MCLE SELF-STUDY ARTICLE

WHAT DO I NEED TO KNOW ABOUT THE CORPORATE TRANSPARENCY ACT?

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I. INTRODUCTION

When I mention the Corporate Transparency Act (CTA) to most people, I tend to garner a lot of blank stares. Acronyms rarely make for exciting cocktail party conversation, especially when they come from the mouth of a tax lawyer. But there is good reason for lawyers to understand the CTA and prepare themselves to explain the law's requirements to their clients: under the CTA, tens of millions of entities will be required to report detailed ownership information to the Treasury Department, possibly as early as next year.

Enacted by Congress in January 2021 as part of the Anti-Money Laundering Act of 2020, the CTA aims to put an end to (or at least significantly curtail) the use of anonymous shell companies in connection with money laundering and other illegal activity. Specifically, the new law directs the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) to create a database of beneficial ownership information that will allow the government to identify the individual owners of all manner of privately held assets. Where will that data come from? Perhaps, it may come from you or your clients.

This article will address some of the most common questions I receive once practitioners realize the importance of the CTA, namely: Who will need to report? What information? When is reporting required? What are the penalties for non-compliance? Who gets access to this treasure trove of information?

II. HOW DID WE GET HERE?

A. International Criticism

For years, the international community has expressed its dismay at the state of financial secrecy laws in the United States. The country's shortcomings were perhaps most famously documented in the Financial Action Task Force's (FATF) 2016 Mutual Evaluation Report ("The Report").[01] FATF, the self-described "global money laundering and terrorist financial watchdog," is an inter-governmental organization with 37 country members and 2 regional organization members, including the United States, Australia, Brazil, Canada, China, France, Germany, India, Japan, Mexico, Russia, Switzerland, the United Kingdom, and the European Union. It further includes as observer organizations, groups such as the International Monetary Fund (IMF), Interpol, the Organization for Economic Cooperation and Development (OECD), various entities within the United Nations, and the World Bank.[02] In other words, FATF's opinions matter.

> What did FATF have to say? In sum:
>
> Lack of timely access to adequate, accurate, and current beneficial ownership (BO) information remains one of the fundamental gaps in the U.S. context. The [National Money Laundering Risk Assessment] identifies examples of legal persons being abused for ML [(money laundering)], in particular, through the use of complex structures to hide ownership. While authorities did provide case examples of successful investigations in these areas, challenges in ensuring timely access to and availability of BO information more generally raises significant concerns, bearing in mind risk and context.[03]

The Report further highlighted the very deficiency at which the CTA is directed, i.e., "the use of complex structures, shell or shelf corporations, other forms of legal entities, and trusts, to obfuscate the source, ownership, and control of illegal proceeds."[04]

Of the 11 categories of effectiveness rated by FATF, the United States received a "Low" (the worst possible rating) in the "Legal persons and arrangements" category. The country received an "NC" (non-compliant, again the lowest possible rating) for compliance in the area of "Transparency & BO of legal persons."[05]

In part, this state of affairs was made possible by the decentralized way in which business entities—corporations, limited liability companies (LLCs), limited partnerships, and the like—are formed in the United States. Rather than having a single authority or nationally standardized process for entity formation, each state has developed its own rules, own processes, and own tolerance for secrecy. States such as Delaware, Nevada, and Wyoming have long been famous for permitting the formation of business entities with little to no disclosure of the identity of the beneficial owners; i.e., those individuals who exercise ultimate ownership or control over the enterprise.[06] If you have ever tried to figure out the names of the people at the top of an endless chain of LLCs and turned up empty-handed, you will understand the need for the CTA.

Even states that historically required more robust disclosures of beneficial ownership information were not exempt from FATF's criticism, however:

> The ability of the U.S. to use the States' formation processes as a means of ... timely access to accurate and adequate BO information is significantly impeded, because the *States do not verify the information they collect on legal persons*. The States consider their role in company formation to be administrative in nature without any control function. In keeping with the States' views on [money laundering/terrorist financing] risk generally, States do not consider that they have a significant AML/CFT [(anti-money laundering/counter-terrorist financing)] role during the company formation/registration process.[07]

Lastly, FATF expressed frustration about the lack of "meaningful sanctions" imposed for non-compliance with state-level reporting requirements and the absence of AML/CFT obligations imposed on the lawyers, accountants, company formation agents, and/or trustees who are involved in an entity's formation.[08]

FATF has not been alone in its criticism. The Tax Justice Network's 2018 and 2020 Financial Secrecy Index ranked the United States second among the countries "most complicit in helping individuals hide their finances from the rule of law." By 2022, the United States had achieved the not-so-coveted top spot on the list, besting the notable secrecy jurisdictions of Switzerland (#2), Singapore (#3), Hong Kong (#4), and Luxembourg (#5).[09]

Similarly, Transparency International, a global organization with chapters in more than 100 countries, issued a report in 2015 concluding that "[t]he US lacks an adequate definition of beneficial ownership and anti-money laundering laws have key loopholes."[10] In that same year, the United States scored 76 points (out of 100) on the organization's Corruption Perceptions Index, ranking the country number 16 out of 168 (with 1 being best).[11] Six years later, on the 2021 index, the United States had sunk to number 27 out of 180, with a score of 67, putting it in the same corruption level band as the United Arab Emirates, Bhutan, Taiwan, the Bahamas, Qatar, and South Korea.[12]

B. The U.S. Response

It would be unfair to paint the United States as sitting idly by as international critiques piled up. On numerous occasions, beginning as early as 2008, Congress considered some version of the CTA, but lacked the necessary political power to turn any of the proposals into law.[13] Most recently, Congresswoman Carolyn Maloney introduced the Corporate Transparency Act of 2019,[14] forming the basis for the CTA that was enacted in January 2021. Fatefully, the framework proposed by Congresswoman Maloney was eventually included in the National Defense Authorization Act for Fiscal Year 2021 (NDAA) as part of the broader Anti-Money Laundering Act of 2020. Following its passage in the House (in July 2020) and the Senate (in November 2020), the NDAA was presented to the President on December 11, 2020. Twelve days later, the NDAA—including the long-awaited CTA—was vetoed.[15]

