPORATE TRANSPARENCY ACT

Many topics for regulation are specifically identified in the Corporate Transparency Act, including:

- regulations designating any entity or class of entities as exempt under Section 5336(a)(11)(xxiv);
- regulations regarding submission of beneficial ownership information reports to FinCEN under Section 5336(b)(1)(A);
- regulations regarding submission of beneficial ownership reports to FinCEN by reporting companies formed or registered before the effective date of the regulations under Section 5336(b)(1)(B);
- regulations regarding submission of beneficial ownership reports to FinCEN by newly formed or registered reporting companies under Section 5336(b)(1)(C);
- regulations regarding submission of beneficial ownership reports to FinCEN that update the information related to the change under Section 5336(b)(1)(D);
- regulations regarding the delivery and contents of beneficial ownership information reports under Section 5336(b)(2)(A);
- regulations relating to reporting requirements for exempt subsidiaries under Section 5336(b)(2)(D);
- regulations relating to reporting requirements for exempt grandfathered entities under Section 5336(b)(2)(E);
- regulations prescribing procedures for FinCEN identifiers under Section 5336(b)(4);
- regulations prescribing the form of and manner in which information shall be provided to financial institutions under Section 5336(c)(2)(C);

- regulation protocols to protect the security and confidentiality of beneficial ownership information under Section 5336(c)(3);
- regulations governing agency coordination under Section 5336(d); and
- regulations regarding submitting reports to correct inaccurate information under Section 5336(h)(3)(C)(i)(I)(bb).

Beyond the topics for regulation specifically identified in the Corporate Transparency Act, there are a number of terms and phrases used in the Corporate Transparency Act that could be clarified in regulations prescribed by Treasury. The Corporate Transparency Act does not contain a mechanism for Treasury to modify the terms of the statute, but Treasury would have the authority through regulation to interpret the meanings of the constituent parts of the statute, including the definitions of "reporting company," "beneficial owner" and "applicant." Those regulations would provide reporting companies, beneficial owners and practitioners with guidance in complying with the requirements of the Corporate Transparency Act.

Focusing on the definitions of reporting company, beneficial owner and applicant, following is a discussion of some of the terms and phrases that could be clarified by regulation.

Reporting Companies

Other Similar Entity that is Created by the Filing of a Document with a Secretary of State or Similar Office. It is clear that the term "reporting company" includes corporations and limited liability companies. It is also clear that the term does not include general partnerships, which are formed by agreements among partners, and donative trusts, which are traditional estate planning and property-owning vehicles and are not required to register with any state or territory.[62] It is not clear whether certain other entities, such as limited partnerships, business trusts, testamentary trusts, and non-U.S. entities similar to corporations and limited liability companies, are reporting companies under the Corporate Transparency Act.

Proposed federal legislation, beginning with the Incorporation Transparency and Law Enforcement Assistance Act and continuing through the 2019 Transparency Proposal, contemplated that the reporting requirements would apply to corporations and limited liability companies formed under the laws of a state based on the meaning given to those terms under the laws of the applicable state. Limited partnerships and other business entities would not have been made subject to the legislation. Commentators discussing that proposed federal legislation noted that the proposed legislation should apply to all types of business entity structures. It has been argued that the basic elements of a system of reporting beneficial ownership information will only be effective if those elements cover all forms of business entities.[63]

Although those observations did not lead to an expansion of the Corporate Transparency Act specifically to identify business entities other than corporations and limited liability companies, they (along with a desire to cover the non-U.S. entities that are similar to corporations and limited liability companies) likely did lead to the language in the Corporate Transparency Act definition of "reporting company" which provides that a reporting company would include an:

other similar entity that is (i) created by the filing of a document with a secretary of state or similar office under the law of a State or Indian Tribe; or (ii) formed under the law of a foreign country and registered to do business in the United States by the filing of a document with a secretary of state or similar office under the laws of a State or Indian Tribe.[64]

The language employed in the Corporate Transparency Act is open to at least two interpretations. Is a "similar entity" to be determined by comparing its characteristics to those of a corporation or limited liability company (*e.g.*, limited liability and continuity of life) or is it merely enough that the entity is created by a filing with the Secretary of State or similar office? In this respect, it should be noted that there are state law distinctions between organizations with similar

monikers. For example, while the formation of a statutory trust in the State of Delaware requires the filing of a Certificate of Trust with the Delaware Secretary of State, [65] no similar filing is required in the Commonwealth of Massachusetts in order to bring a business trust into existence.[66]

