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Corporate Transparency Act: Beneficial Ownership Disclosure Requirements for Domestic and Foreign Entities Doing Business in the United States

Advisory

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On January 1, 2021, Congress enacted the Corporate Transparency Act (the Act) imposing significant disclosure and reporting requirements related to the beneficial ownership of domestic and foreign corporations, limited liability companies and similar entities.¹

Overview of the Act

The stated purpose of the Act is to prevent the use of anonymously formed entities to facilitate money laundering, tax evasion, securities fraud and other crimes, and to aid in law enforcement's investigations of such crimes.² According to the Act's preamble, more than two million domestic corporations and limited liability companies are formed each year, with the majority being formed in states lacking disclosure or reporting requirements similar to that provided under the Act.³

The Act requires the Secretary of the Treasury to adopt regulations to implement the Act no later than January 1, 2022 (the Regulations), at which time the Act shall become effective.⁴

Entities Subject to the Act as Reporting Companies

Subject to certain exemptions discussed below, the Act requires most types of entities (including, corporations, limited liability companies and "other similar entities")⁵, defined as "Reporting Companies", to identify certain ownership information and applies to both new entities and entities that have been previously formed.⁶

Beneficial Ownership and Control Tests

The Act's disclosure requirements center around identifying the "Beneficial Owners" of the reporting entities. Beneficial Owner is broadly defined (emphasis added) but focuses on ultimate individual owners:

(A) . . . with respect to an entity, **an individual** who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise

(i) exercises substantial control over the entity; **or**

(ii) owns or controls not less than 25% of the ownership interests of the entity⁷

Notably, the definition of Beneficial Owner consists of both ownership and control tests. The Act also appears to apply only to individual persons that, directly or indirectly, satisfy the Beneficial Owner criteria. For example, the Act does not seem to consider an *entity* that is the 100% owner of a subsidiary as the "Beneficial Owner" of such subsidiary; instead the subsidiary would be required to report *individuals* (whether at the 100% owner level or even higher up the ownership chain) that actually meet the ownership or control tests. Of course, each entity in an ownership structure would likely be its own Reporting Company with its own disclosure obligations (unless such entity is otherwise exempt).

Reporting and Disclosure Requirements

The Act requires all Reporting Companies to file a report with the Financial Crimes Enforcement Network of the Department of Treasury (FinCEN) listing the Beneficial Owners of the entity and identifying their:

(i) full legal name;

(ii) date of birth;

(iii) current, as of the date on which the report is delivered, residential or business street address; and

(iv)(I) a unique identifying number from an acceptable identification document⁸; or

(II) FinCEN identifier in accordance with requirements in paragraph (3) [which paragraph relates to the issuance of a FinCEN identifier and its use].⁹

Reporting Companies in existence prior to the Act must comply with the Act not later than two years after the date the Act becomes effective.¹⁰ Once an entity complies with the Act, it must disclose to FinCEN any changes to reported information within one year of such changes, including a change of Beneficial Owners.¹¹

Civil and Criminal Penalties for Violation

If a person willfully provides false ownership information or willfully fails to report complete or updated beneficial ownership information to FinCEN, there may be (i) a civil penalty of not more than \$500 for each day the violation continues or is not remedied and (ii) a fine of not more than \$10,000, imprisonment for not more than two years, or both.¹² There is a safe harbor for individuals who have acted in good faith when submitting the reports.¹³

Exemptions and Implications

Exclusions From the Definition of Beneficial Owner

There are a number of important exclusions from the definition of Beneficial Owner. In particular, an employee of a Reporting Company is exempt if such employee's control or economic benefit arises solely from that person's employment status.¹⁴ This exception raises numerous practical and technical questions in the real estate context, including whether the Regulations will ultimately distinguish between employees, principals and board members of an entity.

Additionally, creditors are exempt from the definition of Beneficial Owner unless they "meet the requirements of subparagraph (A)" (i.e., the main Beneficial Owner test set forth above).¹⁵ This latter exemption raises interesting questions about lenders (including mezzanine lenders) that may arguably have substantial control over the management and operations of their real estate borrowers. This question, and any resulting reporting requirements, gets even trickier when you consider a securitized loan (where the originating creditor may not be the primary owner of the loan).