While its inclusion in the NDAA worked against the CTA on its journey to the President's desk, advocates of greater corporate transparency were quickly rewarded after both the House (in a 322-87 vote) and Senate (in an 81-13 vote) garnered the two-thirds majority necessary to override the President's veto.[16] Finally, on January 1, 2021, the CTA became law.[17]

Congress made its intent regarding the CTA abundantly clear in the "sense of Congress" included in section 6402 of the NDAA, noting:

- "more than 2,000,000 corporations and limited liability companies are being formed under the laws of the States each year."[18]
- "most or all States do not require information about the beneficial owners of the corporations, limited liability companies, or other similar entities...."[19]
- "malign actors seek to conceal their ownership of [such] entities in the United States to facilitate illicit activity...."[20]

- "money launderers and others ... intentionally conduct transactions through corporate structures in order to evade detection ...."[21]
- "Federal legislation providing for the collection of beneficial ownership information for ... entities formed under the law of the States is needed to— (A) set a clear, Federal standard for incorporation practices; ... (E) bring the United States into compliance with international anti-money laundering and countering the financing of terrorism standards."[22]

Sound familiar?

C. Implementing Regulations

Codified at 31 USC, section 5336, the CTA provides the conceptual framework for the development of a national database of beneficial ownership information to be maintained by FinCEN. It begins by defining a series of key terms, most notably "beneficial owner," "applicant" and "reporting company," and proceeds to describe the information required to be reported to FinCEN and the required timing of such reporting.[23] The remainder of the statute is largely devoted to answering two questions of significant concern to those who will be required to report: who may access the database and for what reasons, and what are the penalties for non-compliance with this new set of complex reporting rules?[24] While the statute provides high-level guidance, it is purposefully fuzzy on the details of implementation.

It is therefore unsurprising that the CTA contains dozens of references to regulations to be promulgated by the Treasury Department to build out this new reporting regime. Congress was not vague when it came to its expectations of the Treasury Department with respect to this exercise. In promulgating the regulations that govern the procedures and standards for reporting under the CTA, Congress specifically directed Treasury to:

> (i) minimize burdens on reporting companies associated with the collection of beneficial ownership information, including by eliminating duplicative requirements; and (ii) ensure the beneficial ownership information reported to FinCEN is accurate, complete and highly useful.[25]

Conscious of the burdens that the law will place on companies without the resources of large corporations, Congress also specifically directed FinCEN to "reach out to members of the small business community and other appropriate parties to ensure efficiency and effectiveness of the process for the entities subject to the requirements of the CTA."[26] All of this was to be achieved no later than January 1, 2022.[27]

Just under the wire, FinCEN issued a Notice of Proposed Rulemaking (NPRM) on December 8, 2021, addressing "Beneficial Ownership Information Reporting Requirements," with comments requested by February 7, 2022.[28] After considering the comments submitted, final regulations were transmitted to the Office of Information and Regulatory Affairs (OIRA) on August 30, 2022.[29] As the final regulations have not yet been reviewed by OIRA or released to the public, the remainder of this article will discuss the CTA and the proposed regulations in the NPRM.

III. WHO MUST REPORT?

If you have read this far, you are no doubt wondering who, in fact, is required to report information to FinCEN in order to populate this new beneficial ownership database. The statute itself is the best place to start.[30]

Section 5336 (a)(11) defines—at length—who is (and is not) included in the expansive definition of "reporting company." Broadly, the term encompasses any corporation, LLC or "other similar entity" created by filing a document with a State[31] or Indian Tribe or formed in a foreign jurisdiction and registered to do business in the United States through the filing of a document with a State or Indian Tribe.[32] The proposed regulations refer to the former category as "domestic reporting companies" and the latter as "foreign reporting companies."[33]

Depending on your (or, rather, FinCEN's) interpretation of "similar entity," the term "reporting company" could encompass almost every business operating in the United States.[34] But of course, there are exceptions, and they are numerous. The CTA provides 24 categories of entities that are exempt from the beneficial ownership reporting requirements. Most of the categories are obvious, as they are comprised of entities already subject to substantial Federal or state regulation. These include:

- Banks, Federal or state credit unions, and bank or savings and loan holding companies[35]
- Entities registered with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 or with the Commodity Futures Trading Commission (CFTC) under the Commodity Exchange Act, including –
    - Issuers of publicly traded securities
    - Broker-dealers
    - Exchange or clearing agencies
    - Retail foreign exchange dealers

- Those dealing in futures, swaps and commodities[36]

- Investment companies and investment advisors[37]
- Certain pooled investment vehicles[38]
- Money transmitting businesses registered with FinCEN[39]
- Insurance companies and producers[40]
- Public accounting firms[41]
- Financial market utilities[42]
- Entities that exercise governmental authority on behalf of the United States, a state, Indian Tribe, or political subdivision thereof[43]
- Public utilities[44]
- Tax exempt entities and assisting organizations[45]

Another category sweeps in entities owned or controlled by one of the above.[46]

Yet others fall into what I think of as the "not a good use of my time" bucket. Those include:

- Domestic entities that are, in effect, defunct (i.e., no longer engaged in business, not foreign owned, essentially no assets or activities)[47]
- Entities with respect to which collecting beneficial ownership information "would not serve the public interest"
- Entities with respect to which collecting beneficial ownership information "would not be highly useful" for detecting, preventing, or prosecuting money laundering, terrorist financing, proliferation finance, serious tax fraud, or other crime

The latter two categories of entities must be identified in regulations promulgated by the Treasury Department with the written concurrence of the Attorney General and Homeland Security Secretary.[48] Unsurprisingly, the proposed regulations do not identify any entities for either of those categories.[49]

The most interesting exemption, however, is for specified large operating companies. These companies are defined in the statute as entities that: (i) have more than 20 full-time employees in the United States; (ii) reported more than $5 million in sales or gross receipts on their previous year's tax return; and (iii) have a physical office with an *operating presence* in the United States.[50]

Are you unclear about what constitutes an "operating presence"? So, too, was FinCEN, which defined the term in the proposed regulations as follows:

> The term "has an operating presence at a physical office within the United States" means that an entity [i] regularly conducts its business, [2] at a physical location in the United States, [3] that the entity owns or leases, [4] that is not the place of residence of any individual, and [5] that is physically distinct from the place of business of any other unaffiliated entity.[51]