The FinCEN CDD Requirements and the related adopting release are instructive in adding clarity to universe of covered entities. The FinCEN CDD Requirements define "legal entity customer" to mean "a corporation, limited liability company, or other entity that is created by the filing of a public document with a Secretary of State or similar office; a general partnership, and any similar entity formed under the laws of a foreign jurisdiction that opens an account."[67] The adopting release goes on to clarify, among other distinctions, that the defined term would include business trusts that are created by a filing with a state office and would not include trusts (other than statutory trusts created by a filing with a Secretary of State or similar office).

Exemption for Entities Owned or Controlled by One or More Exempt Entities. Section 5336(a)(11)(xxii) of the Corporate Transparency Act exempts from the definition of reporting company "any corporation, limited liability company, or other similar entity of which the ownership interests are owned or controlled, directly or indirectly, by 1 or more entities" described in certain specified clauses of the exemptions from the definition of reporting company. This exemption has been referred to as an "exemption for subsidiaries of an exempt entity."[68]

The exemption in the statute is logical – if the parent entity that owns or controls the subject entity is exempt under the specified clauses of Section 5336(a)(11), the subject entity should not have to report the beneficial ownership information of the parent entity, which itself does not need to report beneficial ownership information of its own beneficial owners. The language, however, could be clarified with respect to the degree or ownership or control that is required for an entity to be eligible for the exemption.

Although it appears that the exemption was intended to capture subsidiaries of certain exempt entities, the reference to "owned or controlled" could be read to imply that the subject entity must be wholly-owned or wholly-controlled by one or more exempt entities. Alternatively, it could be asserted that control, which is achieved at a level below that necessary to treat the subject entity as a subsidiary, is sufficient to satisfy that requirement that the ownership interests of the subject entity are controlled by an exempt entity.

In prescribing regulations under the Corporate Transparency Act, Treasury should provide clarity regarding the level of ownership or control necessary to consider an entity that is owned or controlled by an exempt entity to be an exempt subsidiary.

Identification of Beneficial Owners

As described above, the identification of beneficial owners is at the heart of the Corporate Transparency Act. There are several aspects of the definition of the term "beneficial owner" where Treasury should prescribe regulations that provide guidance in order to make the definition of "beneficial owner" clear enough that entities can determine what information to collect and report.

While the Corporate Transparency Act requires each reporting company to report beneficial ownership information for its beneficial owners, there is no corresponding affirmative obligation that the beneficial owners furnish that information to the reporting company. In prescribing regulations under the Corporate Transparency Act, Treasury should provide relief for reporting companies who fail to report beneficial ownership information despite their best efforts to obtain it.

Substantial Control. The first clause of the definition of "beneficial owner" includes an individual who, directly or indirectly, through contract, arrangement, understanding, relationship, or otherwise, exercises substantial control over the entity. The term "substantial control" is not defined in

the Corporate Transparency Act and without further guidance is inherently unclear. For example, should substantial control focus on day-to-day decision-making, strategic oversight or major decision consent rights (or vetoes)?[69] Similarly, could a third-party manager, a lender or an important customer be considered to exercise substantial control through contractual rights or other arrangements or relationships? Can more than one person exercise substantial control? Could officers of an entity who are otherwise exempt but who own more than 25% of the ownership interests of a reporting company be seen to exercise substantial control?[70]

Although Treasury could refer to the concepts of "control" and "affiliate" status under the securities laws, those provisions are not particularly helpful in providing the type of clarity that is needed to determine beneficial ownership under the Corporate Transparency Act where the term used is "substantial control." Rule 405 under the Securities Act of 1933 (the "Securities Act") defines control to mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. Since at least 1980, the staff of the Division of Corporation Finance of the SEC has declined to respond to requests for "no-action" letters regarding the question of control inasmuch as such determination involves "factual questions which the staff is not in a position to resolve."[71]

In prescribing regulations under the Corporate Transparency Act, Treasury should provide clarity regarding the meaning of "substantial control," including by making it clear that only one person can exercise substantial control,[72] so that entities can determine what information to collect and report.