Exclusions From the Definition of Reporting Company

An entity is not considered a Reporting Company (and thus exempted from compliance with the reporting requirements) to the extent such entity is described in § 5336(a)(11)(B) of the Act. This list includes (among others) (i) publicly traded companies, (ii) 501(c) tax exempt entities under the Internal Revenue Code, (iii) certain pooled investment vehicles, (iv) any entity that (a) employs more than 20 employees on a full-time basis in the United States, (b) filed in the previous year's federal income tax returns more than \$5,000,000 in gross receipts or sales in the aggregate (including the receipts or sales of other entities owned by the entity and other entities through which the entity operates) and (c) has an operating presence at a physical office within the United States, and (v) corporations, limited liability companies and similar entities that are owned or controlled, directly or indirectly, by certain exempt entities identified in § 5336(a)(11)(B)(xxii).¹⁶

Additional Considerations:

1. State Level Cooperation. To help with enforcement, the Act requires Secretaries of State to notify filers of the Act's reporting requirements and provide various information at the time an entity is formed or registered, or when an entity renews its registration.¹⁷ In addition, the Treasury Department is tasked (as part of the Act) with establishing partnerships at the State and local levels, as well as collecting required disclosures from existing Federal, State and local processes (where possible).¹⁸

Since the Act does not attempt to preempt State and local law, entities will likely still be required to comply with both State specific filing requirements and the Act. For example, the District of Columbia recently amended its existing entity formation and filing requirements to strengthen required disclosure of direct and indirect beneficial owners of certain

entities.

These requirements have been outlined in Arnold & Porter's **Control and Beneficial Ownership Disclosure Requirements for Domestic and Foreign Entities Doing Business in the District of Columbia** Advisory. Notable differences between the two acts include (1) DC has a 10% ownership threshold that triggers reporting, while the Act has a 25% threshold, (2) DC requires reporting of both individuals and entities, while the Act appears to just require reporting of individuals, and (3) under the DC requirements reported information is publicly available, while under the Act the information is not (though it may be subject to FOIA).¹⁹

2. Loans—KYC Requirements. One notable purpose of the Act is to "confirm beneficial ownership information provided to financial institutions to facilitate the compliance of the financial institutions with anti-money laundering, countering the financing of terrorism, and customer due diligence requirements under applicable law".²⁰ Given the prevalence of "Know Your Customer" (KYC) requirements in commercial real estate lending, it will be important for borrowers to provide identical information to the applicable State and financial institutions in the various disclosure processes.

3. Entities With No Beneficial Owner. What happens if a Reporting Company is ultimately owned by an entity that is exempt from the definition of Reporting Company? The Act states that in such case, the Reporting Company must only list the name of the entity exempted from compliance.²¹ At the simplest level, imagine an LLC that is fully owned by a publicly listed corporation. The LLC itself would qualify as a Reporting Company, but because there would not be an individual that satisfies the Beneficial Ownership test, we would assume that the LLC would simply report the name of such exempted entity in its disclosure report. On the other hand, in the context of a traditional 90/10 real estate joint venture, where the 90% partner is ultimately excluded from the definition of the Reporting Company (for example, where the 90% partner is a public company), the joint venture entity would nonetheless have to report any individuals satisfying the Beneficial Ownership test on the developer/sponsor (10%) side of the deal.

4. Comments on Regulations. Once the proposed Regulations are published by the Department of Treasury this year, the public will be able to provide comments on them.

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¹ The Act also applies to entities formed under tribal governments. *William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 - Actions Overview*, Congress (January 7, 2021); *See* 31 U.S.C. § 5336, (adopted Jan. 1, 2020).

² *Id.* at Sec. 6402(3)-(4).

³ *Id.* at Sec. 6402(1)-(2).

⁴ *See* 31 U.S.C. § 5336(b)(5) (adopted Jan. 1, 2020)

⁵ *Id.* at § 5336(a)(2)

⁶ *Id.* at § 5336(b)(1)(B)&(D) (adopted Jan. 1, 2020).

⁷ *Id.* at § 5336(a)(3)(A) (adopted Jan. 1, 2020).

⁸ Such as a passport or driver's license. *See Id.* at § 5336(a)(1).

⁹ *Id.* at § 5336(b)(2)(A) (adopted Jan. 1, 2020).

¹⁰ *Id.* at § 5336(b)(1)(B) (adopted Jan. 1, 2020).

¹¹ *Id.* at § 5336(b)(1)(D) (adopted Jan. 1, 2020)

¹² *Id.* at § 5336(h) (adopted Jan. 1, 2020).

¹³ *Id.* at § 5336(h)(3)(C) (adopted Jan. 1, 2020).

¹⁴ *Id.* at § 5336(a)(3)(B)(iii) (adopted Jan. 1, 2020).

¹⁵ *Id.* at § 5336(a)(3)(B)(v) (adopted Jan. 1, 2020).

¹⁶ *Id.* at § 5336(a)(11)(B)(i), (a)(11)(B)(xix)(I), (a)(11)(B)(xviii), (a)(11)(B)(xxi) & § 5336(a)(11)(B)(xxii) (adopted Jan. 1, 2020).

¹⁷ *Id.* at § 5336(e)(2)(A)(i) (adopted Jan. 1, 2020).

¹⁸ *Id.* at § 5336(d) (adopted Jan. 1, 2020).

¹⁹ *National Defense Authorization Act for Fiscal Year 2021*, at § 6402(7).

²⁰ *National Defense Authorization Act for Fiscal Year 2021*, at § 6402(6)(B).

²¹ *Id.* at § 5336(b)(2)(B).