It does not take long to dream up a list of businesses that—although they might otherwise appear to be large operating companies—will not qualify for the exemption. Jane owns a thriving IT consulting business that she runs from her home office in New York; all her 50 employees work remotely from their homes or at client sites across the metro area. Requirements 3, 4, and 5, above, would likely not be satisfied. Joe has built a large fleet of taco trucks that serve office parks across suburban Chicago; his 40 employees show up at Joe's home every morning to load up their trucks (which they park at their homes overnight) and then head out to wherever hungry office workers spend their days. Does the company even have an actual physical location? If so, it is not one that is owned or leased by the company or that is not also a place of residence. Thomas owns a large dance studio that is physically located in Dallas; he has a staff of 30 employees who teach ballet, tap, and jazz to children and adults, primarily early mornings, at night and on weekends. As a service to the neighborhood, he lets a local arts non-profit use the studio to operate a gallery that is open from 10-4 Monday through Friday. There goes requirement 5. In the post-COVID era, is a physical, non-residential, solely owned/leased and occupied business location increasingly a thing of the past? Does that fact increase the risk of money laundering for the businesses described above as compared to a standard brick and mortar?

IV. WHAT MUST BE REPORTED?

Now that we understand the entities subject to reporting under the CTA, the next logical question is: what do they have to report? Here again, the CTA itself is the best place to start.

A. Information to be Reported

The categories of information required to be reported to FinCEN are deceptively simple. For the vast majority of reporting entities, the following will need to be reported for all "beneficial owners" and "applicants" (each of which must be a natural person):

- Full legal name
- Date of birth

- Current residential or business *street* address (i.e., no P.O. Boxes)
- ID number from an "acceptable identification document" or FinCEN identifier[52]

The statute provides a range of options to satisfy the identification document requirement, including an unexpired U.S. passport, an unexpired U.S. driver's license or other state-issued ID, or—if the individual does not have any of the above—an unexpired foreign passport.[53] A person who feels squeamish about handing over one of their sensitive ID numbers to a reporting company can instead opt to have FinCEN directly issue them a unique FinCEN identifier that can be used in lieu of one of the above-listed acceptable identification documents.[54]

But what if one of the part-owners of a reporting company is an entity that is among the two dozen categories of entities exempted from reporting its beneficial owners? Does it need to reveal its beneficial owners to the reporting company so the reporting company can include those individuals in its own reporting to FinCEN? In a word, no. The reporting company need only report the exempt entity's name. It need not report further up the ownership chain.[55]

To illustrate the above, suppose ABC Co. is an insurance company, and therefore is exempt from reporting to FinCEN under the CTA. ABC Co. passively owns a 30% interest in an unrelated business, DEF LLC. DEF LLC is required to report under the CTA. As it reviews its list of owners, DEF LLC reaches out to each non-individual stockholder and asks for a list of the stockholding entities' beneficial owners (who, remember, must all be natural persons) so that it can include the names, dates of birth, addresses and ID numbers of each person in its submission. ABC Co. receives DEF LLC's request and responds with "No way, we don't need to report this stuff to FinCEN, so we're certainly not giving it to you to do so!" Aside from that not being a very nice way to speak to your business partners, ABC Co. is right. All DEF LLC needs to report to FinCEN with respect to ABC Co. is ABC Co.'s name.

Easy peasy, right?

Just to keep things interesting, the proposed regulations add a few more twists to the information FinCEN expects reporting companies to include in their initial report. Specifically, the proposed regulations require the following additional information regarding the reporting company itself:

- Full legal name, as well as any trade names or "DBAs"
- Business street address
- State or Indian Tribe in which the entity was formed or registered to do business
- Internal Revenue Service (IRS)-issued Employer Identification Number (EIN) or Taxpayer Identification Number (TIN)
    - If no TIN or EIN has been issued, either the entity's Dun & Bradstreet Universal Numbering System (DUNS) number or Legal Entity Identifier (LEI)[56]

For beneficial owners and applicants, in addition to the ID number required in the statute, the proposed regulations also require an *image* of the relevant identification document showing both the ID number and a photograph of the individual.[57] And the proposed regulations clarify that the street address provided for beneficial owners must be the owner's residential address that is used for tax residency purposes. Applicants, in contrast, may use their business street address.[58]

B. Whose Information Must be Reported

Speaking of beneficial owners and applicants, who exactly are these people anyway? Let's turn back to the statute.

1. Applicants

The "applicant" (or "company applicant," to which they are referred in the proposed regulations) is simply the person who either files the application to form a domestic entity with the state or Indian Tribe or registers a foreign entity to do business in the United States with a state or Indian Tribe.[59] The very act of doing either of these administrative tasks renders a person reportable under the CTA. Practice pointer: if you occasionally do either of these things for clients, you might want to make sure your passport or driver's license is up to date.

As usual, the proposed regulations put a slight gloss on the definition of "applicant." In addition to the individuals named in the statute, the proposed regulations also include anyone who "directs or controls the filing of such document by another person."[60] In other words, it is not the courier service whose name and photo needs to be submitted, but that of the person who prepared and signed the documents and sent the courier to the clerk's office.

2. Beneficial Owners

If only the definition of "beneficial owner" were as clear. The statute starts out simply enough. A beneficial owner is anyone who: (i) exercises *substantial control* over the entity; or (ii) owns or controls at least 25% of the entity's ownership interests.[61] The beneficial owner must do so "directly or indirectly," or "through any contract,

arrangement, understanding, relationship *or otherwise*."[62] The proposed regulations attempt, but ultimately do little, to clarify these vague terms. In some ways, they make things much, much worse.