25% of the Ownership Interests. The second clause of the definition of "beneficial owner" includes an individual who, directly or indirectly, through contract, arrangement, understanding, relationship, or otherwise, owns or controls not less than 25% of the ownership interests of the entity.

At one end of the spectrum, applying that clause to a corporation with one class of ownership interests is fairly straightforward. At the other end of the spectrum, applying that clause to a limited liability company with multiple classes of interests, consent or veto rights, and negotiated distribution priorities will create a compliance challenge. Reporting companies will have to determine how to deal with promote interests, payment waterfalls, contingent payment rights, and agreements between or among equity holders.[73]

In prescribing regulations under the Corporate Transparency Act, Treasury should provide interpretive guidance in determining when an interest constitutes 25% of the ownership interests of an entity. In addition, regulatory clarity could be provided with respect to what constitutes a "contract, arrangement, understanding, relationship, or otherwise" that would cause a person to be deemed to own or control a 25% ownership interest. Will the principles applied under the federal securities laws be applicable?[74] Although many of the components of the definition of "beneficial owner" need clarity, this component seems to be among the most challenging to tackle.

Treatment of Creditors. Subparagraph (B)(v) of the definition of "beneficial owner" states that a creditor of a corporation, limited liability company or similar entity will not be considered a beneficial owner "unless the creditor meets the requirements of subparagraph (A)." One of the requirements of subparagraph (A) is that an individual, directly or indirectly, through contract, arrangement, understanding, relationship, or otherwise, exercises substantial control over the entity. Read together, the language could be considered to be circular – that is, if a creditor in its capacity as such, including through the covenants in its credit agreement or other contract, exercises substantial control over the entity, that creditor would meet the requirements of subparagraph (A). However, it seems that the exclusion was likely only meant to be inapplicable if the creditor exercised substantial

control in a non-creditor capacity, such as being both a creditor and holder of more than 25% of the ownership interests.

In prescribing regulations under the Corporate Transparency Act, Treasury should provide clarity for reporting companies and creditors as to the nature of this exclusion.

Who is an Applicant?

The Corporate Transparency Act defines the term applicant to mean "any individual who (A) files an application to form a corporation, limited liability company, or other similar entity under the laws of a State or Indian Tribe or (B) registers or files an application to register a corporation, limited liability company, or other similar entity formed under the laws of a foreign country to do business in the United States by filing a document with the secretary of state or similar office under the laws of a State or Indian Tribe."[75] The term "applicant" is used twice in the Corporate Transparency Act. First, information for each applicant (along with each beneficial owner) must be reported to FinCEN – *i.e.*, a report must identify each applicant with respect to a reporting company by setting forth the beneficial ownership information with respect to the applicant.[76] Second, the applicant has a reporting obligation – *i.e.*, if an exempt entity has or will have a direct or indirect ownership interest in a reporting company (regardless of the amount of the ownership interest), the reporting company or the applicant is required to report the name of the exempt entity.[77]

Considering the compliance burdens applicable to providing beneficial ownership information and the penalties for failure to report that information, clear guidance regarding how to interpret the term "applicant" is critical. Many individuals can be involved in the filing of an application to form a reporting company or the registration of a reporting company. For example, a lawyer or law firm employee could prepare the documentation for electronic submission or submission via filing agent, which could file the documentation personally or via messenger; and one or

more of those parties may be the incorporator or organizer. Regardless of the process, in that example, the reporting company needs to identify who among those parties is an "applicant" and obtain their beneficial ownership information.

In prescribing regulations under the Corporate Transparency Act, Treasury should provide interpretive guidance on the definition of "applicant," including:

- Should lawyers or law firm personnel be considered applicants when acting on behalf of a client? For example, is a lawyer or law firm employee acting on behalf of a client an applicant if the lawyer or employee: (i) acts as an incorporator or organizer; (ii) files or electronically transmits formation documents; or (iii) coordinates with a service company to file or transmit documents with a secretary of state or similar office?[78]
- Similarly, are filing agents or employees of registered agents, service companies or messenger services considered applicants if they file, deliver or electronically transmit formation documents on behalf of others?

