Proskauer

The Corporate Transparency Act – Government KYC

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Summary of the Corporate Transparency Act under the National Defense Authorization Act for Fiscal Year 2021

On January 1, 2021, the Corporate Transparency Act (the "CTA"), which is part of the National Defense Authorization Act for Fiscal Year 2021, became effective after both houses of Congress overrode a presidential veto. The CTA amends the Bank Secrecy Act (the "BSA") and, once the Treasury Department's reporting procedures and standards are established, it will require many companies, which have historically been unregulated, to file a report with the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN") identifying the companies' beneficial owners. In an attempt to ban anonymous shell companies and "better enable critical national security, intelligence, and law enforcement efforts to counter money laundering, the financing of terrorism, and other illicit activity," government authorities will, for the first time, have access to a database of such beneficial ownership information.

Historically, the United States has been behind most countries' reporting standards for anti-money laundering and countering the financing of terrorism. Under the CTA, however, the United States will have a database of beneficial ownership information of most unregulated entities that will be available to government authorities. In effect, the CTA will ban anonymous shell companies.

What is a reporting company?

A reporting company is a corporation, limited liability company or other similar entity 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 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.

A reporting company does not include:

- An issuer of securities registered under section 12 of the Securities Exchange Act of 1934 or who is required to file supplementary and periodic information under section 15(d) of the Securities Exchange Act of 1934;
- An entity established under the laws of the United States, an Indian Tribe, a State, or a political subdivision of a State, or under an interstate compact between two (2) or more States; and exercises governmental authority on behalf of the United States or any such Indian Tribe, State, or political subdivision;
- A bank;
- A federal or state credit union;
- A bank holding company;
- A money transmitting business registered with the Secretary of the Treasury (the "Secretary") under section 5330 of title 31, United States Code;
- A broker or dealer registered under section 15 of the Securities Exchange Act of 1934;
- An exchange or clearing agency;
- Any other entity registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934;
- An investment company or advisor that is registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934;
- An investment advisor under the Investment Advisers Act of 1940 that has filed Item 10, Schedule A, and Schedule B of Part 1A of Form ADV, or any successor thereto, with the Securities and Exchange Commission;
- An insurance company;
- 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;
- A registered entity under section 1a of the Commodity Exchange Act; or an entity that is a futures commission merchant, introducing broker, swap dealer, major swap participant, commodity pool operator, or commodity trading advisor; or a retail foreign exchange dealer; and registered with the Commodity Futures Trading Commission under the Commodity Exchange Act;
- A public accounting firm;
- 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 under section 804 of the Payment, Clearing, and Settlement Supervision Act of 2010;
- A pooled investment vehicle that is operated or advised by a bank, a federal or state credit union, a broker or dealer registered under section 15 of the Securities Exchange Act of 1934, an investment company or advisor that is registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, or an investment advisor under the Investment Advisers Act of 1940 that has filed Item 10, Schedule A, and Schedule B of Part 1A of Form ADV, or any successor thereto, with the Securities and Exchange Commission;
- A corporation, political organization, charitable trust, or split-interest trust exempt from taxes;
- A company that operates exclusively to provide financial assistance to, or hold governance rights over, a corporation, political organization, charitable trust or split-interest trust exempt from taxes; is a United States person; is beneficially owned or controlled exclusively by one (1) or more United States persons that are United States citizens or lawfully admitted for permanent residence; and derives at least a majority of its funding or revenue from one (1) or more United States persons that are United States citizens or lawfully admitted for permanent residence;
- A company that employs more than 20 people on a full-time basis in the United States, filed in the previous year Federal income tax returns demonstrating more than $5 million in gross receipts or sales, and has an operating presence at a physical office within the United States;
- A company owned or controlled, directly or indirectly, by an aforementioned exempt entity, as applicable (an “exempt subsidiary”);
- An entity that has been in existence for over one (1) year; not engaged in active business; not owned, directly or indirectly, by a foreign person; has not, in the preceding 12-month period, experienced a change in ownership or sent or received funds greater than $1,000; and does not otherwise hold any asset, including an ownership interest in any corporation, limited liability company, or other similar entity (a “dormant entity”); and
- Any other entity that the Secretary, with the written concurrence of the Attorney General and the Secretary of Homeland Security, has, by regulation, determined 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 against money laundering and the financing of terrorism, tax fraud, or other crimes.

What information must be reported?