Under the proposed regulations, the term "substantial control" is defined to include (but certainly not be limited to):

- Serving as a senior officer of the reporting company (e.g., president, secretary, treasurer, CEO, COO, CFO, or general counsel)
- Having authority over the appointment or removal of any senior officer or of a majority (or dominant minority!) of the board of directors
- Being in a position to direct, determine, decide or exercise substantial influence over "important matters affecting the reporting company" such as—
    - Amendments of governance documents, such as the articles of incorporation, bylaws, and significant policies and procedures
    - The nature and scope of the entity's business or selection or termination of business lines or areas of geographic focus
    - The reorganization, dissolution or merger of the entity
    - The sale, lease, mortgage or transfer of the entity's "principal assets"
    - The approval of the entity's operating budget
    - Major expenditures or investments
    - Agreement to or termination of significant contracts
    - Compensation and incentives for senior officers[63]

"Substantial control" also includes—and here I promise I am not joking—"[a]ny other form of substantial control over the reporting company."[64] The definition has swallowed itself whole.

And yet, it gets worse. The proposed regulations also provide a definition of "direct or indirect exercise of substantial control" that potentially sweeps even more people into the giant tent that is beneficial ownership. They include individuals whose control arises through board representation, through rights associated with a financing arrangement, or through "arrangements or financial or business relationships, whether formal or informal, with other individuals or entities acting as nominees."[65] I am honestly not sure whether I know what that last category means. Note, too, that an individual need not actually exercise any of this broadly defined substantial control to qualify as a beneficial owner. It is enough to simply have the right or ability to do so.[66]

If you thought the second half of the beneficial ownership definition—ownership or control of at least 25% of the entity's ownership interests—would be simple, you would be wrong. The proposed regulations provide five categories of interests that could potentially qualify as an "ownership interest," ranging from the obvious to the arcane:

- Equity, stock, and similar instruments, including both voting and non-voting shares
- Any capital or profit interest, including limited and general partnership interests
- Any proprietorship interest
- Any instrument convertible into any of the above, including any future, warrant or convertible debt
- Any put, call, straddle, or other option on any of the above[67]

Of course, any of these interests will qualify the owner for beneficial owner status, whether held *directly or indirectly*, a term that here includes joint ownership of an undivided interest; "control" of an ownership interest owned by someone else; and, in some cases, as a grantor, settlor, trustee, or beneficiary of a trust that holds an ownership interest.[68]

There are precious few exceptions to the broad definition of beneficial owner to be found in the proposed regulations. They include: children (but only if their parent or legal guardian reports in their place); those who simply act as a nominee, intermediary, custodian, or agent of another person; heirs whose only rights are through a future inheritance; and creditors whose only rights are to payment of principal and interest (i.e., those who have no conversion rights). The proposed regulations also provide some relief for non-senior officer employees whose control originates solely from their status as employees. Such employees will not be considered beneficial owners of their employer unless they check some other beneficial ownership box.[69]

V. WHEN MUST INFORMATION BE REPORTED?

While the actual data that must be reported under the CTA is not terribly burdensome, the time and effort required to, first, identify each and every individual who may qualify as a beneficial owner and, second, obtain the required information from each person can very quickly add up. When I advise clients to start thinking about their reporting obligations now, they often think I am crazy given that the final regulations have not even been released. Assuming they contain definitions of beneficial ownership that are similar to the proposed regulations, however, there truly is no time to waste.

Under the proposed regulations, entities in existence (or registered to do business in the United States) on the effective date of the final reporting regulations will have one year from such date to file their initial report.[70] New entities will have a mere *14 calendar days* from their date of formation or registering to do business in the United States to file with FinCEN.[71]

Unlike tax returns or annual state filings, there is no periodic CTA filing requirement. Instead, reporting companies are expected to constantly monitor the accuracy of the information reported to FinCEN and, under the proposed regulations, report any changes (including the failure to continue to qualify for a reporting exemption) within 30 calendar days.[72] The effect of this short timeframe is to effectively convert CTA reporting into a monthly obligation. Notably, Congress would have been comfortable with the equivalent of an annual report requirement, as the statute requires that changes be reported to FinCEN no later than *one year* after their occurrence.[73] Imposing an annual filing requirement for all entities subject to the CTA would accomplish that goal. Given that seven of the twelve months of the year contain 31 days, not even a monthly filing obligation would completely satisfy FinCEN's more stringent requirement.

FinCEN's choice to require the reporting of changes within 30 days seems especially harsh in light of the broad and often vague definitions in the proposed regulations. The process of analyzing each of the significant number of permutations of what constitutes beneficial ownership alone could take days. Collecting personal data from each qualifying person is itself no small feat. If FinCEN truly expects reporting companies to report even the most minor of changes within 30 days, it should reconsider the breadth of the definitions it employs.

Congress took pains in the CTA to direct the Treasury Department to "minimize burdens on reporting companies associated with the collection of the information [required under the CTA] in light of the private compliance costs placed on legitimate businesses."[74] In this author's opinion, FinCEN has failed on that front.

One last note on reporting: Congress directed the Department of Treasury to "take reasonable steps to provide notice to persons of their obligations to report beneficial ownership information ... including by causing appropriate informational materials describing such obligations to be included in ... forms or other informational materials regularly distributed by the Internal Revenue Service and FinCEN."[75] As a tax lawyer who regularly accesses IRS and FinCEN forms and other materials, I have yet to see any such guidance. With the impending release of the final regulations and the currently proposed 14-day reporting deadline for newly-formed or registered entities, Treasury should move quickly to begin this important education process.

VI. PENALTIES FOR NON-COMPLIANCE

Virtually every federal agency uses penalties or fines to encourage voluntary compliance with rules and regulations. The Department of Treasury, and FinCEN in particular, is no different. The CTA imposes penalties for both failing to provide FinCEN with the information required under the CTA, as well as providing false or fraudulent information.[76] In both cases, the conduct must be *willful*, i.e., the voluntary, intentional violation of a known legal duty.[77] The government may impose a civil penalty of up to $500 per day of violation and/or a criminal fine of up to $10,000 and/or up to 2 years in jail.[78]

The statute provides a safe harbor for individuals who inadvertently report erroneous information to FinCEN. So long as such individuals voluntarily submit a corrected report within 90 days of the original filing (and, pursuant to the proposed regulations, within 14 days of discovering the inaccuracy) no penalty will be imposed.[79] In light of the willful standard incorporated in the penalty provisions, it is unclear why this safe harbor is necessary, however, as it only applies to individuals who did not have actual knowledge that they were violating the law. Under both the statute and the proposed regulations, no penalties would appear to apply in such cases in any event.