The regulations promulgated by Treasury should make it clear that the applicant is the person on whose behalf the entity is being formed and not the individual or entity that effects the drafting of the organizational document and its submission to the secretary of state for filing. Further, the requirement to file information as to the applicant should be only with respect to entities organized after the effective date of the regulations (*i.e.*, it should not apply to reporting companies whose existence pre-dates the effective date of the regulations) when the reporting company had no awareness of the need to capture information on incorporators and organizers and those incorporators and organizers had no awareness of the future filing obligation with respect to personal information.

CONCLUSION

The Corporate Transparency Act represents a significant development in the responsibility for collecting and reporting beneficial ownership information. While this new law is intended to provide law enforcement with beneficial ownership information for the purpose of detecting, preventing and punishing terrorism, money laundering and other misconduct accomplished through business entities, it places a significant burden on small businesses. Treasury's recent Advance Notice of Proposed Rulemaking is a welcome first step to solicit input to achieve the clarity needed for compliance by reporting companies and applicants, including clarification of many of the points raised herein. In light of the criminal and civil penalties associated with lack of compliance and the challenges and burdens facing business entities in complying with the Corporate Transparency Act, it is in everyone's interest to provide clarity and precision with respect to the requirements, thereby reducing the burden on reporting companies and applicants as well as increasing compliance and the value of the information reported.

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[1] The authors are members of the Corporate Laws Committee and/or the LLCs, Partnerships and Unincorporated Entities Committee of the Business Law Section of the American Bar Association and have followed issues related to beneficial ownership transparency as members of task forces formed by those committees. Ms. Smiley, Chair of the Corporate Laws Committee, and Mr. Downes have co-chaired the Corporate Laws Committee's Task Force on Beneficial Ownership Transparency, and Messrs. Ludwig and Rutledge have co-chaired the LLCs, Partnerships and Unincorporated Entities Committee's task force. The views expressed in this article reflect views of the individual authors and not the views of the American Bar Association, the Business Law Section of the American Bar Association or the Corporate Laws Committee or the LLCs, Partnerships and Unincorporated Entities Committee of the Business Law Section of the American Bar Association.

[2] The full name of the NDAA is the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub.L. No. 116-283 (H.R. 6395), 134 Stat. 338, 116th Cong. 2d Sess. Congress' override of the President's veto was taken in Record Vote No. 292 (Jan. 1, 2021). The anti-money laundering provisions are found in §§ 6001-6511 of the NDAA. The Corporate Transparency Act consists of §§ 6401-6403 of the NDAA. Section 6402 of the NDAA sets forth Congress' findings and objectives in passing the Corporate Transparency Act, and § 6403 contains its substantive provisions, primarily adding § 5336 to Title 31 of the United States Code.

[3] Office of Representative Carolyn Maloney, Press Release, "Maloney Celebrates Inclusion of Corporate Transparency Act in FY2021 NDAA" (Nov. 19, 2020).

[4] FinCEN's Customer Due Diligence Requirements for Financial Institutions (the "FinCEN CDD Requirements") require covered financial institutions to collect identification information for the identity of beneficial owners of legal entity customers when a new account is opened. The Corporate Transparency Act mandates that the Secretary of the Treasury revise the FinCEN CDD Requirements to bring them into conformance with the Corporate Transparency Act and to "reduce any burdens on financial institutions and legal entity customers that are, in light of the enactment of [the Corporate Transparency Act], unnecessary or duplicative." 31 U.S.C. § 5336(d)(1).

[5] On April 1, 2021, the Treasury released an Advance Notice of Proposed Rulemaking, Beneficial Ownership Information Reporting Requirements (the "ANPR"), soliciting comments on a wide variety of questions pertinent to the Corporate Transparency Act and its implementation. *See* Financial Crimes Enforcement Network, "Beneficial Ownership Information Reporting Requirements," 86 Fed. Reg. 17557 (April 5, 2021). Comments on the ANPR are due prior to May 5, 2021.

[6] The Financial Action Task Force is a global inter-governmental body established in 1989 with the objective of setting standards and promoting effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. FATF currently comprises 37 member jurisdictions and two regional organizations.

[7] *See* Financial Action Task Force, Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism (23 June 2006), table 2, ¶¶ 5.1, 5.2; *see also id.*, chapter 5 (pp. 226-249).