A reporting company must provide the following information of each beneficial owner of the company (hereinafter "beneficial ownership information"): (i) full legal name, (ii) date of birth, (iii) current residential or business address, and (iv) a unique identifying number from an acceptable identification document; or a FinCEN identifier. If an individual is a beneficial owner of a reporting company due to its interest in an entity that, directly or indirectly, holds an interest in the reporting company, the reporting company may report the FinCEN identifier of the entity instead of the aforementioned information with respect to the individual.

Beneficial owner. A beneficial owner of an entity is 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 entity. Effectively, individuals will not be able to hide behind anonymous shell companies in conducting business. The CTA does not include a definition of what it means to exercise "substantial control;" presumably this will be addressed in regulations or other guidance to come.

A beneficial owner does not include (i) a minor child; (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 or economic benefits from such entity derive solely from the person's employment status; (iv) an individual whose only interest in the entity is through a right of inheritance; or (v) the entity's creditor, unless the creditor exercises substantial control over the entity, or owns or controls not less than 25% of the ownership interests of the entity.

Identification document. An acceptable identification document is a:

- Nonexpired passport issued by the United States;
- Nonexpired identification document issued by a State, local government, or Indian Tribe to the individual acting for the purpose of identification of that individual;
- Nonexpired driver's license issued by a State; or
- Nonexpired passport issued by a foreign government, if the individual does not have a document described above.

Exempt entities. If an exempt entity has or will have a direct or indirect ownership interest in a reporting company, the reporting company need only provide the name of such exempt entity. However, exempt pooled investment vehicles that are formed under the laws of a foreign country must file with FinCEN a written certification providing the aforementioned identification information of an individual that exercises substantial control over the pooled investment vehicle.

Agency Coordination. The Secretary shall, to the greatest extent practicable, update beneficial ownership information by working collaboratively with other relevant Federal, State, and Tribal agencies. Such agencies shall, consistent with applicable legal protections, cooperate with and provide information requested by FinCEN to maintain an accurate and complete database of beneficial ownership information.

When must beneficial ownership information be reported?

The Secretary must by regulation prescribe procedures and standards governing reports and FinCEN identifiers by January 1, 2022, one (1) year after the date of enactment of the CTA.

A reporting company that has been formed or registered before the effective date of the Secretary's regulations must submit to FinCEN a report no later than two (2) years after the effective date of the regulations. A reporting company formed after the effective date of the Secretary's regulations must submit to FinCEN a report at the time of its formation or registration. If there are changes in reported beneficial ownership, a reporting company must file an updated report to FinCEN no later than one (1) year after the date of the change.

At the time an exempt subsidiary or a dormant entity, each as described above, is no longer exempt, it must submit a report to FinCEN.

The CTA also provides that, within one year after the FinCEN regulations are in place, the due diligence requirements on financial institutions to collect beneficial ownership information will be revised to bring those requirements into conformance with the FinCEN regulations, to account for the access of financial institutions to beneficial ownership information under the FinCEN regulations, and to reduce any burdens on financial institutions and their customers that are unnecessary or duplicative.

How is beneficial ownership information retained, disclosed, and protected?

Retention. FinCEN retains beneficial ownership information for each reporting company for not fewer than five (5) years after the date on which the reporting company terminates.

Disclosure. Beneficial ownership information is considered confidential and may not be disclosed by an officer or employee of the United States; an officer or employee of any State, local, or Tribal agency; or an officer or employee of any financial institution or regulatory agency receiving such information.

FinCEN may disclose beneficial ownership information upon receipt of requests from a:

- Federal agency engaged in national security, intelligence, or law enforcement activity, for use in furtherance of such activity; or from a State, local, or Tribal law enforcement agency, if authorized by a court to seek information in a criminal or civil investigation;
- Federal agency on behalf of foreign law enforcement under a treaty, agreement, or convention, or an official request from law enforcement in a trusted foreign country, that is issued in response to a request for assistance in an investigation or prosecution and that either requires compliance with the disclosure and use provisions of the relevant treaty, agreement, or convention, or limits the use of the information for any purpose other than the authorized investigation or national security or intelligence activity;
- Financial institution subject to customer due diligence requirements with the reporting company's consent to facilitate the institution's compliance with customer due diligence requirements; or
- Federal functional regulatory or other appropriate regulatory agency if the agency is authorized by law, the agency uses the information solely as authorized, and the agency enters into an agreement with the Secretary providing appropriate protocols governing the safekeeping of the information.