Never missing a chance to infuse additional complexity, the proposed regulations add one significant nuance to the categories of persons potentially subject to penalties under the CTA. In addition to persons (which, the proposed regulations note, could include individuals, reporting companies or other entities)[80] who knowingly fail to report or intentionally misreport information to FinCEN, the regulations add to the list of potential violators those who willfully provide false or fraudulent information *to another person* for the purposes of inclusion in a report to FinCEN and those who are in substantial control of a reporting company when the company fails to report to FinCEN.[81] This latter expansion should send chills up the spines of every senior officer and board member of a potential reporting company.

In April 2022, I took part in a panel discussion about the CTA and FinCEN's proposed regulations that included three other attorneys in private practice and a FinCEN section chief.[82] The biggest concern I raised then—and still have today—is that the government will turn its enforcement efforts on good actors who are trying their best to comply with an exceedingly complex set of new reporting rules, while the bad actors will flout the reporting requirements altogether and may never be caught. My request then (and

now) is that FinCEN bear this in mind when deciding on its CTA enforcement priorities and exercise leniency when presented with companies who were demonstrably trying to do the right thing.

VII. PERMITTED USES OF INFORMATION

Once FinCEN acquires this large volume of beneficial ownership information, what exactly is the agency going to do with it? Who gets to look at all this sensitive data? And for what purposes?

A. In General

Here is where the current proposed regulations cease to provide us with further guidance. While FinCEN has indicated that it is working on a second tranche of regulations that will address "access to and disclosure of beneficial ownership information," such regulations have not yet been proposed.[83]

Helpfully, the statute provides a list of entities to which FinCEN is permitted to release information from the CTA database, *but only for the stated purposes*, including:

- Federal agencies engaged in national security, intelligence or law enforcement activities, *for national security, intelligence or law enforcement purposes*
- State, local, or Tribal law enforcement agencies, but only if authorized by a court *in connection with a criminal or civil investigation*
- Foreign law enforcement agencies, prosecutors or judges, if requested (i) through a U.S. Federal agency under an international agreement, or (ii) directly by a "trusted" foreign country when no applicable international agreement exists *in connection with an investigation or prosecution by such foreign country*
- Financial institutions subject to customer due diligence requirements, only with the consent of the reporting company, *for the purposes of complying with such requirements.*[84]

Notably, information may not be disclosed to any of the above unless requested, meaning FinCEN does not appear to have the ability to send data to another federal agency on its own accord. Requests for data must be made "through appropriate protocols," to be expanded upon in the forthcoming proposed regulations.[85] FinCEN may deny any data request for failure to comply with the established protocols, if FinCEN believes the data is being requested for an "unlawful purpose," or—broadly—for "other good cause."[86]

B. "Tax Administration Purposes"

One additional authorized disclosure is notable for its breadth, especially to tax, trusts, and estates professionals:

> Officers and employees of the Department of Treasury may obtain access to beneficial ownership information *for tax administration purposes*[87]

This disclosure—reasonably read to include employees of the IRS—is not located in the same part of the statute as the list of disclosures discussed above. As such, it does not appear to be as narrowly curtailed as the other permitted disclosures in terms of requiring a request through specific protocols.[88] Instead, such disclosures must only be "subject to procedures and safeguards" to be described in future regulations.[89]

Taxpayers and tax advisors alike should be anxious to see what the second tranche of FinCEN regulations will say about this permitted disclosure, and what, exactly, "tax administration purposes" includes. There should be no doubt that IRS-CI, the agency's criminal investigation division, will find the information in the CTA database useful to their work, which frequently involves counterterrorism, money laundering, and other financial crimes. Indeed, IRS-CI is the largest user of Bank Secrecy Act data currently and would likely qualify under both the law enforcement and Treasury employee disclosure categories.[90]

But what about civil enforcement? In the recent past, we have seen the IRS attempt to use data reported by foreign financial institutions under the Foreign Account Tax Compliance Act (FATCA) to enforce civil reporting requirements. During the pandemic, the IRS sent out what appeared to be (at least) thousands of letters to taxpayers alerting them of their responsibility to file Form 8938, Statement of Specified Foreign Financial Assets, with respect to assets listed on an attachment to the letter. The IRS told recipients of the letter that they had neglected to file Form 8938 for those assets and that they could be subject to stiff penalties for non-compliance. The problem: many of the recipients of the letter *had* filed Form 8938 and *had* reported the assets listed on the letter. The agency's matching algorithm appeared to be significantly flawed.[91]

Could the IRS attempt to perform a similar exercise with respect to the CTA database? If so, the sweeping definitions of "beneficial ownership," "substantial control," and "ownership interest" could pose a significant problem, as the CTA database could reasonably include individuals so far detached from the entity that they would have no possible reporting obligations other than to FinCEN. And it remains to be seen whether the FinCEN reporting form will require reporting companies to identify the specific capacity of

each named individual or the definition of "beneficial owner" or "applicant" that triggered their reporting. Without that kind of detail, the IRS would not be able to distinguish an owner from a convertible note holder from the company's HR director who sets senior officer salaries.

There are, however, a number of civil enforcement efforts that could, potentially, be assisted through access to the data in the CTA database. For example, the IRS's Global High Wealth Group, better known as the "Wealth Squad," focuses on high-net-worth taxpayers whose financial affairs often involve multiples entities (many of which are privately held), complex structures, and foreign financial assets. In conducting its audits, the Wealth Squad will generally examine all entities affiliated with the subject individual, including corporations, LLCs, partnerships, trusts, and even their non-profit foundations, pulling in IRS subject-matter experts from across the agency to assist.[92] Currently, these auditors must try to trace affiliation and ownership through tax returns or publicly available information. In the future, much of that information could be available using a simple name search in the CTA database.