[8] S. 2956, 110th Cong. 2d Sess.

[9] S. 2956, 110th Cong. 2d Sess., Preamble.

[10] The Incorporation Transparency and Law Enforcement Assistance Act broadly defined a "formation agent" as a person who, for compensation, acts on behalf of another person to assist in the formation of a corporation or limited liability company under the laws of a State. As such, the term formation agent broadly covered attorneys assisting in the formation of an entity, as well as service providers preparing and filing documents on behalf of an entity.

[11] In 2016, FATF described the lack of beneficial ownership disclosure requirements as a "significant gap" and a "serious deficiency" in the United States' anti-money laundering and countering the financing of terrorism regime. *See* FATF, Anti-money laundering and counter terrorist financing measures – United States, Fourth Round Mutual Evaluation Report (2016).

[12] S. 3268, 114th Congress, 2d Sess.

[13] Senators Carper and Coons represent the State of Delaware, the leading state for the organization of publicly-traded entities.

[14] The Counter Terrorism and Illicit Finance Act was an unnumbered draft bill, which included beneficial ownership provisions in Section 9. On June 12, 2018, Representatives Pearce and Luetkemeyer introduced a version of the bill, not including Section 9, as H.R. 6068. H.R. 6068 was referred to the House Financial Services Committee, but there was no further action taken on the bill.

[15] S. 1454, 115th Congress, 1st Sess.

[16] H.R. 3089, 115th Congress, 1st Sess. and S. 1717, 115th Congress, 1st Sess.

[17] Even as these federal requirements were being considered, various states and local jurisdictions considered and adopted requirements as to disclosure, typically in the public record, of the beneficial ownership/control (however defined) of various business entities. *See, e.g.*, Ariz. Rev. Stat. § 29-3201(B)(4)(a); *id.* § 29.3201(B)(4)(b); D.C. Code § 29-102.01(a)(6); *id.* § 29-102.11(a); Kan. Stat. Ann. § 17-76, 139(a)(2); Nev. Rev. Stat. § 86.263(1)(c),(d). Some of the enhanced disclosure requirements are triggered when an entity is engaged in a particular industry. *See, e.g.*, Mo. Rev. Stat. § 347.048(1).

[18] Under the FinCEN CDD Requirements, "beneficial owner" is broadly defined by two prongs: (i) the ownership prong (each individual, if any, who directly or indirectly owns 25% or more of the equity interests of a legal entity customer); and (ii) the control prong (a single individual with significant responsibility to control, manage, or direct a legal entity customer, including an executive officer or senior manager or any other individual who regularly performs similar functions). Under the FinCEN CDD Requirements, at least one individual must be identified under the control prong while zero to four individuals can be identified under the ownership prong.

[19] Under the geographic targeting orders, "beneficial owner" is defined to mean "each individual who, directly or indirectly, owns 25% or more of the equity interests" of the purchaser.

[20] Geographic targeting orders were first issued in 2016. The current (as of this writing) geographic targeting order was issued on November 4, 2020, and is available at https://www.fincen.gov/sites/default/files/shared/508_Real%20Estate%20GTO%20Order%20FINAL%20GENERI

[21] H.R. 2513, 116th Congress, 1st Sess.

[22] S. 2956, Section 3(a)(1) (adding § 2009(a)(1) to Section 6 of the United States Code).

[23] Even though states do not have responsibility for collecting beneficial ownership information under the Corporate Transparency Act, states are required to notify filers of the requirements of the Corporate Transparency Act, provide those filers with a copy of or link to the forms created by the Secretary of the Treasury, and update their websites, incorporation forms and physical premises to notify filers of the requirements of the Corporate Transparency Act. 31 U.S.C. § 5336(e)(2). The Corporate Transparency Act also provides that "the Secretary of the Treasury shall, to the greatest extent practicable, establish partnerships with State, local and Tribal government agencies [and] collect information . . . through existing Federal, State and local processes and procedures." 31 U.S.C. § 5336(b)(1)(F)(i);(ii).

[24] H.R. 3089, Section 3(a)(1) (adding § 5333(d)(3) to Title 31 of the United States Code). As such, the term formation agents broadly covered attorneys assisting in the formation of an entity as well as service providers filing documents on behalf of an entity. See note 6, supra.