Generally, beneficial ownership information is accessible for inspection or disclosure to officers or employees of the Department of the Treasury whose official duties require inspection or disclosure, subject to procedures and safeguards prescribed by the Secretary. Such officers and employees may obtain access to beneficial ownership information for tax administration purposes.

Protection. The Secretary must establish regulation protocols to safeguard beneficial ownership information. Among other things, the protocols must:

- Require the agency requesting beneficial ownership information to establish and maintain, to the Secretary's satisfaction, a secure system to store beneficial ownership information;
- Require the requesting agency to provide the Secretary with a report, when the Secretary prescribes, describing the agency's procedures to ensure the confidentiality of the beneficial ownership information;
- Require the requesting agency to limit to the greatest extent practicable the scope of information sought;
- Restrict access to beneficial ownership information only to users at the requesting agency who are directly engaged in the authorized investigation or activity, whose duties or responsibilities require such access, who have undergone appropriate training or use staff to access the database who have undergone appropriate training, who use appropriate identity verification mechanisms to obtain access to the information, and who are authorized by agreement with the Secretary to access such information;
- Require the requesting agency to establish and maintain a permanent system of standardized records with respect to an auditable trail of each request for beneficial ownership information; and
- Require the requesting agency and the Secretary to conduct an annual audit verifying that beneficial ownership information received is accessed and used appropriately.

The Secretary must maintain security protections, including encryption, for information reported to FinCEN consistent with federal standards and guidelines governing information security to prevent the loss of confidentiality, integrity, or availability of information.

Reports filed under the CTA and records of such reports are exempt from disclosure under the Freedom of Information Act ("FOIA"), and may not be disclosed under any State, local, tribal, or territorial "freedom of information," "open government," or similar law. FinCEN will withhold beneficial ownership information pursuant to exemption (b)(3) under FOIA.[1]

What constitutes a violation of the CTA and what are the resulting penalties?

Violations. 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. Except as authorized, it is unlawful for any person to knowingly disclose or knowingly use beneficial ownership information obtained by the person through a report submitted to FinCEN or a disclosure made by FinCEN.

Penalties for Violations.

Reporting Violations. Any person that violates the CTA's reporting requirements (i) shall be liable to the United States for a civil penalty of not more than $500 for each day that the violation continues or has not been remedied; and (ii) may be fined not more than $10,000, imprisoned for not more than two (2) years, or both. However, a person shall not be subject to such civil or criminal penalty if the person submits a report containing corrected information no later than 90 days after the date on which the person submitted the report originally. Such exemption is not available if at the time the person submitted the original report, the person acted for the purpose of evading the CTA's reporting requirements and had actual knowledge that any information contained in the report was inaccurate.

Use/Disclosure Violations. The Secretary may suspend or debar a requesting agency from access to beneficial ownership information for violations of the Secretary's regulation protocols. Any person that knowingly discloses or uses beneficial ownership information except as authorized (i) shall be liable to the United States for a civil penalty of not more than $500 for each day that the violation continues or has not been remedied; and (ii) shall be fined not more than $250,000, or imprisoned for not more than five years, or both; or if such person was doing so while violating another law of the United States or as part of a pattern of any illegal activity involving more than $100,000 in a 12-month period, shall be fined not more than $500,000, imprisoned for not more than 10 years, or both.

We will continue to evaluate the CTA and its effects on potential reporting companies and their beneficial owners in anticipation of further regulation and guidance from the U.S Department of the Treasury.

[1] Under FOIA exemption (b)(3), a statute is exempt from disclosure under FOIA if it establishes particular criteria for withholding or refers to particular types of matters to be withheld. The BSA states that reports filed under the BSA and records of such reports are exempt from disclosure under FOIA, and may not be disclosed under any State, local, tribal, or territorial "freedom of information," "open government," or similar law. The BSA need not specifically refer to paragraph (b)(3) of FOIA because it was enacted before the date of enactment of the OPEN FOIA Act of 2009. Accordingly, beneficial ownership information provided under the CTA, and thus under the BSA, is exempt from disclosure pursuant to paragraph (b)(3) of FOIA. Beneficial ownership information may also be exempt from disclosure under FOIA exemption (b)(1) as information classified to protect national security, (b)(4) as confidential, personal financial information, or (b)(7) as information compiled for law enforcement purposes.

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