Lastly, to the extent that "tax administration" includes collections, the IRS could attempt to use the CTA database to locate assets to satisfy outstanding tax debts. Here, again, the breadth of the definitions involved could make this an unwieldy process, with Revenue Agents contacting numerous individuals with no possible liability for a company's tax liabilities. Given the staggering amount of uncollected taxes—potentially as high as $600 billion this year alone—this extra effort may be worth it to collect even a fraction of the liabilities that are currently known to the IRS.[93]

One final note on data collection and access: FinCEN is required by statute to retain the information submitted for as long as the reporting company exists, plus a minimum of five additional years. There is no directive, however, regarding when data *must* be purged.[94] While this might pose a nightmare scenario for those concerned about data security (which, frankly, should be all of us), it could be excellent news for the IRS, which frequently finds itself examining facts and events from many years ago.[95]

VIII. OTHER PROVISIONS

A. Bearer Shares

The CTA's efforts to crackdown on money laundering and terrorist financing are not limited to the establishment of a beneficial ownership database. Buried toward the end of the Act is section 5336(f), which quietly and without fanfare formally eliminated the use of bearer shares in the United States: "A corporation, limited liability company, or other similar entity formed under the laws of a State or Indian Tribe may not issue a certificate in bearer form evidencing either a whole or fractional interest in the entity."[96]

A bearer share is a security that—instead of being registered to a specific owner in the issuer's books and records—is owned by whoever holds the physical stock certificate.[97] In that sense, bearer shares function much like cash: generally, no one knows who holds a specific share/piece of currency at any given time, there is no trail documenting the chain of ownership, and possession (and therefore ownership) of the asset is easily accomplished without documentation or recording. The anonymity provided by the use of bearer shares (like cash) has made them prime candidates for money laundering. While most countries (and many individual U.S. states[98]) had already abolished the use of bearer shares, the United States had yet to do so on a national level.[99]

B. State Coordination and Education

While the majority of the obligations under the CTA are targeted at FinCEN, the statute also requires the secretary of state or similar office of each state and Indian Tribe to assist with educating the public regarding the filing obligations under the CTA. Specifically, each such office must update its website, incorporation forms, and "physical premises" to alert potential reporting companies of their obligations under the CTA, including providing a link to the CTA reporting form to be developed by FinCEN.[100] The statute further requires "periodic" reminders—for example, at the time of initial formation, upon assessment of an annual fee, or renewal of a license—to potential filers in the form of a link to or copy of the CTA reporting form.[101] All of these notifications must "explicitly state" that they are being made on behalf of the Treasury Department "for the purpose of preventing money laundering, the financing of terrorism, proliferation financing, serious tax fraud, and other financial crime."[102] These gentle reminders must be put in place no later than two years following the promulgation of the reporting regulations.[103]

IX. WHAT'S NEXT?

As noted earlier, the final version of FinCEN's first tranche of regulations regarding who must report and what information must be reported were submitted to OIRA for final approval on August 30, 2022. Given the vast number of comments received by FinCEN in response to the NPRM, it is anyone's guess what changes may have been incorporated into the final regulations.[104]

We also continue to await the remaining two tranches of proposed rulemaking under the CTA. The first will address protocols for the retention, disclosure, and security

of the information stored in the beneficial ownership database. FinCEN has had initial comments on these topics for well over a year now, as its April 2021 advanced notice of proposed rulemaking (ANPRM) identified 48 questions, many with numerous subparts, on which FinCEN was seeking comprehensive guidance related to CTA rulemaking.[105] The questions posed in the ANPRM related not just to the reporting regulations, but also to the second tranche of required rulemaking on access and disclosure. In February of this year, FinCEN indicated that they anticipated publishing the second round of proposed regulations "later this year."[106] As of the time of writing this article, those proposed regulations have yet to be released.

The third and final tranche of regulations will revise the existing customer due diligence rules currently imposed on financial institutions. The CTA requires the agency to finalize these revisions no later than one year after the effective date of the reporting regulations, which could be any day now.[107]

X. CONCLUSION

A beloved mentor of mine once described lawyers—and, in particular, tax controversy lawyers like she and I—as highly skilled in the art of catastrophic thinking. I take some pride in that but am also cognizant of the fact that it makes me a Class A Skeptic. I sincerely applaud Congress for finally bringing the United States into the 21st Century in terms of anti-money laundering laws, and I do not envy FinCEN's task of having to not only implement the new reporting regime but also define its parameters through regulations. That job is not easy.

But (and there is always a "but" with us skeptics), I have concerns. I worry that the ultra-broad definitions FinCEN felt compelled to use in the proposed regulations to close potential loopholes will result in a database that is so large and full of over-reporting that it becomes unwieldy and useless. I worry that the bar for compliance is so high that innocent actors trying to interpret the complex reporting rules will find themselves running afoul of the law for missing an aggressive due date. I worry that all the while the bad actors—the ones the CTA was aimed at shutting down—will have simply taken their money and schemes elsewhere (literally or figuratively) to avoid having to report. Or they simply will not report at all because they do not believe anyone will catch them.

In a rare act of defiant hope, I also contemplate a world where one of the planet's largest economies is no longer open for business to those who desire anonymity. With the impending creation of FinCEN's beneficial ownership database and the reporting obligations that come with it, it will not be long before we find out which of these visions is right.

* *Caplin & Drysdale, Chartered, Washington, DC*

01 Financial Action Task Force, *Anti-money laundering and counter-terrorist financing measures - United States, Fourth Round Mutual Evaluation Report* (2016) <www.fatf-gafi.org/publications/mutualevaluations/documents/mer-united-states-2016.html> (as of Oct. 20, 2022) (hereafter "2016 FATF MER").

02 Financial Action Task Force, *Members and Observers* (2022) <http://www.fatf-gafi.org/about/membersandobservers/> (as of Oct. 20, 2022).

03 2016 FATF MER, *supra*, at p. 4.

04 2016 FATF MER, *supra*, at p. 4.

05 2016 FATF MER, *supra*, at p. 4.

06 See, e.g., Diaz-Struck & Gallego, *Beyond Panama: Unlocking the world's secrecy jurisdictions* (May 9, 2016) Int'l Consortium Investigative Journalists < https://www.icij.org/investigations/panama-papers/20160509-beyond-panama-secrecy-jurisdictions> (as of Oct. 20, 2022).

07 2016 FATF MER, *supra*, at p. 153 (emphasis added).

08 2016 FATF MER, *supra*, at pp. 154-55.