[25] H.R. 2513, Section 3(a)(1) (adding § 5333(d)(1) to Title 31 of the United States Code). The definition of the term "applicant" as used in the Corporate Transparency Act is discussed further below under "Discussion of Clarifying Points to be Considered in Regulations under the Corporate Transparency Act—Who is an Applicant?"

[26] As discussed below, the term "reporting company" was introduced after the introduction of the 2019 Transparency Proposal.

[27] The Corporate Transparency Act generally refers to states and Indian tribes. For purposes of this article, when discussing the Corporate Transparency Act, references to "states" will generally mean states and Indian tribes unless otherwise indicated. The term "State" as used in the Corporate Transparency Act means "any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, American Samoa, Guam, the United States Virgin Islands, and any other commonwealth, territory, or possession of the United States."

[28] The Corporate Transparency Act of 2019 did not specifically provide for reporting by partnerships, trusts or other entities. The Corporate Transparency Act included in the NDAA expanded the entities required to report beyond corporations and limited liability companies to cover other similar entities "created by the filing of a document with a secretary of state or a similar office under the law of a State or Indian Tribe." 31 U.S.C. § 5336(a)(11)(A)(i). This provision is discussed further below under "Discussion of Clarifying Points to be Considered in Regulations under the Corporate Transparency Act – Reporting Companies – Other Similar Entity that is Created by the Filing of a Document with a Secretary of State or Similar Office."

[29] This provision is discussed further below under "Discussion of Clarifying Points to be Considered in Regulations under the Corporate Transparency Act – Reporting Companies – Exemption for Entities Owned or Controlled by One or More Exempt Entities."

[30] S. 2956, 110th Cong. 2d Sess., Section 3(a) (adding § 2009(e)(1) to the Homeland Security Act of 2002).

[31] Formulations of beneficial ownership that have an ownership prong but not a control prong have been criticized given the ability to establish ownership structures where no person owns in excess of the requisite percentage.

[32] As described below, the "substantial economic benefits" prong was not included in the Corporate Transparency Act included in the NDAA.

[33] The circularity of the creditor exclusion as it relates to the exercise of substantial control is discussed further below under "Discussion of Clarifying Points to be Considered in Regulations under the Corporate Transparency Act – Identification of Beneficial Owners – Treatment of Creditors."

[34] The legislative finding set forth in § 6402(5)(A) of the Corporate Transparency Act provides that federal legislation providing for the collection of beneficial ownership information is needed to "set a clear, Federal standard for incorporation practices." The authors believe that this legislative finding, in the context of the collection of beneficial ownership information, is not to mandate federal requirements of incorporation, but rather to specify common information for federal data collection.

[35] 31 U.S.C. § 5336(a)(11)(A).

[36] The Corporate Transparency Act does not define how an entity determines who are its "employees" and whether an employee is on a "full-time basis." In prescribing regulations under the Corporate Transparency Act, Treasury should assess who is an employee (*e.g.*, does the term include contract employees (so-called "gig workers") or members of a limited liability company or partners in a firm) and defining how a full-time basis should be determined, including whether part-time employees count on a full-time equivalent basis, whether seasonal employees are considered employees for purposes of the determination, and when the determination should be made.

[37] Although this exemption is intended to exempt operating businesses, according to 2014 U.S. Census Bureau data, 88% of the United States' 28.7 million business firms had fewer than 20 employees.

[38] If the clause "hold any kind or type of asset" is applied literally, this exemption will be rendered essentially meaningless. In prescribing regulations under the Corporate Transparency Act, Treasury should exclude intangible assets (such as goodwill or contract rights) and/or de minimis non-operating assets.

[39] 31 U.S.C. § 5336(a)(11)(B).

[40] 31 U.S.C. §5336(b)(2)(C) – (E).

[41] An applicant is "any individual who (A) files an application to form a corporation, limited liability company, or other similar entity under the laws of a State or Indian Tribe or (B) registers or files an application to register a corporation, limited liability company, or other similar entity formed under the laws of a foreign country to do business in the United States by filing a document with the secretary of state or similar office under the laws of a State or Indian Tribe." 31 U.S.C. § 5336(a)(2). The definition of the term "applicant" is discussed further below under "Discussion of Clarifying Points to be Considered in Regulations under the Corporate Transparency Act – Who is an Applicant?"

[42] Beneficial ownership information does not include either (i) the reason why the person is identified as a beneficial owner; or (ii) the amount of ownership interest or other ownership attributes of the beneficial owner. As a result, changes to the amount or nature of beneficial ownership are not required to be reported.

[43] 31 U.S.C. § 5336(b)(2)(A). An "acceptable identification document" is a defined term. *See* 31 U.S.C. §5336(a)(1). A "FinCEN identifier" means the unique identifying number assigned by FinCEN to a person under § 5336. *See* 31 U.S.C. §5336(a)(6). Section 5336(b)(3)(B) provides that any person required to report information with respect to an individual may report the FinCEN identifier of the individual. In prescribing regulations under the Corporate Transparency Act, consistent with § 5336(b)(3)(B), Treasury should provide interpretive guidance to make it clear that the full legal

name, date of birth and residential or business street address do not need to be provided if the FinCEN identifier is provided.

[44] 31 U.S.C. § 5336(b)(2)(B).

[45] Consistent with prior legislative efforts, the Corporate Transparency Act focuses on an individual who controls the entity "directly or indirectly," requiring the reporting company to ascertain the identity of an individual regardless of the number of intermediate entities through which that individual owns an interest or otherwise exercises control. As described below, the requirement to report beneficial ownership information for indirect beneficial owners poses significant uncertainty and burden for reporting companies.

[46] The vague wording of this clause stands in clear opposition to the clarity in the control prong of the FinCEN CDD Requirements, which requires identification of "a single individual with significant responsibility to control, manage, or direct a legal entity customer, including an executive officer or senior manager or any other individual who regularly performs similar functions."

[47] 31 U.S.C. § 5336(a)(3)(A). The third prong of the definition of beneficial owner from the 2019 Transparency Proposal, which defined a beneficial owner to include an individual who "receives substantial economic benefits from the assets of a corporation or limited liability company," was not included in the Corporate Transparency Act included in the NDAA.

[48] The Corporate Transparency Act does not set out the parameters of what is meant by "a right of inheritance."

[49] 31 U.S.C. § 5336(a)(3)(B).

[50] 31 U.S.C. § 5336(b)(5).

[51] 31 U.S.C. § 5336(b)(1)(A) – (D). The requirement to report changes in reported beneficial ownership information (which includes a current address and an identifying

number) poses a significant burden for reporting companies. There can easily be changes in the beneficial ownership information of indirect beneficial owners of which a reporting company is unaware.

[52] 31 U.S.C. § 5336(b)(1)(E).

[53] 31 U.S.C. § 5336(c)(2)(A).

[54] The Corporate Transparency Act does not define "consent" for purposes of this requirement. In prescribing regulations under the Corporate Transparency Act, Treasury should address whether consent needs to be clear and specific or whether, for example, it would be sufficient if the standard customer materials of a financial institution include a consent for purposes of the Corporate Transparency Act, such that an account with a financial institution could not be opened without a consent.

[55] *See* 15 U.S.C. § 6809(2).

[56] The Corporate Transparency Act does not define "other appropriate regulatory agency" for purposes of this requirement. In prescribing regulations under the Corporate Transparency Act, Treasury should specify that appropriate regulatory agencies are those engaged in national security, intelligence or law enforcement activity.

[57] 31 U.S.C. § 5336(c)(2)(B) – (C).

[58] 31 U.S.C. § 5336(c)(3).

[59] 31 U.S.C. § 5336(h)(3)(A).

[60] Although the Corporate Transparency Act is clear that the civil penalties are payable to the United States, it is not clear who has the right to bring an action for civil penalties for unauthorized disclosure of information.

[61] 31 U.S.C. § 5336(h)(1) – (2).

[62] The Corporate Transparency Act directs the Comptroller General to submit a report to Congress studying whether the lack of beneficial ownership information for trusts, partnerships and other legal entities presents money laundering and terrorism financing risks, suggesting that these entity types do not fall within the definition of reporting company contemplated by Congress. *See* § 6502(d) of the NDAA. Regardless of the scope of entities covered, the coverage of general partnerships may be problematic due to the informal nature of their formation.