09 Tax Justice Network, *Country Detail—Financial Secrecy Index* (2018) <https://fsi.taxjustice.net/country-detail/#country=US&period=18> (as of Oct. 20, 2022); Tax Justice Network, *Country Detail—Financial Secrecy Index* (2020) <https://fsi.taxjustice.net/country-detail/#country=US&period=20> (as of Oct. 20, 2022); Tax Justice Network, *Financial Secrecy Index 2022* (2022) <https://fsi.taxjustice.net> (as of Oct. 20, 2022).

10 Transparency International, *United States Beneficial Ownership Transparency* (2015) < https://www.transparency.org/files/content/publication/2015_BOCountryReport_US.pdf> (as of Oct. 20, 2022).

11 Transparency International, *Corruption Perceptions Index* (2015) <https://www.transparency.org/en/cpi/2015> (as of Oct. 20, 2022).

12 Transparency International, *Corruption Perceptions Index 2021* (2022) at p.2 <https://images.transparencycdn.org/images/CPI2021_Report_EN-web.pdf> (as of Oct. 20, 2022).

13 For an excellent summary of the various legislative efforts, see Downeset al. *The Corporate Transparency Act – Preparing for the Federal Database of Beneficial Ownership Information* (April 16, 2021) Bus. L. Today <https://businesslawtoday.org/2021/04/corporate-transparency-act-preparing-federal-database-beneficial-ownership-information/#_ftnref3> (as of Oct. 20, 2022).

14 H.R. 2513, 116th Cong., 1st Sess.

15 H.R. 6395, 116th Cong., 1st Sess. <https://www.congress.gov/bill/116th-congress/house-bill/6395/actions> (as of Oct. 20, 2022).

16 H.R. 6395, 116th Cong., 1st Sess. <https://www.congress.gov/bill/116th-congress/house-bill/6395/actions> (as of Oct. 20, 2022).

17 Pub.L. No. 116-283, sections 6401-03 (Jan. 1, 2021), codified as 31 USC, section 5336.

18 Pub.L. No. 116-283, section 6402(1).

19 Pub.L. No. 116-283, section 6402(2).

20 Pub.L. No. 116-283, section 6402(3).

21 Pub.L. No. 116-283, section 6402(4).

22 Pub.L. No. 116-283, section 6402(5).

23 31 USC, section 5336(a)-(b).

24 31 USC, section 5336(c), (h).

25 31 USC, section 5336(b)(4)(B).

26 31 USC, section 5336(g).

27 31 USC, section 5336(b)(5).

28 86 Fed. Reg. 69920 (hereafter "NPRM") (the proposed regulations included in the NPRM are hereafter cited as "proposed 31 CFR 1010.380").

29 Pending Exec. Order No. 12866 <https://www.reginfo.gov/public/do/eoDetails?rrid=262863> (as of Oct. 20, 2022).

30 The proposed regulations repeat the definitions used in the statute virtually verbatim; compare 31 USC, section 5336(a)(11) with proposed 31 CFR section 1010.380(c).

31 As in many other Federal statutes, the word "state" is defined in the CTA to include the 50 states of the United States, the District of Columbia, Puerto Rico, Guam, American Samoa, the Northern Mariana Islands, the U.S. Virgin Islands and any other commonwealth, territory, or possession of the United States (31 USC, section 5336(a)(12)).

32 31 USC, section 5336(a)(11)(A). The term "Indian Tribe" is further defined by the statute to include those included on the Federally Recognized Indian Tribe List (31 USC, section 5336(a)(8)). For the current listing, see 87 Fed. Reg. 4636.

33 Proposed 31 CFR section 1010.380(c).

34 "In general, FinCEN believes the proposed definition of domestic reporting company would likely include limited liability partnerships, limited liability limited partnerships, business trusts (a/k/a statutory trusts or Massachusetts trusts), and most limited partnerships, in addition to corporations and limited liability companies (LLCs), because such entities appear typically to be created by a filing with a secretary of state or similar office." NPRM at 69938-39.

35 31 USC, section 5336(a)(11)(B)(iii)-(v).

36 31 USC, section 5336(a)(11)(B)(i), (vii)-(ix), (xiv).

37 31 USC, section 5336(a)(11)(B)(x)-(xi).

38 31 USC, section 5336(a)(11)(B)(xviii).

39 31 USC, section 5336(a)(11)(B)(vi).

40 31 USC, section 5336(a)(11)(B)(xii)-(xiii).

41 31 USC, section 5336(a)(11)(B)(xv).

42 31 USC, section 5336(a)(11)(B)(xvii).

43 31 USC, section 5336(a)(11)(B)(ii).

44 31 USC, section 5336(a)(11)(B)(xvi).

45 31 USC, section 5336(a)(11)(B)(xix)-(xx).

46 31 USC, section 5336(a)(11)(B)(xxii). The exception to this exception is that it does not apply to entities owned or controlled by money transmitters (31 USC, section 5336(a)(11)(B)(vi)), pooled investment vehicles (31 USC, section 5336(a)(11)(B)(xviii)), or entities that assist tax-exempt entities (31 USC, section 5336(a)(11)(B)(xx)).

47 31 USC, section 5336(a)(11)(B)(xxiii).

48 31 USC, section 5336(a)(11)(B)(xxiv).

49 See NPRM at 66971-72.

50 31 USC, section 5336(a)(11)(B)(xxi); this category also includes entities owned or controlled by a large operating company; see 31 USC, section 5336(a)(11)(B)(xxii).

51 Proposed 31 CFR section 1010.380(f)(6).

52 31 USC, section 5336(b)(2)(A).

53 31 USC, section 5336(a)(1).

54 31 USC, section 5336(b)(3). To obtain a FinCEN identifier, the individual first submits one of the enumerated identification numbers to FinCEN for validation. FinCEN then, after verifying the person's identity, issues the person a unique identification number to be used for CTA reporting purposes.

55 31 USC, section 5336(b)(2)(B).

56 Proposed 31 CFR section 1010.380(b)(1)(i).

57 Proposed 31 CFR section 1010.380(b)(1)(ii)(D)-(E).

58 Proposed 31 CFR section 1010.380(b)(1)(ii)(C).

59 31 USC, section 5336(a)(2).

60 Proposed 31 CFR section 1010.380(e).

61 31 USC, 5336(a)(3)(A).