[63] For example, in the United Kingdom, press reporting outlined how the Scottish limited partnership ("SLP") corporate form had been used in money laundering, in part because SLPs were not covered by the UK's beneficial ownership disclosure regime until June 2017. *See* "Crackdown Plan on Scottish limited partnerships," BBC (April 29, 2018).

[64] The scope of entities covered under this clause seems similar to the scope of entities that are "registered organizations" under the Uniform Commercial Code, where a registered organization means "an organization organized solely under the law of a single State or the United States by the filing of a public organic record with, the issuance of a public organic record by, or the enactment of legislation by the State or the United States."

[65] *See* Del. Code Ann. tit. 12, § 3810.

[66] Although the trustees of a Massachusetts business trust are required to file a copy of the declaration of trust with the secretary of state and the clerk of every city or town where the trust has its usual place of business, the filing of the declaration of trust is not a condition precedent to the existence of the trust. *See* Mass. G.L.c. 182, § 2 and Mass. DOR Letter Ruling 91-2.

[67] *See* Financial Crimes Enforcement Network, "Customer Due Diligence Requirements for Financial Institutions," 81 Fed. Reg. at 29412 (effective July 11, 2016).

[68] 31 U.S.C. § 5336(b)(2)(D), which provides for reporting if the subject entity no longer meets the criteria described in the exemption, is labelled "Reporting Requirement for Exempt Subsidiaries." That reference is the only instance of the use of the term "subsidiar[y]" in the Corporate Transparency Act.

[69] Consider, for example, a limited liability company having three members holding, respectively, a 20%, a 40% and a 40% interest therein and with an operating agreement that provides that the company may act only by the unanimous consent of the members. Does the holder of the 20% interest have "substantial control" over the company by virtue of the ability to prevent an action from being taken?

[70] In many cases, as described above, such a compliance challenge would be exacerbated by the reporting company's lack of a contractual right to require a third party to provide the required beneficial ownership information.

[71] Procedures Utilized by the Division of Corporation Finance for Rendering Informal Advice, Securities Act Release No. 6253, 1 Fed. Sec. L. Rep. (CCH) ¶ 373 at 1255 (Oct. 28, 1980). Among the facts and circumstances that the courts, the SEC and commentators have considered relevant to a determination of the existence or absence of control under the securities laws are: (i) the power to select a majority of a board of directors; (ii) the owner of a substantial block of securities; (iii) a position as a director or officer; (iv) involvement in day-to-day management; (v) the existence of historical, familial, business or contractual relationships as a result of which control may be exercised; and (vi) the power to cause a registration statement under the Securities Act to be filed by the issuer in the absence of a contractual right to cause such filing.

[72] Providing that no reporting company can have more than one beneficial owner who is considered to be in substantial control of a reporting company would be consistent with the FinCEN CDD Requirements, which require identification of "a single individual with significant responsibility to control, manage, or direct a legal entity

customer, including an executive officer or senior manager or any other individual who regularly performs similar functions."

[73] It is not clear from the statute whether "group" concepts and attribution rules applicable in other situations (such as under § 13(d) of the Exchange Act) will be applicable. The ANPR (*see supra* note 5), at page 17562 (question 3(a)) asks "To what extent should FinCEN's regulatory definition of beneficial owner in this context be the same as, or similar to, the current CDD rule's definition or the standards used to determine who is a beneficial owner under 17 CFR 240.13d–3 adopted under the Securities Exchange Act of 1934?"

[74] *See* Rule 13d-3(a) promulgated under the Exchange Act.

[75] 31 U.S.C. § 5336(a)(2).

[76] 31 U.S.C. § 5336(b)(2)(A).

[77] 31 U.S.C. § 5336(b)(2)(B).

[78] Among the practical complications of a broad definition of "applicant" is identifying the applicant(s) for existing entities. Reporting companies formed before the effective date of the Corporate Transparency Act are required to file beneficial ownership information not later than two years after the regulations are promulgated, but a corporation that has existed for a number of years may not be able to obtain beneficial ownership information for its incorporator, who is often a law firm employee, much less others who were involved in the incorporation process. And even if that person could be identified, they may be unresponsive to a request for the personal information responsive to 31 U.S.C. § 5336(b)(2)(A)(i) – (iv).

ABOUT THE AUTHORS