62 31 USC, 5336(a)(3)(A).

63 Proposed 31 CFR section 1010.380(d)(1)(i)-(iii).

64 Proposed 31 CFR section 1010.380(d)(1)(iv).

65 Proposed 31 CFR section 1010.380(d)(2).

66 Proposed 31 CFR section 1010.380(d)(2).

67 Proposed 31 CFR section 1010.380(d)(3)(i).

68 Proposed 31 CFR section 1010.380(d)(3)(ii).

69 Proposed 31 CFR section 1010.380(d)(4).

70 Proposed 31 CFR section 1010.380(a)(1)(iii). In the CTA, Congress allowed FinCEN to give existing entities up to 2 years to file initial reports (31 USC, section 5336(b)(1)(B)).

71 Proposed 31 CFR section 1010.380(a)(1)(i)-(ii). The CTA provides that new entities shall file with FinCEN "at the time" of formation or registration (31 USC, section 5336(b)(1)(C)).

72 Proposed 31 CFR section 1010.380(a)(1)(iv), (a)(2).

73 31 USC, section 5336(b)(1)(B). Unlike the proposed regulations, the CTA sets a shorter timeframe for reporting a change that renders an entity no longer exempt from CTA reporting (see 31 USC, section 5336(b)(2)(D)-(E) [requiring that an entity that is no longer exempt report to FinCEN "at the time" of the change in status]).

74 31 USC, section 5336(b)(1)(F).

75 31 USC, section 5336(e)(1).

76 31 USC, section 5336(h)(1).

77 31 USC, section 5336(h)(6).

78 31 USC, section 5336(h)(3)(A).

79 31 USC, section 5336(h)(3)(C); proposed 31 CFR section 1010.380(a)(3), (g).

80 Proposed 31 CFR section 1010.380(g)(2).

81 Proposed 31 CFR section 1010.380(g)(4)-(5). Here, it is helpful to remember that the violator must still act "willfully" for penalties to apply.

82 See Miller & Chevalier, *Practitioners Note the Corporate Transparency Act's Potential, But Caution 'Wait and See' on Final Rules* (May 23, 2022) <https://www.millerchevalier.com/publication/practitioners-note-corporate-transparency-acts-potential-caution-wait-and-see-final> (as of Oct. 20, 2022).

83 NPRM at 69921. A third tranche of regulations to be issued will address changes to existing customer due diligence rules for financial institutions.

84 31 USC, section 5336(c)(2)(B)(i)-(iii) (emphases added).

85 31 USC, section 5336(c)(2)(B)(i); NPRM at 69921.

86 31 USC, section 5336(c)(6).

87 31 USC, section 5336(c)(5)(B) (emphasis added).

88 Compare 31 USC, section 5336(c)(2)-(3) with 31 USC, section 5336(c)(5).

89 31 USC, section 5336(c)(5)(A).

90 *IRS-CI Highlights*, IRS Fact Sheet 2022-19 (Mar. 2022) < https://www.irs.gov/newsroom/irs-ci-highlights> (as of Oct. 20, 2022).

91 See generally Bonner, *IRS'S FATCA enforcement fell short, TIGTA says* (Apr. 13, 2022) J.Acct. < https://www.journalofaccountancy.com/news/2022/apr/irs-fatca-enforcement-fell-short-tigta-says.html> (as of Oct. 20, 2022).

92 See Kossman, *IRS Wealth Squad* (Apr. 1, 2022) Tax Adviser <https://www.thetaxadviser.com/issues/2022/apr/irs-wealth-squad.html> (as of Oct. 20, 2022).

93 All Things Considered, *The IRS misses billions in uncollected tax each year. Here's why* NPR (Apr. 19, 2022) < https://www.npr.org/2022/04/18/1093380881/on-tax-day-the-treasury-department-urges-for-more-funding-to-the-irs> (as of Oct. 20, 2022). Note that the "tax gap" includes both tax liabilities known and unknown (due to non-reporting or inaccurate reporting) to the IRS.

94 31 USC, section 5336(c)(1).

95 The statute itself (and the next forthcoming tranche of regulations) address these security concerns in far greater detail than this tax lawyer can do justice (See generally 31 USC, section 5336(c)). The statute also provides penalties for those who unlawfully disclose or use the information in the CTA database (31 USC, section 5336(h)(2), (h)(3)(B)).

96 31 USC, section 5336(f).

97 See generally Chen, *Bearer Share* (Dec. 25, 2020) Investopedia <https://www.investopedia.com/terms/b/bearer_share.asp> (as of Oct. 20, 2022).

98 Delaware, in 2002, was the first U.S. state to do so. See Delaware Laws, *Facts and Myths* <https://corplaw.delaware.gov/facts-and-myths/> (as of Oct. 20, 2022).

99 See generally Harari, et al., *Ownership registration of different types of legal structures from an international comparative perspective: State of play of beneficial ownership – Update 2020* (Jun. 1, 2020) Tax Justice Network <https://www.taxjustice.net/wp-content/uploads/2020/06/State-of-play-of-beneficial-ownership-Update-2020-Tax-Justice-Network.pdf> (as of Oct. 20, 2022).

100 31 USC, section 5336(e)(2)(A)(ii).

101 31 USC, section 5336(e)(2)(A)(i).

102 31 USC, section 5336(e)(2)(B).

103 31 USC, section 5336(e)(2)(A).

104 FinCEN received over 230 comments in response to the NPRM. *FinCEN Statement Regarding Beneficial Ownership Information Reporting and Next Steps* (Feb. 8, 2022) Fin. Crimes Enf't Network <https://www.fincen.gov/news/news-releases/fincen-statement-regarding-beneficial-ownership-information-reporting-and-next> (as of Oct. 20, 2022).

105 86 Fed. Reg. 17557 (hereafter "ANPRM") at pp. 17561-65.

106 See *FinCEN Statement Regarding Beneficial Ownership Information Reporting and Next Steps* (Feb. 8, 2022) Fin. Crimes Enf't Network <https://www.fincen.gov/news/news-releases/fincen-statement-regarding-beneficial-ownership-information-reporting-and-next> (as of Oct. 20, 2022).

107 Pub.L. No. 116-283, section 6403(d)(1).